



CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS, INC.

December 19, 2014

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

Submitted Electronically to rule@comments@sec.gov

Re: Proposed Amendments to Regulation D, Form D and Rule 156 under the Securities Act (File No. S7-06-13)

Dear Mr. Fields:

Certified Financial Planner Board of Standards (CFP Board)¹ submits this comment letter to the Securities and Exchange Commission (SEC or Commission) in response to its request for comments (Proposing Release) regarding its proposal to amend Regulation D, Form D and Rule 156 under the Securities Act of 1933 (Securities Act).²

The Proposing Release addresses the SEC's implementation of rules designed to oversee private issuer's newfound ability to engage in general solicitation and general advertising; proposed simultaneously with the SEC's adoption of the final rule permitting general solicitation and general advertising. The Proposing Release also requests comment on potential changes to the accredited investor definition found in Rule 506 of Regulation D.³

¹ CFP Board is a non-profit organization that acts in the public interest by fostering professional standards in personal financial planning through setting and enforcing education, examination, experience and ethics standards for financial planning professionals who hold the CFP® certification and upholding it as the standard of excellence for personal financial planning. CFP Board currently certifies more than 70,000 CFP® professionals who provide financial planning services under a fiduciary standard. CFP® professionals also voluntarily agree to comply with CFP Board's standards and subject themselves to CFP Board's disciplinary oversight. For further information on CFP Board, visit www.cfp.net.

² Exchange Act Release No. 33-9416.

³ 17 C.F.R. §230.501-230.508.

CFP Board will direct its comments to the need to update and strengthen the eligibility criteria to qualify as an accredited investor under Rule 506. As the SEC undertakes its review of the accredited investor definition,⁴ CFP Board urges the Commission to further modify the criteria in order to maintain the level of investor protection that Rule 506 contemplates. This is particularly important in light of the large sums of money issuers raise through private offerings⁵ and the recent changes that permit general advertising and solicitation in connection with private offerings.

I. Current Landscape

Generally, U.S. public companies raise capital by seeking to offer and/or sell securities to the public and they must register the offering and sale with the SEC pursuant to Section 5 of the Securities Act⁶ unless the offering is subject to an applicable exemption. This registration requirement is intended to protect potential investors from fraud by ensuring that they receive all the material information (defined as information that would affect a reasonable investor's evaluation of the issuer's stock) they need in order to make an informed investment decision. The type of information issuers must disclose to potential investors includes, but is not limited to, descriptions of the business, the company's past performance, audited financial statements and risks the company may face in the future.

Not all investors, however, are created equal. There are varying degrees of investment experience, education and financial sophistication among investors that necessarily impacts their ability to make investment decisions and deal with the potential losses that can result from those decisions. In acknowledging these distinctions, Congress determined that some investors do not need the same level of information and protection. These investors who have higher levels of investment experience, education or financial sophistication are deemed more capable of fending for themselves when it comes to making investment decisions.

Thus, Congress authorized the SEC to adopt exemptions to the registration requirement that permit issuers to engage in private securities transactions with certain classes of investors who are deemed capable of making informed investment decisions without necessarily having access to the information that would otherwise be available to them in a registered offering. Many issuers, particularly small businesses, rely on these exemptions to lower their cost of raising capital and Rule 506, the accredited investor exemption, is among the most commonly used exemptions.

⁴ The SEC is required to undertake a review of the accredited investor definition at least every four years pursuant to the Dodd-Frank Wall Street Reform and Investor Protection Act. (Pub. L.No. 111-203 (2010)).

⁵ According to the SEC's report entitled "Capital Raising in the U.S.: An analysis of Unregistered Offerings Using the Regulation D Exemption, 2009-2012" (July 2013), issuers raised \$903 billion in 2012, with Rule 506 offerings accounting for 99% of amounts sold through Regulation D offerings.

⁶ 15 U.S.C. §77c.

As noted, the SEC's rationale in adopting Rule 506 is that there are certain classes of investors who are, theoretically, better able to evaluate the suitability of an investment opportunity with less information and that they are better able than the average investor to bear potential investment losses. In other words, as the Supreme Court noted, the availability of the exemption "should turn on whether the particular class of persons affected needs the protection of the Act."⁷ The SEC is faced with the challenge of developing criteria that provide necessary investor protections but do not unreasonably diminish business' ability to raise capital.

This challenge is made more difficult by the increased complexity of our financial markets that has taken place over time. It makes sense, therefore, that the SEC should periodically evaluate laws and regulations to ensure that they remain necessary and effective. The current review of the accredited investor definition is just such an evaluation. The SEC adopted the accredited investor definition in the 1980s and had only recently modified it for the first time when directed to do so under the Dodd-Frank Act and the Jump Start Our Business Startups Act (JOBS Act).⁸

II. The SEC Should Update the Accredited Investor Definition

CFP Board recognizes that the SEC has a broad mission to "protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation." And like many issues the Commission must address, consideration of the accredited investor definition touches upon more than one prong of its mission – here, investor protection and capital formation. It is, therefore, appropriate that the Commission consider the impact that any proposed changes to the accredited investor definition will have on issuers' (particularly small businesses) ability to raise capital as well as on investor protection. It is important to note that these two prongs of the SEC's mission are not mutually exclusive but that they do result in a tension the Commission must reconcile. CFP Board believes the SEC should revise the current accredited investor definition in order to ensure that investors, particularly those least able to withstand financial losses, continue to receive appropriate protection.

The business community has been able to successfully raise large sums of money to invest in small businesses and startup companies. CFP Board is not indifferent to the concerns of many in the business community who fear that modifying the accredited investor definition will significantly reduce the pool of potential investors qualified under Rule 506 and thereby limit their access to capital.⁹ Conversely, state regulators, who are on the frontlines of investor protection, have expressed their concerns that issuers' ability to advertise and solicit investors

⁷ *SEC v. Ralston-Purina Co.*, 346 U.S. 119, 125 (1953).

⁸ Pub. L. No. 112-106 (2012).

⁹ We note that the SEC received numerous comments from, among others, the Angel Capital Association, which assists start-up companies by providing capital raised from accredited investors. They have expressed their concerns regarding the SEC's implementation of the JOBS Act and the impact that potential amendments to Rule 506 may have on their ability to raise capital. See, <http://www.sec.gov/comments/s7-06-13/s70613-490.pdf>.

will serve as fertile ground for those issuers who were already abusing the Rule 506 exemption to prey on unwitting investors.¹⁰

As an organization whose mission is to serve the public, CFP Board believes that it is incumbent upon the SEC to develop accredited investor criteria that are more rationally related to investors' ability to understand the risks associated with private offerings and survive the losses if the investment fails. An updated definition must protect investors by taking account of changes in the marketplace that render the current criteria ineffective while preserving a deep pool of potential investors for businesses to access capital inexpensively.

III. Sophistication is More Than Income and Net Worth

As a result of marketplace evolution, investor protection advocates have urged Congress and the Commission to reevaluate the accredited investor definition based on concerns that many investors eligible for the exemption should probably not be in this category.¹¹ For example, investor advocates were troubled that many investors were able to meet the net assets test only by including the value of their homes. Investor advocates contended that potential investors' ability to meet the net worth threshold by including the value of a home did not necessarily mean that these investors possessed the financial sophistication that the exemption presumed.

In an effort to make the net worth criteria a more realistic gauge of an investor's ability to survive losses, Congress directed the SEC in the Dodd-Frank Act to adopt a rule excluding the value a person's primary residence from the \$1 million net worth determination.¹² CFP Board agrees that this is a good start but the SEC must go further to protect investors, particularly in light of recent changes to the private offerings landscape.

We know that the potential for abuse in private placement offerings is not theoretical because it is happening today. The accredited investor definition's impact on consumers is immense. The North American Securities Administrators Association (NASAA), which represents the state-level securities regulators who are on the front lines of protecting retail investors presents a sobering picture. According to NASAA, in 2011 and 2012, state securities regulators brought 340 enforcement actions in connection with Rule 506 offerings – more than any other product or scheme.¹³

¹⁰ See, e.g., A. Heath Abshire, President, NASAA (<http://www.sec.gov/comments/s7-06-13/s70613-430.pdf>) and William F. Galvin, Secretary, Commonwealth of Massachusetts (<http://www.sec.gov/comments/s7-06-13/s70613-394.pdf>).

¹¹ An accredited investor is defined as "Any natural person whose individual net worth, or joint net worth with that person's spouse, at the time of his purchase exceeds \$1,000,000; [or] 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 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." 17 C.F.R. § 230.501(a) and 17 C.F.R. § 230.215(e).

¹² <http://www.sec.gov/rules/final/2011/33-9287.pdf>. The Commission adopted additional amendments to Rule 506 implementing section 926 of the Dodd-Frank Act prohibiting issuers from relying on section 506 if "felons" or other "bad actors" are participating in the offering (<http://www.sec.gov/rules/final/2013/33-9414.pdf>).

¹³ See A. Heath Abshire, President, NASAA *supra*.

This potential for abuse in private offerings rose dramatically with the enactment of section 201(a) of the JOBS Act, which changed long-standing guidelines prohibiting issuers from advertising or soliciting in connection with unregistered offerings. This proscription was put in place to limit private issuers' ability to defraud investors who may be vulnerable to sales pitches and advertising about investment opportunities – opportunities about which they would receive little information on which to base their decisions.

The new rule, however, allows issuers to advertise and engage in general solicitations (e.g., using the Internet, mass mailings, website banner ads, etc.) in connection with certain unregistered offerings when certain conditions are met and all the investors are accredited. Issuers' ability to reach more potential investors through advertising and general solicitations only increases the need for the Commission to adjust the accredited investor definition to ensure that investors qualifying for this exemption are capable of protecting their own interests and withstanding potential investment losses – the accreditation requirements' principal goals.

Currently, income and net worth are used as proxies for sophistication. If these metrics alone were ever a sufficient measure of an investor's level of financial sophistication (and we doubt they were), they no longer can serve as such. First, the increased complexity of financial products and services in the marketplace over the last 30 years makes it more difficult for average investors to make informed investment decisions. This complexity is only magnified in the context of private offerings where potential investors receive far less information and may be exposed to far more risk. Moreover, the reality is that a \$1 million net worth just does not equate to what it did thirty years ago. While there are potential investors whose income and net worth alone would allow them to withstand losses, there are many others for whom these are dubious guideposts.

Although as noted above, recent regulation now excludes the value of an investor's primary residence (often an investor's most valuable asset) from being calculated in the net-worth determination, there remain other permissible considerations that CFP Board likewise deems inappropriate and potentially damaging to investors. We believe that retirement savings accounts should also be excluded from the net worth determination. Current law appropriately places extra protections on retirement savings accounts in order to, among other things, encourage Americans to save and to protect their savings. Thus, in furtherance of this laudable public policy objective, it seems reasonable to extend protection to investors in the context of risky private securities offerings.

Older Americans who for years have worked hard and saved for a comfortable retirement are particularly vulnerable, especially now that the ban on advertising and solicitation has been lifted from private securities offerings. These investors should not have their retirement

jeopardized by losses suffered from illiquid private securities offerings in which they may have no business investing.

Some may argue that this is a paternalistic view that assumes all older Americans are incapable of making informed investment decisions. To the contrary, we do not suggest that every investor who satisfies the income or net worth criteria will lack the level of sophistication contemplated under the definition. There are undoubtedly investors who are very capable of making informed investment decisions by virtue of their education and/or experience, and they should be permitted to do so. It is equally clear, however, that many investors lack this level of sophistication and would benefit from the types of disclosure they would otherwise receive.

IV. Changes the SEC Should Consider

The U.S. Government Accountability Office conducted a review of existing and potential criteria for qualifying as an accredited investor and recommended that

“to further advance the goals of investor protection and capital formation in its accredited investor standard, SEC should consider alternative criteria, including those in this report, to help determine an individual’s ability to bear and understand the risks associated with investing in private placements.”¹⁴

CFP Board believes the SEC should give thoughtful consideration to amending the current accredited investor definition to incorporate the recommendations set forth below. Requiring issuers to do more than consider income and net worth alone in determining an investor’s financial sophistication will strengthen the definition and make it a more useful tool for issuers while providing investors the protection they deserve.

a. Raising Income and Net Worth Thresholds

According to Commission data, there were more than three times as many private placement offerings in 2012 (18,000) as there were registered offerings (5,800).¹⁵ Because so many companies are availing themselves of this option, it is imperative that the SEC take a close look at the accredited investor criteria to ensure that investors who need the protection will, consistent with the Supreme Court’s pronouncement in *Ralston*, receive it.

¹⁴ *Alternative Criteria for Qualifying As An Accredited Investor Should Be Considered* (July 18, 2013) (GAO Report).

¹⁵ *Id.*

Some investor protection advocates have argued that adjusting the income and net worth levels upward to account for inflation would better protect investors. Making such an adjustment would significantly raise the income and net worth levels to approximately \$500,000 and \$2.4 million, respectively, in today's dollars.¹⁶ This action, as the GAO Report points out, would result in decreasing the number of qualifying investors from 8.5 million to 3.7 million.¹⁷ Although there is no way to know how many of these investors would actually participate in a private securities offering, opponents nonetheless argue that it would result in a substantial loss of potential investments.

We suggest that it is not good policy to assume that an individual who has an income or net worth that meets the current accredited investor threshold necessarily has the appropriate experience and sophistication to engage in private placement offerings. This criteria must be considered in a context broader than just the level of financial resources. This is why CFP Board is concerned that, for example, retirement savings continue to be eligible for inclusion in the net worth calculation. As noted above, retirees are particularly vulnerable to fraud and abuse and they do not have the luxury of time to recoup losses. To illustrate, a 60 year-old with an annual income of \$100,000 is much less likely to recover from a large financial loss than is a 30-year-old with an annual income of \$50,000. The same rationale that led to Congress' decision to exclude primary residences from the net worth calculation should, at a minimum, apply to retirement savings accounts.

CFP Board reiterates that it is sensitive to the impact that raising income and net worth levels would likely have on businesses and, therefore, does not advocate that the SEC simply play "catch up" with regard to modifying the criteria by merely raising the income and net worth levels to account for inflation since the 1980s. Rather, CFP Board urges the Commission to conduct an appropriate economic analysis of the impact that increasing income and net worth levels will have on both business' ability to raise capital and the level of protection afforded to investors. In conducting this analysis, the SEC should be able to find a point at which investors receive meaningful protection and issuers are able to raise the capital they need cost-effectively.

b. Including a Percentage of Liquid Investments Test

CFP Board agrees with the GAO Report's recommendation that the SEC consider adding a liquid investments requirement to the existing criteria. While no litmus test is perfect, requiring an investor to have a minimum amount of resources in liquid assets – assets that are easily quantifiable and have market value – will go far in ensuring that investors in private placements have the financial wherewithal to survive in the face of significant losses, particularly when used together with increased income and net worth thresholds.

¹⁶ Bureau of Labor Statistics, CPI Inflation Calculator, www.bls.gov/data/inflation_calculator.htm.

¹⁷ GAO Report at 18.

c. Including a Fixed Percentage of Net Worth Test

The Commission should also consider enhancing the accredited investor definition's efficacy by limiting the percentage of an individual's net worth that can be invested in any given private offering. While an investor's risk obviously increases with the percentage of their assets invested,¹⁸ the current accredited investor definition that relies on arbitrary income or net worth thresholds alone does not reflect the relative risks that different investors may face.

As the Commission's Investor Advisory Committee (IAC) pointed out in its recently adopted recommendation, an investor who meets the current \$200,000 income or \$1 million net worth thresholds can invest any percentage of their money they dare to risk in a private placement. To illustrate, it is reasonable to assume that a person who meets the current net worth threshold is better able to absorb, for example, a \$50,000 investment loss (5%) than a \$200,000 or \$300,000 loss (20% and 30% of net worth, respectively). Yet, while it is likely that few investors would be willing to do it, there is nothing more than common sense preventing them from investing dangerously higher percentages (i.e., 50% or more) of their net worth in a private offering.

Another paradoxical effect of the current criteria is the fact that a person whose income and net worth are just below the thresholds at \$199,000 and \$999,000, respectively, and who may have a high financial IQ, cannot invest a penny in a private placement. We agree with the IAC recommendation that a more rational test should be fashioned that restricts investment based on a percentage of the investor's income and net worth. As an investor's income or net worth increases, these restrictions could be reduced. But given the inherent risks in private offerings, CFP Board would be very wary of eliminating restrictions entirely.

d. Requiring Advice of a Registered Investment Adviser

The GAO Report determined that there was significant support for adding to the existing criteria a requirement that investors seek the advice of a registered investment adviser (investment adviser). CFP Board urges the SEC to consider this alternative as a way to protect investors without unduly limiting business' access to capital.

Investment advisers are legally bound to provide services under a fiduciary standard of care and cannot have a financial stake in the recommendation. They are, therefore, in a perfect position to provide advice that is in the investor's best interest. Given the compensation structure of most investment advisers, (e.g., compensated for managing assets), we note that there could be an additional cost to investors for this advice but this potential cost should not

¹⁸ While this is true of public offerings as well, investors in public offerings are, at least theoretically, better informed about the risks associated with their investment.

prevent the SEC from seriously considering the benefit that such a requirement could bring to investors.

Further, the use of investment advisers does not necessarily have to be to the exclusion of other safeguards. The SEC could, for example, fashion criteria that increase the income and net worth thresholds for investors who do not avail themselves of an investment adviser's expertise, which could mitigate the impact of increasing the thresholds.

e. Education as a Proxy for Sophistication

The GAO Report and others have suggested that the Commission should consider certain educational or professional credentials as qualifications to satisfy the accredited investor definition. CFP Board certainly agrees that there are many potential investors who could, by virtue of their academic or professional training, be considered sufficiently knowledgeable to understand the risks associated with private securities offerings. For these individuals, the income and net worth thresholds would be less relevant because they will be presumed to have sufficient knowledge to understand the risks.

Individuals who have earned an advanced business degree, for example, have been suggested as candidates for such treatment. CFP Board cautions that studying business generally, without more, is unlikely to provide the level of knowledge about participating in illiquid investments necessary to protect investors. Any educational criteria should demonstrate a clear understanding of the nature of the risks involved in investing in illiquid private offerings.

Other possible exemptions discussed include persons holding a CPA license, securities license or holding the Chartered Financial Analyst® credential. Although this pool of potential investors may be relatively small, such criteria will positively address consumer protection and are not likely to negatively impact the pool of potential investors.

If the SEC determines that there are certain degrees and certifications that qualify an individual as an accredited investor, we urge the Commission to include the CFP® certification among the designations. To earn CFP® certification, individuals must meet rigorous academic, examination, experience and ethics standards and agree to adhere to the principles of integrity, objectivity, competence, fairness, confidentiality, professionalism and diligence when dealing with clients. Further, to earn CFP® certification, a candidate must demonstrate competency, through our education and examination requirements, in a broad range of key subject areas, including the general principles of financial planning, investments, insurance, income tax, retirement, education planning, estate planning and risk analysis – which are certainly desirable competencies in anyone who would be considered a highly competent and sophisticated investor.

In addition to passing the comprehensive CFP® Certification Examination, a candidate for CFP® certification must also hold a bachelor's degree or higher from a regionally-accredited college or university and institution and have at least 3 years of professional experience in the financial planning process, or 2 years of apprenticeship experience that meets additional requirements. The completion time for this demanding certification process typically ranges from 6 to 18 months but can be longer if the candidate needs time to meet the education or experience requirements. CFP Board also requires CFP® professionals to remain substantively current by completing 30 hours of continuing education every two years. Thus, given the rigorous criteria that CFP® professionals must meet, we believe that they should be considered on par with other designations that the Commission might consider.

Conclusion

The accredited investor definition, despite recent changes, remains less effective than it should be in light of its stated purpose of protecting investors and facilitating access to capital. CFP Board strongly urges the SEC to adopt reasonable and effective changes to the existing criteria, as set forth above, in a manner that enhances investor protection while not unnecessarily restricting the pool of potential investors.

Respectfully submitted,

A handwritten signature in black ink, reading "Marilyn Mohrman-Gillis". The signature is written in a cursive, flowing style.

Marilyn Mohrman-Gillis
Managing Director, Public Policy
& Communications