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**pfm**

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Ms. Vanessa A. Countryman, Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1090

**Re:** Concept Release on Harmonization of Securities Offering Exemptions  
File Number S7-08-19

Recommendations for Changes in the Definitions of Accredited Investor and  
Qualified Institutional Buyer

Dear Ms. Countryman:

PFM Asset Management LLC (“PFM”) appreciates the opportunity to respond to the request by the Securities and Exchange Commission (“Commission” or “SEC”) for comments on the Concept Release on Harmonization of Securities Offerings Exemptions (the “Concept Release”).<sup>1</sup> PFM is an investment adviser registered under the Investment Advisers Act of 1940. We are one of the largest investment advisers in the United States that specializes in advising state and local governments and non-profit institutional enterprises performing governmental-type roles.

PFM’s comments and recommendations are addressed to the definition of “accredited investor” in Regulation D under the Securities Act of 1933 (“1933 Act”)<sup>2</sup> and the definition of “qualified institutional buyer” (“QIB”) in Rule 144A under the 1933 Act,<sup>3</sup> as applied to governmental entities and other entities. We believe that all entities, and not merely the enumerated entities set forth under the current list-based approach, should be eligible to be accredited investors and QIBs, assuming that they

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<sup>1</sup> Concept Release on Harmonization of Securities Offering Exemptions, Release Nos. 33-10649, 34-86129, IA-5256, IC-33512 (June 18, 2019), 84 Fed. Reg. 30460 (June 26, 2019).

<sup>2</sup> 1933 Act Rule 501(a).

<sup>3</sup> 1933 Act Rule 144A(a)(1).



otherwise qualify under those definitions. In addition, to the extent that entities are subject to a \$5 million total assets test in order to be accredited investors, we believe that test should be replaced with a \$5 million investments test.

PFM believes that there is widespread consensus supporting these views, as demonstrated by the history of these provisions and comments received prior to and on the Concept Release. Accordingly, while other issues raised by the Concept Release may require further consideration and analysis, PFM requests that the Commission propose targeted amendments to its regulations that would effect these changes on an expedited basis.

## **I. Executive Summary**

### **A. PFM Support for Goals of the Concept Release**

PFM strongly supports the Commission's goals in issuing the Concept Release. As the Commission stated in describing these goals:

- We believe our capital markets would benefit from a comprehensive review of the design and scope of our framework for offerings that are exempt from registration.
- More specifically, we also believe that issuers and investors could benefit from a framework that is more consistent and addresses gaps and complexities.
- Therefore, we seek comment on possible ways to simplify, harmonize, and improve the exempt offering framework to promote capital formation and expand investment opportunities while maintaining appropriate investor protections.<sup>4</sup>

In particular, PFM supports the Commission's request for recommendations of appropriate changes that would expand the pool of sophisticated investors eligible to invest in certain types of offerings where current restrictions do not serve an investor protection or other regulatory interest.

The Commission specifically asks whether the current definition of "accredited investor" in Regulation D, which includes only specific types of entities enumerated in the regulation and imposes a financial test based on holding \$5 million in total assets, (a) should be expanded to include all entities, not only those enumerated in the rules, and/or (b) should be based on a financial test tied to investments instead of assets. Such a change would be consistent with the SEC

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<sup>4</sup> See Concept Release at 30460.



staff's 2015 "Report on the Review of the Definition of 'Accredited Investor'" (the "2015 Report" or the "Accredited Investor Staff Report").<sup>5</sup>

The Release also generally asks for other recommendations for changes that would meet the Commission's goal of promoting capital formation and expanding investment opportunities while maintaining appropriate investor protections.

PFM commends the Commission for launching this important initiative.

### **B. PFM's Interest**

PFM has a strong interest, on behalf of its state and local government clients, in expanding both the definition of accredited investor under Regulation D and the definition of QIB under Rule 144A, so that state and local governments, as well as their agencies and instrumentalities ("governmental entities"), are expressly included and can participate in both Regulation D and Rule 144A offerings, subject to appropriate financial tests. In their current forms, both definitions, by their terms, include entities only if the specific type of entity in question is enumerated in the definitions (e.g., corporations and business trusts). Many governmental entities are not organized as one of the types of entities enumerated in the definitions, thus limiting their investment opportunities simply based on the form of organization.

### **C. The Commission's Specific Request for Comments**

The Concept Release asks the following specific questions about the accredited investor definition as it relates to entities (as opposed to natural persons):

20. Should we change the definition of accredited investor or retain the current definition? If we make changes to the definition, should the changes be consistent with any of the recommendations contained in the Accredited Investor Staff Report? Have there been any relevant developments since the 2015 issuance of the Accredited Investor Staff Report, such as changes to the size or attributes of the pool of persons that may qualify as accredited investors; developments in the market or industry that may assist in potentially identifying new categories of individuals that may qualify as accredited investors; or changes in the risk profile, incidence of fraud, or other investor protection concerns in offerings involving accredited investors that we should consider? How do those changes affect investors, issuers, and other market participants?

21. Should we revise the . . . list-based approach for entities to qualify as accredited investors? If so, should we consider any of the following

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<sup>5</sup> Report on the Review of the Definition of "Accredited Investor" (Dec. 18, 2015), <http://www.sec.gov/corpfin/reportspubs/special-studies/review-definition-of-accredited-investor-12-18-2015.pdf>.



approaches to address concerns about how the current definition identifies accredited investor . . . entities:

- Revise the definition as it applies to entities with total assets in excess of \$5 million by replacing the \$5 million assets test with a \$5 million investments test and including all entities rather than specifically enumerated types of entities . . . .

25. Are there other changes to the definition that we should consider when harmonizing our exempt offering rules? For example, should we amend Rule 501(a)(3) to expand the types of entities that may qualify as accredited investors? If so, what types of entities should be included? Should we consider amendments to apply an investments-owned standard, or other alternative standard, for entities to qualify as accredited investors?<sup>6</sup>

The Concept Release also solicits comment on any other aspect of the exempt offering framework that commenters believe may be improved.<sup>7</sup>

## **D. Summary of Recommendations**

### **1. Substance of Recommendations**

PFM recommends that the Commission amend the definition of both “accredited investor” and “QIB” to take a principles-based approach that includes any entity, subject to an appropriate financial test, rather than continuing with the current “list-based” entity approach.

For the accredited investor definition, PFM recommends that the appropriate financial test should be amended to be tied to investments rather than assets. We believe that \$5 million remains the appropriate level for the test. Accordingly, the definition of “accredited investor” should be amended to include any entity with investments in excess of \$5 million and not formed for the specific purpose of investing in the securities offered.

For the QIB definition, PFM does not recommend a change to the current financial threshold at this time. Accordingly, the definition of “QIB” should be amended to include any entity that holds at least \$100 million in securities of issuers that are not affiliated with the entity.

### **2. Consensus and Timing**

PFM notes that while the Concept Release is broad in scope and addresses many issues, some of which would involve fundamental changes in the current framework, the recommendations above reflect modest changes in existing rules that

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<sup>6</sup> Concept Release at 30477 – 78 (footnotes omitted).

<sup>7</sup> *Id.* at 30522.



have been under consideration by the Commission for over a decade, and for which there is a consensus, reflecting the views of both the investor community and the SEC staff, that change is necessary.

As discussed below, PFM's recommendation to amend the definition of accredited investor corresponds to the recommendation made by the SEC staff in 2015. PFM's recommendation to amend the definition of QIB reflects the Commission's historical approach of aligning the entities approach in Rule 144A to the approach taken in Regulation D. We do not see any rational basis for maintaining the list-based approach to the QIB definition while changing it for the accredited investor definition.

Accordingly, we believe that these changes could be proposed and adopted on an accelerated time frame, independently of consideration of the more fundamental issues raised by the Concept Release. In this regard, we note that the Commission recently added an agenda item on the accredited investor definition to its short-term Unified Agenda of Regulatory and Deregulatory Actions, and this could serve as an appropriate vehicle for these changes.<sup>8</sup>

## **II. Background**

### **A. Current Definitions – the “List-Based” Approach**

#### **1. Definition of “Accredited Investor”**

At present, Rule 501(a) of Regulation D allows only certain enumerated entities to be accredited investors. These include banks, savings and loan associations, broker-dealers, insurance companies, registered investment companies, business development companies, and small business investment companies; state and local benefit plans with total assets in excess of \$5 million; ERISA employee benefit plans if the investment decision is made by certain plan fiduciaries or if the plan has total assets in excess of \$5 million or, for a self-directed plan, with investment decisions made solely by persons that are accredited investors; any organization described in section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of \$5 million; any trust with total assets in excess of \$5 million, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by certain sophisticated persons; and any entity in which all of the equity owners are accredited investors.

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<sup>8</sup> Accredited Investor Definition, RIN 3235-AM19 (Fall 2019), <https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201910&RIN=3235-AM19>. The Concept Release was issued in connection with a separate agenda item. See Harmonization of Exempt Offerings, RIN 3235-AM27 (Fall 2019), <https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201910&RIN=3235-AM27>.



## 2. Definition of “QIB”

The definition of “QIB” in Rule 144A(a)(1), which was adopted subsequent to Regulation D and was modeled on the list-based approach reflected in the Regulation D definition of “accredited investor,” includes substantially the same list of entities as Regulation D. The Commission specifically looked to the Regulation D list of entities when it proposed Rule 144A.<sup>9</sup>

### B. Consensus Recognizing Need to Expand or Replace the “List-Based” Approach

It has long been recognized that the “list-based” entity approach to the accredited investor and QIB definitions is unnecessarily restrictive and outmoded. The list, which was formulated in 1982 and has not been significantly revised since 1988, does not include certain types of entities that were not prevalent at the time but are now commonplace (for example, limited liability companies), nor does it include governmental entities that are organized in forms that are not enumerated on the list but that serve the same purpose as governmental entities and not-for-profit entities in forms that are on the list.

Furthermore, it is widely recognized that any list-based approach will inevitably become outdated as new forms of entities emerge.

The Commission or its staff has remedied the restrictions of the list-based approach in specific situations by interpretive or no-action relief, but such an approach continues to leave gaps and leaves uncertainty that introduces inefficiencies into the capital formation process.<sup>10</sup>

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<sup>9</sup> See Resale of Restricted Securities; Changes to Method of Determining Holding Period of Restricted Securities under Rules 144 and 145, Release No. 33-6806 (Oct. 25, 1988), 53 Fed. Reg. 44016, 44028 n.164 (Nov. 1, 1988).

<sup>10</sup> The 2015 Report notes the following staff interpretive and no-action letters: See, e.g., Alaska Permanent Fund, SEC Division of Corporation Finance Interpretive Letter (July 14, 2011) (the “Alaska Permanent Fund Interpretive Letter”); Cardinal Financial Management Corporation, SEC Division of Corporation Finance Interpretive Letter (May 31, 1982) (the “Cardinal Financial Management Interpretive Letter”); Voluntary Hospitals of America, Incorporated, SEC Division of Corporation Finance Interpretive Letter (Dec. 30, 1982) (the “Voluntary Hospitals of America Interpretive Letter”); The Equitable Life Assurance Society of the United States, SEC Division of Corporation Finance Interpretive Letter (Feb. 1, 1986) (the “Equitable Life Assurance Society Interpretive Letter”); MIG Realty Advisors, Incorporated, SEC Division of Corporation Finance Interpretive Letter (Nov. 2, 1987) (the “MIG Realty Advisors Interpretive Letter”); Wolf, Block, Schorr and Solis-Cohen, SEC Division of Corporation Finance No-Action Letter (Dec. 11, 1996) (the “Wolf, Block No-Action Letter”). 2015 Report at 76 n.273.



Over the past twelve years, a consensus has emerged recognizing the need to expand or, preferably, replace the current list-based approach. This consensus is memorialized in two key publications by the Commission or its staff:

- **The 2007 Proposal.** In 2007, the Commission proposed to revise the term “accredited investor” by expanding the entity list to include, among other types of entities, governmental bodies and entities with legal attributes substantially similar to those enumerated in the definition. While the 2007 Proposal did not include a proposal to amend the definition of “QIB,” the Commission recognized that the QIB definition was based on the accredited investor definition and asked for comments on whether the QIB definition should be amended in tandem.
- **The 2015 Report.** In December 2015, the SEC staff issued a report recommending the replacement of the entities list with a principles-based approach that would include all entities (not limited to those on a specific list) as long as the entity in question met a \$5 million investments test. This is the same recommendation that PFM is making in this letter. The 2015 Report, which was specifically directed at evaluating the accredited investor definition, did not address QIBs or any aspect of Rule 144A, other than as background.

A discussion of both the 2007 Proposal and the 2015 Report, as well as the history of and rationale for the consensus supporting the replacement of the list-based approach with a principles-based approach, is attached as **Appendix A**.

### **III. Public Interest Discussion**

#### **A. Support for Replacing the “List-Based” Approach**

The accredited investor concept is intended to encompass those persons whose financial sophistication and ability to sustain the risk of loss of investment or ability to fend for themselves render the protections of the 1933 Act’s registration process unnecessary.<sup>11</sup> This objective will be met by amending the definition of “accredited investor” to incorporate all entities that otherwise qualify as accredited investors, rather than limiting it to specified entities.

- There is no investor protection or other regulatory rationale supporting the inclusion of some types of entities on the list of accredited investors and excluding others. This has been recognized by the Commission, its staff, and commenters for over a decade. To the extent that some excluded entities may lack investment experience and sophistication (e.g., because they hold primarily non-financial assets, such as land, buildings

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<sup>11</sup> Regulation D Revisions; Exemption for Certain Employee Benefit Plans, Release No. 33-6683 (Jan. 16, 1987), 52 Fed. Reg. 3015, 3017 (Jan. 30, 1987).



and vehicles, and under the present test they would otherwise qualify as accredited investors even if they have no investment experience), this is equally true of the currently enumerated entities. Conversely, some entities are currently excluded even though they are among the most sophisticated investors in the marketplace.

- Enumeration of entities has proven to be problematic and has required staff attention and regulatory relief on a case-by-case basis.<sup>12</sup> For example, the present definition does not include limited liability companies, even though these are among the most popular forms of entity and often have enormous size and sophistication. Although the SEC staff has provided no-action relief for limited liability companies,<sup>13</sup> this is indicative of the limitations of an enumeration approach. No enumeration approach can anticipate future changes to forms of entity.<sup>14</sup>
- As further discussed below, private placements under Regulation D frequently are limited to accredited investors.<sup>15</sup> The arbitrary exclusion of sophisticated investing entities from such offerings, simply because their form of organization is not listed in the regulation, reduces the pool of investment capital and adversely affects capital formation.
- The use of a list-based approach has increased the complexity of the offering process. The inclusion of all entities that meet an appropriate standard would result in greater simplicity and consistency, reducing uncertainty and easing the offering and investment process.
- The list-based approach is inconsistent with the definition of “qualified purchaser” under the Investment Company Act of 1940 (“1940 Act”), which extends to any organized group of persons whether incorporated or not.<sup>16</sup> The “qualified purchaser” definition identifies financially sophisticated investors that are in a position to appreciate the risks

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<sup>12</sup> See *supra* note 10 and accompanying text.

<sup>13</sup> See Wolf, Block No-Action Letter, *supra* note 10.

<sup>14</sup> Moreover, some of the staff letters providing relief for the entity list approach were issued prior to the adoption of Rule 144A and do not expressly address QIBs. See, e.g., Equitable Life Assurance Society Interpretive Letter, *supra* note 10.

<sup>15</sup> See Rule 502(b) (providing information standards for offerings to unaccredited investors, and noting that when an issuer provides information to an unaccredited investor pursuant to these standards, it should consider providing such information to accredited investors as well, in view of the anti-fraud provisions of the federal securities laws). In light of this, it is common for Regulation D private placements to exclude unaccredited investors altogether.

<sup>16</sup> A “qualified purchaser” includes any person, acting for its own account or the accounts of other qualified purchasers, who in the aggregate owns and invests on a discretionary basis, not less than \$25 million in investments. 1940 Act § 2(a)(51)(A)(iv). A “person,” under the 1940 Act, includes a company, and a “company” includes a corporation, a partnership, an association, a joint-stock company, a trust, a fund, or “any organized group of persons whether incorporated or not.” 1940 Act § 2(a)(28) (defining “person”); 1940 Act § 2(a)(8) (defining “company”).



associated with private investment funds and do not need the protections of the 1940 Act.<sup>17</sup> It is anomalous that these investors, which Congress has identified as not requiring statutory protections, should nevertheless be excluded from the Commission’s definition of “accredited investor.”

## **B. Evolution of the Relevant Markets to the Disadvantage of Governmental Entities**

One of the premises of the Concept Release is that changes in both the markets and investor profiles over the many years since the current exempt offering framework has been in place warrant a fresh and comprehensive look. PFM believes that there have been developments in the markets for commercial paper and bank obligations that heighten the importance for governmental entities of the definitional changes that we recommend and that the Commission should consider in assessing the need for and potential benefits of these changes.

In the last decade it has become more difficult for entities that are not accredited investors or QIBs to invest in commercial paper or bank obligations. State and local governmental entities seek safety and liquidity when investing their operating cash reserves, and for this they rely on short-term high quality credit instruments, including commercial paper and negotiable bank certificates of deposit. Changes in the fixed income markets have notably narrowed options for these investors and now restrict investor access to these high quality investments.

- The limitation is particularly acute in the short-term market. Because of regulatory changes affecting banks and changes in issuer uses of proceeds of short-term borrowing, the once-robust issuance of commercial paper

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<sup>17</sup> The definition of “investment company” excludes any issuer, the outstanding securities of which are owned exclusively by persons who, at the time of acquisition of such securities, are qualified purchasers, and which is not making and does not at that time propose to make a public offering of such securities. 1940 Act § 3(c)(7). The legislative history of this exclusion includes the following description of qualified purchasers:

The qualified purchaser pool reflects the [Senate Banking] Committee’s recognition that financially sophisticated investors are in a position to appreciate the risks associated with investment pools that do not have the Investment Company Act’s protections. Generally, these investors can evaluate on their own behalf matters such as the level of a fund’s management fees, governance provisions, transactions with affiliates, investment risk, leverage, and redemption rights.

....

In defining any new class of qualified purchasers by rule, the Commission should consider, among other things, factors such as the participants’ net worth, knowledge and experience in financial matters, and amount of assets owned or under management. The Committee intends the SEC to deem as qualified purchasers only those persons the SEC determines may fend for themselves without the protection of the Investment Company Act.

S. Rep. No. 104-293, at 10 (1996), <https://www.congress.gov/104/crpt/srpt293/CRPT-104srpt293.pdf>.



under section 3(a)(3) of the 1933 Act has been replaced by issuance under other sections of the 1933 Act, primarily section 4(a)(2) and Regulation D thereunder. An analysis by PFM of 190 issuers of commercial paper regularly listed on Bloomberg's offering screens (what we characterize as the commercial paper universe) shows that currently the vast majority of borrowers fund themselves by issuing restricted securities. This practice has changed the markets notably. By our analysis, 75% of the issuers utilize section 4(a)(2) (including Regulation D thereunder), and only 16% of the issuers rely on Section 3(a)(3).<sup>18</sup> State and local governments rely significantly on short-term high grade credit instruments for investment of surplus operating funds.

- The limitation also impacts the full investment grade market. A similar analysis of the ICE BofAML Corporate Investment Grade Bond Index showed that 22% of the market value of bonds in this broad index is represented by restricted securities, including offerings that could only be purchased by QIBs under Rule 144A.<sup>19</sup> State and local governments look to investment grade corporate bonds with short and intermediate maturities to invest reserves where liquidity is less important.
- The growth of mutual funds as intermediaries that qualify as institutional investors has encouraged the move by issuers to utilize restricted securities, further disadvantaging government and similar entities that do not qualify as eligible purchasers for these offerings.
- The inability of governmental entities to qualify to buy these securities has reduced investment opportunities and limited the ability of these entities to diversity the credit and maturity characteristics of their portfolios, thus magnifying the risk related to investment concentration.

We note that similar points were made in the comment submitted by the Chief Investment Officer of San Bernardino County, California, which is ineligible to invest in many issues of commercial paper and asset-backed commercial paper, despite having approximately \$6.5 billion of investment assets.<sup>20</sup>

### **C. Addressing Investor Protection Concerns through an Investments Test**

Commenters have highlighted the need to address an appropriate financial test to serve as a proxy for financial sophistication. This is a key component of the

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<sup>18</sup> Source: PFM analysis of Bloomberg offerings in May 2019. The remaining 9% rely on other provisions of the 1933 Act and the rules thereunder.

<sup>19</sup> Source: PFM analysis of ICE BofAML Corporate Investment Grade Bond Index as of April 2019.

<sup>20</sup> Comment of Parth Bhatt, Chief Investment Officer, San Bernardino County, California (Sept. 24, 2019), <https://www.sec.gov/comments/s7-08-19/s70819-6190346-192425.htm>.



Commission’s framework for exempt offerings. The purpose of the definition of “accredited investor” is to identify investors for whom the protections of registration under the 1933 Act are not required.

We agree with the recommendation of the 2015 Report that the SEC should replace the existing \$5 million total assets test with a \$5 million investments test and should make it applicable to all entities that are subject to a financial threshold. Concerns about sophistication apply to all entities (with the possible exception of certain regulated entities), and experience with investments is a better test of sophistication than is ownership of assets.

#### **D. Definition of “QIB”**

The SEC should also revise the definition of “QIB” to include all entities that own and invest on a discretionary basis at least \$100 million in securities of issuers that are not affiliated with the entity.<sup>21</sup> The arguments against limiting accredited investors to certain enumerated entities are equally applicable to QIBs, and making the change would be consistent with the historical use of substantially the same entities for both accredited investors and QIBs.<sup>22</sup> As we have noted, the evolution of the market has increased the number of offerings that are only available to QIBs, reducing investment opportunities for sophisticated governmental entities that fail to be QIBs only because they are not among the currently acceptable forms of entity.

#### **IV. Conclusion**

In summary, we support the recommendation of the 2015 Report to revise the definition of “accredited investor” by replacing the \$5 million assets test with a \$5 million investments test and including all entities rather than specifically enumerated types of entities. Similarly, we believe that the definition of “QIB” should be harmonized to include all entities rather than specifically enumerated types of entities. We believe these changes would have the following benefits:

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<sup>21</sup> PFM does not object to the additional net worth test that applies to banks and savings and loan associations.

<sup>22</sup> When it initially proposed Rule 144A, the Commission explained the purpose of the QIB definition as follows:

In defining a “qualified institutional buyer,” the Commission attempted to establish a level at which it can be confident that participating investors have extensive experience in the private resale market for restricted securities. In addition, the Commission is seeking to identify a class of investors that can be conclusively assumed to be sophisticated and in little need of the protection afforded by the Securities Act’s registration provisions.

Resale of Restricted Securities; Changes to Method of Determining Holding Period of Restricted Securities under Rules 144 and 145 (Oct. 25, 1988), 53 Fed. Reg. 44016, 44028 (Nov. 1, 1988). It should be obvious that meeting this standard is not dependent on the investor’s form of organization.



- They would further the Commission's goals of simplifying and improving its exempt offerings framework.
- They would be more conducive to capital formation, avoiding the needless exclusion of sophisticated investors from certain markets.
- For institutional investors, they would support diversification of investment holdings in the high grade credit markets.
- They would provide greater certainty and clarity to the offering process.
- For accredited investors, the investments test would provide an improved proxy for financial sophistication.
- They would address changes in the relevant markets since the accredited investor and QIB definitions were last revised.

We appreciate the Commission's attention and would be happy to discuss these issues further.

Very truly yours,

/s/ Marty Margolis

Marty Margolis  
Managing Director

cc: The Honorable Jay Clayton  
The Honorable Robert J. Jackson Jr.  
The Honorable Hester M. Peirce  
The Honorable Elad L. Roisman  
The Honorable Allison Herren Lee  
Dalia O. Blass, Director, Division of Investment Management  
Mark T. Uyeda, Senior Special Counsel, Division of Investment Management



## Appendix A

### **History of Consensus Recognizing Need to Expand or Replace the “List-Based” Approach**

Over the past twelve years the Commission and its staff have repeatedly grappled with the problems caused by the existing list of entities that can be accredited investors under Regulation D.

#### **1. The 2007 Proposal**

In 2007, as part of a set of proposals designed to revise Regulation D to provide additional flexibility to issuers and to clarify and improve the application of the rules, the Commission proposed to revise the term “accredited investor” in Regulation D “to clarify the definition and reflect developments since its adoption.”<sup>23</sup> In particular, the Commission proposed to add categories of entities to the list of permitted accredited investors.

In the 2007 Proposal, the Commission recognized that the list of entities qualifying as accredited investors in Regulation D did not include limited liability companies, Indian tribes, labor unions, governmental bodies, and similar entities, and that these exclusions led to “some degree of uncertainty as to whether these types of entities may qualify as accredited investors.”<sup>24</sup>

Accordingly, the Commission proposed to amend the list of entities included in Rule 501(a)(3) of Regulation D to expressly include any corporation (including any non-profit corporation), Massachusetts or similar business trust, partnership, limited liability company, Indian tribe, labor union, governmental body or other legal entity with substantially similar legal attributes.<sup>25</sup> The Commission also proposed to add a definition of the term “governmental body” to Rule 501(a), similar to the definition of that term that appears commonly in transactional financing documents.<sup>26</sup>

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<sup>23</sup> Revisions of Limited Offering Exemptions in Regulation D, Release Nos. 33-8828, IC-27922 (Aug. 3, 2007), 72 Fed. Reg. 45116, 45116 (Aug. 10, 2007) (“2007 Proposal”).

<sup>24</sup> *Id.* at 45126.

<sup>25</sup> As proposed in 2007, the definition of accredited investor would include:

(c) Any corporation (including any non-profit corporation), Massachusetts or similar business trust, partnership, limited liability company, Indian tribe, labor union, governmental body, or other legal entity with substantially similar legal attributes, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of \$5,000,000 or investments in excess of \$5,000,000 (each as adjusted for inflation in accordance with the Note to paragraph (a)).

*Id.* at 45142.

<sup>26</sup> The proposed definition of “governmental body” was as follows:

(g) Governmental body. “Governmental body” shall mean any:



The 2007 Proposal noted that the SEC staff was regularly asked questions about which entities may qualify as accredited investors, and has provided guidance that limited liability companies and certain governmental units may so qualify.<sup>27</sup> The proposed changes were intended to “reduce uncertainty and legal costs and promote more efficient private capital formation.”<sup>28</sup> The proposal also requested comment on whether the Commission should delete the list entirely and simply say that any legal entity that can sue or be sued in the United States, assuming it meets the other standards for becoming an accredited investor, can qualify as an accredited investor.<sup>29</sup>

The 2007 Proposal did not include a proposal to amend the definition of QIB for Rule 144A purposes. However, the Commission noted that that the QIB definition was based on the entities list and list-based approach in Regulation D and asked whether the QIB definition should be changed to align with the accredited investor definition.<sup>30</sup>

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- (1) Nation, state, county, town, village, district or other jurisdiction of any nature;
  - (2) Federal, state, local, municipal, foreign or other government;
  - (3) Governmental or quasi-governmental authority of any nature (including any governmental agency, branch, department, official or entity and any court or other tribunal);
  - (4) Multi-national organization or body; or
  - (5) Body exercising, or entitled to exercise, any administrative, executive, judicial, legislative, police, regulatory or taxing authority or power of any nature.

*Id.* at 45143.

<sup>27</sup> *Id.* at 45126.

<sup>28</sup> *Id.* at 45126 – 27.

<sup>29</sup> *Id.*

<sup>30</sup> When we first proposed Rule 144A, we noted that the type of “qualified institutional buyers” contemplated under that rule would generally include “very large institutions, long involved in the resale market for restricted securities, as to which there has been little concern with respect to Section 5 implications.” As a result, we looked to the list of institutional accredited investors contained in Rule 501(a)(3) to develop the Rule 144A(a)(1)(i)(H) list of qualified institutional buyers. Because we are now proposing to amend Rule 501(a)(3) by expanding the list of institutional accredited investors, we are seeking comment on whether the Rule 144A(a)(1)(i)(H) list of qualified institutional buyers should be expanded in a similar manner.

*Id.*



Response to the 2007 Proposal was generally favorable, and commenters specifically supported moving away from a list-based approach.<sup>31</sup> However, the Commission did not take final action on the proposal.<sup>32</sup>

## 2. The 2015 Report

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) requires the Commission to undertake a review of the definition of “accredited investor” not less frequently than every four years, to determine whether the requirements of the definition should be adjusted or modified for the protection of investors, in the public interest, and in light of the economy.<sup>33</sup> Although the statute requires this review only as the term applies to natural persons, the legislative history shows that Congress was also concerned about other accredited investors, particularly governmental entities, and believed it would be appropriate for the Commission to adjust the accredited investor and QIB definitions to include them.<sup>34</sup>

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<sup>31</sup> See, e.g., Comments of David F. Freeman, Jr., Arnold & Porter (Feb. 24, 2010), <https://www.sec.gov/comments/s7-18-07/s71807-70.pdf> (“Investors should not be excluded from the definition of ‘accredited investor’ simply because the rules do not contemplate the form of association selected by the investor”); Karen Tyler, President, North American Securities Administrators Ass’n (Oct. 26, 2007), <https://www.sec.gov/comments/s7-18-07/s71807-57.pdf> (“NASAA Letter”) (“This change will eliminate arbitrary distinctions based on the organizational types of various entities, where there is no correlation between the form of the entity and the need for the protections of securities registration”); Keith F. Higgins, Lawrence A. Goldman, and Ellen Lieberman, American Bar Ass’n (Oct. 12, 2007), <https://www.sec.gov/comments/s7-18-07/s71807-52.pdf> (“Although we agree with the entities proposed to be added, we recommend that the Commission take a more principles-based approach by simply using the term ‘any legal entity’ without specifying any particular types of entities”); Katten Muchin Rosenman LLP Financial Services Group (Oct. 9, 2007), <https://www.sec.gov/comments/s7-18-07/s71807-35.pdf> (“In order to allow more flexibility with regard to the manner of association, a more principles-based definition, or one with a catch-all category such as ‘or any organized group of persons whether incorporated or not’ as used in the definition of ‘company’ under the Investment Company Act, may be preferable”).

<sup>32</sup> The timing of the 2007 Proposal coincided roughly with the events that marked the commencement of the 2007-2008 financial crisis, leading to a re-ordering of the Commission’s priorities. The Commission withdrew the 2007 Proposal from the Fall 2009 semiannual regulatory agenda because of the passage of time.

<sup>33</sup> Dodd-Frank Act § 413(b)(2)(A).

<sup>34</sup> The floor debate on the Dodd-Frank Act includes the following discussion:

Ms. MURKOWSKI. Our State—the great State of Alaska—believes that it would be appropriate and in the public interest and, in the interests of State and local governments across the Nation, for the SEC to add governmental entities to the definitions of “accredited investor” and “qualified institutional buyer” when it promulgates rules pursuant to this legislation. The reasons for including governmental entities in these definitions are as sound today as they were 3 years ago. In particular, governments are large and sophisticated investors with professional treasury management staffs that manage large amounts of the government’s own money and seek to invest in bonds and other securities investments in order to prudently diversify their investment portfolios and obtain a favorable return. Many of the most attractive investments are offered only in private placements to institutional investors conducted under regulation



Following its initial review of the definition of “accredited investor” pursuant to the statutory requirement, the SEC released the Accredited Investor Staff Report in December 2015. The 2015 Report provided an extensive discussion of the definition of “accredited investor” as the term applies to natural persons and, in the interest of providing a comprehensive analysis, also addressed the accredited investor definition as it applies to “entities.” In this connection, the 2015 Report noted that requests for interpretive guidance and comment letters responding to the 2007 Proposal suggested that revisions to the definition as applied to entities may be appropriate.<sup>35</sup>

The 2015 Report recommended that the Commission consider revising the definition of “accredited investor” as it applies to entities by replacing the \$5 million assets test with a \$5 million investments test and including all entities rather than specifically enumerated types of entities.<sup>36</sup> Thus the 2015 Report’s “entities” recommendation had two components:

- Include all “entities” (rather than those on a specific list) and
- Replace the assets test with an investments test (which would remain at the current \$5 million level).

**(a) 2015 Staff Recommendation to Expand the “Entities List”**

The 2015 Report noted that the accredited investor definition for entities relies on a list of enumerated categories found in the various subsections of Rule 501(a) and that entities not covered include limited liability companies, Indian tribes, other governmental entities and educational expense plans operated under Section 529 of the Internal Revenue Code (“529 Plans”). The Report identified the following concern:

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

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D or rule 144A. Without access to these investments, the government earns a lower return and has less diversification in its investments than would be optimal. Does the chairman agree with us that when the SEC promulgates its rules under this legislation, it should address, while taking care to ensure appropriate minimum asset protections are in place, the inclusion of State and local governments in the definitions of accredited investor and qualified institutional buyer?

Mr. DODD. I believe it would be appropriate for the SEC to take the opportunity presented by the rulemakings under this legislation, to consider whether to include State and local government bodies within those definitions. 156 Cong. Rec. S4064 (daily ed. May 20, 2010),

<https://www.congress.gov/111/crec/2010/05/20/CREC-2010-05-20-pt1-PgS4034-2.pdf>.

<sup>35</sup> 2015 Report at 76.

<sup>36</sup> 2015 Report at 7.



investors. In addition, state law developments since the adoption of Regulation D have expanded the types of business entities that exist and relatively recent concepts, such as low profit limited liability companies, suggest that developments in this area are ongoing.

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The principal limitations with the current accredited investor framework for entities are that some types of entities are not accredited investors because the definition does not specifically include them, and that the definition does not provide flexibility for legal developments. As a result, entities not specifically included must request clarification through interpretive guidance, which increases legal costs and creates transactional uncertainties.<sup>37</sup>

With respect to replacing the list-based approach to entities, the 2015 Report also described the 2007 Proposal, which included a similar change reflecting the same concerns, and noted the favorable response to this aspect of the Proposal:

In proposing these changes, the Commission noted that it was attempting to reduce uncertainty and legal costs and promote more efficient private capital formation. Commenters generally supported the proposal to expand Rule 501(a)(3).<sup>38</sup>

The 2015 Report also noted that an entity-list approach would inevitably be outdated, as entity structures evolve:

Rule 501(a)(3) originated as a narrow provision with limited applicability and has evolved over time into a common way for entities to qualify as accredited investors. If the accredited investor definition continues to apply

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<sup>37</sup> 2015 Report at 77 – 78, 83 (footnotes omitted).

<sup>38</sup> *Id.* at 78 (footnote omitted). The 2015 Report also discussed the specific proposal in 2007 to expressly include governmental bodies in the definition of “accredited investor” (other than Indian tribes, which were addressed separately):

Several governmental and quasi-governmental entities have asked the Division of Corporation Finance for interpretive guidance about whether they may qualify as accredited investors under Rule 501(a). For example, in 2011, the Alaska Permanent Fund requested an interpretation that it is an accredited investor under Rule 501(a)(3). The Alaska Permanent Fund is a large sovereign wealth investment fund with a unique form of organization established by name in the constitution of the State of Alaska. The request noted that “[s]ome uncertainty exists as to the coverage of institutions substantially similar to those listed [in Rule 501(a)(3)]” and explained that “because the [Alaska Permanent] Fund has a unique constitutional statutory form and history it does not fit neatly with the more common forms of business trusts, corporations or partnerships that are the form commonly taken by private investment funds.” Based on the facts presented, the Division provided interpretive guidance indicating that, although the Alaska Permanent Fund is not organized as an entity specifically listed in Rule 501(a)(3), it may be treated as an accredited investor if it satisfies the other requirements of the definition.

*Id.* at 79 – 80 (footnotes omitted).



to only specific enumerated entities instead of all types of entities, revisions may be required periodically in response to legal and economic developments.<sup>39</sup>

The Report noted that the 2007 Proposal asked whether the Commission should delete the list entirely and simply say that any legal entity that can sue or be sued in the United States can qualify as an accredited investor, provided it meets the other standards for becoming an accredited investor, and that commenters generally supported a catch-all provision.<sup>40</sup>

The Report concluded that limiting the accredited investor definition to specific entities has resulted in regulatory uncertainty and may not effectively serve Regulation D's investor protection objectives. The Report stated that the Commission could consider modifying the definition to permit any entity with investments in excess of \$5 million, and not formed for the specific purpose of investing in the securities offered, to qualify as an accredited investor.<sup>41</sup>

#### **(b) 2015 Staff Recommendation to Replace the Assets Test with an Investments Test**

As noted above, the “accredited investor” amendment recommended in the 2015 Report included a change in the financial test, from an assets test to an investments test. In this connection, the Report noted concerns raised by one commenter arising from “the involvement of some governmental entities in troubled investments.”<sup>42</sup> The Report concluded that such concerns more generally relate to absence of appropriate levels of an investor's financial sophistication and ability to fend for itself, and could be addressed by an appropriate financial test:

In light of the impact troubled investments can have on governmental entities, their constituents and their states, any expansion of the accredited investor definition to include governmental entities requires careful consideration of an entity's financial sophistication and ability to fend for itself. For example, expanding Rule 501(a)(3) to include any governmental entity could result in entities with \$5 million in non-financial assets, such as land, buildings and vehicles, qualifying as accredited investors even if they have no investment experience. An asset-based test likely would not serve as a reliable method for ascertaining whether a governmental entity is likely to have sufficient knowledge in financial and business matters to evaluate the merits and risks of prospective investments without the protections of

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<sup>39</sup> *Id.* at 83 – 84 (footnote omitted).

<sup>40</sup> *Id.* at 84.

<sup>41</sup> *Id.* at 92.

<sup>42</sup> *Id.* at 80 – 81.



registration. An investments-based test, however, could reflect meaningful investing experience and exposure to financial markets.<sup>43</sup>

However, the 2015 Report noted, using an investments test rather than an assets test could address these concerns, which are not limited to governmental entities, and could result in an improved test for financial sophistication that may be assessed more easily than the assets standard. In this connection, the staff noted that the 2007 Proposal had included addition of an alternative investments-owned standard to the assets test.

The Commission indicated that an investments-owned standard would add a potentially more accurate method to assess an investor's need for the protections of registration under the Securities Act. An investments-owned standard may be a more effective proxy for financial sophistication than an asset-based test, as it reflects exposure to investment markets. The Commission also indicated that an investments-owned standard might reduce and simplify compliance burdens for companies by providing an alternative standard that may be assessed more easily than the assets standard. The Commission received support for including this alternative standard. Commenters generally preferred a principles-based definition of the term "investments" rather than the proposed definition, which was based on Investment Company Act Rule 2a51-1(b).

A revised accredited investor definition for entities that includes a catch-all provision and an investments-owned test may more effectively measure financial sophistication than the current definition, which focuses on an entity's form of organization and its assets, which may include illiquid and non-investment assets. As noted in the 2007 NASAA Letter, "[the revisions included in the 2007 Proposing Release] will eliminate arbitrary distinctions based on the organizational types of various entities, where there is no

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<sup>43</sup> *Id.* at 81. The 2015 Report also described interpretive guidance provided by the staff that permits treating governmental entities as accredited investors if they meet the substantive criteria for qualification as tax-exempt nonprofit organizations:

Internal Revenue Code Section 501(c)(3) tax exempt nonprofit organizations are included in the accredited investor definition but other tax exempt nonprofit organizations are not. Examples of tax exempt nonprofit organizations that do not qualify as accredited investors include civic leagues, labor organizations, business leagues, chambers of commerce and voluntary employees' beneficiary associations. In response to requests for interpretive guidance, the staff has indicated that a federal income tax exempt governmental unit meeting the substantive criteria of Section 501(c)(3) with total assets in excess of \$5,000,000 may be deemed a Section 501(c)(3) organization for purposes of qualifying as an accredited investor. In contrast, the staff has indicated that tax exempt organizations not substantially meeting the requirements of Section 501(c)(3) will not be deemed to constitute accredited investors.

*Id.* at 83 (footnotes omitted).



correction between the form of entity and the need for the protections of securities registration.”<sup>44</sup>

The 2015 Report concluded that the Commission could consider replacing the assets test in the current definition with an investments test because the staff believes it would provide a more meaningful standard in ascertaining whether an entity is likely to have sufficient knowledge in financial and business matters to enable it to evaluate the merits and risks of potential investments without the protections of registration. It noted that the Commission could consider retaining the current provisions that permit certain regulated entities (e.g., banks, savings and loan associations, insurance companies) to qualify as accredited investors without any financial thresholds.<sup>45</sup>

**(c) Commenter Views**

The majority of comments on the 2015 Report that addressed the issue supported moving from a list-based approach to an all-entities approach.<sup>46</sup> We note that a number of the comments on the Concept Release have also supported this change.<sup>47</sup>

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<sup>44</sup> *Id.* at 84 – 85 (brackets original, footnotes omitted) (citing NASAA Letter, *supra* note 31).

<sup>45</sup> *Id.* at 92 – 93.

<sup>46</sup> *See, e.g.*, Comments of Judith Shaw, President, North American Securities Administrators Ass’n (May 25, 2016), <https://www.sec.gov/comments/4-692/4692-34.pdf> (“We support the staff’s recommendation to expand the definition to encompass all entities as long as there is a ‘look-through’ provision to ensure the purpose of an entity’s formation is not solely for investment activities to evade the accredited investor minimum standards”); Todd McCracken, CEO, National Small Business Association (Mar. 29, 2016), <https://www.sec.gov/comments/4-692/4692-18.pdf> (“NSBA also supports the expansion of the definition to encompass any entity, regardless of form, which has investments in the requisite amount to qualify”); Brett Palmer, President, Small Business Investor Alliance (Mar. 7, 2016), <https://www.sec.gov/comments/4-692/4692-15.pdf> (“SBIA supports . . . permitting certain entities such as Indian tribes, LLCs, labor unions, 529 Plans and others to qualify as accredited”).

<sup>47</sup> *See, e.g.*, Comments of Tram Nguyen, Chair, Comm. on Securities Regulation, et al., New York State Bar Ass’n (Oct. 18, 2019), <https://www.sec.gov/comments/s7-08-19/s70819-6315608-193651.pdf>; Barbara Novick, Vice Chairman, and Joanne Medero, Managing Director, BlackRock (Sept. 24, 2019), <https://www.sec.gov/comments/s7-08-19/s70819-6193326-192493.pdf>; Mark D. Epley, Executive Vice-President & Managing Director, Managed Fund Ass’n, and Jiri Król, Deputy CEO, Global Head of Government Affairs, Alternative Investment Management Ass’n (Sept. 24, 2019), <https://www.sec.gov/comments/s7-08-19/s70819-6183180-192413.pdf>; Aseel M. Rabie, Managing Director and Associate General Counsel, and Lindsey Weber Keljo, Managing Director and Associate General Counsel, Asset Management Group, SIFMA (Sept. 24, 2019), <https://www.sec.gov/comments/s7-08-19/s70819-6193329-192494.pdf>.