VIA E-MAIL SUBMISSION

March 13, 2020

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

RE: #S7-25-19, Amending the "Accredited Investor" Definition

Dear Ms. Countryman:

The undersigned is a third-year law student at the Maurice A. Deane School of Law at Hofstra University.[1] As having studied various areas of law that touch upon the rules governing securities, I am grateful for the opportunity to comment on this issue.

The undersigned is submitting this Comment after reading the Commission's 2019 Concept Release and Proposed Rule posted in December of 2019. This Comment mainly focuses on two of the proposed new definitions of an accredited investor: (1) natural persons that would qualify based on professional or academic credentials; and (2) "family offices" with at least $5 million in assets and their "family clients" as defined by the Investment Advisers Act. I support the Commission's proposal in many respects and have a few suggestions. I appreciate the Commission's willingness to find ways of simplifying the enforcement of the securities laws.

A. Background

"Congress established the Securities and Exchange Commission in 1934 to enforce the newly-passed securities laws, to promote stability in the markets and, most importantly, to protect investors."[2] That language does not come from promotional materials of some investor protection group nor from a legal scholar speaking theoretically, but from the Commission itself. Since the Commission considers the congressional mandate of protecting investors as its fundamental mission, that guiding principle should be incorporated in every decision the Commission makes. And, any directive lessening investor protection should only be done in limited scenarios when the Commission is absolutely certain that those investors do not need such protection.

Proper scenarios where investors are deemed not in need of the full protection of the securities laws can be generally categorized in the following way:

1. Offerings that are so local in nature that they are unlikely to affect interstate commerce;
2. Securities offered by the U.S. government;
3. Offerings purchased by entities that are otherwise regulated in another area of government (i.e. insurance companies and financial institutions); and

[1] All views expressed in herein are purely personal.

[2] SEC. EXCH. COMM'N, *What We Do*, https://www.sec.gov/Article/whatwedo.html (last modified June 10, 2013) (emphasis added).

4. Offerings where investors are deemed to be sophisticated enough to evaluate the risks of the security.

Of course, the subject of this comment will only focus on securities issued under the fourth category. In 1980, the first definitions of an "accredited person" were introduced by the Commission in Rule 242, when the Commission created a limited offering exemption under Section 3(b)(1) of the Securities Act of 1933.[3] These primary categories included institutional-type purchasers, those who were purchasing at least $100,000 of securities, and the executive officers and directors of the issuer. Although receiving pressure from industrial commenters to adopt an expansive definition, the Commission took a narrow approach, declining to impose a definition for individuals based on an asset-value or net-worth standard at that time.[4]

Pursuant to Section 2(a)(15)(ii) of the '33 Act, the Commission eventually expanded the meaning of an accredited person when it enacted Regulation D. Under Section 2(a)(15)(ii), the Commission has the authority to adopt specific definitions of an "accredited investor" using the following factors as a basis of such definition: financial sophistication, net worth, knowledge and experience in financial matters, and the amount of assets under management.

Regulation D carved out an exemption under Section 4(a)(2) of the '33 Act. These new categories of "accredited investor" included two which focused on the individual's net worth and annual income. These objective standards were easy to evaluate and provided enough assurance that these investors did not necessarily need all of the protections of the securities laws. The rationale being that one who has a significant income or amount of assets: (1) either has a presumed successful business acumen enabling them to evaluate the risks of an investment or is able to hire someone to evaluate those risks on their behalf; and (2) has enough finances to insulate them from the harm of a potential loss on a poorly chosen investment.[5] Thus, the Commission was able to satisfy several of the factors Congress mandated them to consider when adopting these new accredited investor definitions.

American securities law has long recognized the concept of qualifying a security issued to investors that "can fend for themselves" as a private offering.[6] Those who invest in private offerings are not entitled to the same legal remedies if the offering had been registered. The '33 Act provides numerous private causes of action for investors with respect to registration and disclosure of a registered or should-have-been-registered security. The bulk of these actions are listed in Sections 5, 11, and 12 of the '33 Act. Because private offerings are not bound by these sections, private issuers are not subject to this liability. Aggrieved accredited investors can only rely on the harder-to-prove anti-fraud provisions of the securities laws in order to get relief even if the material provided to them would have been a violation for a registered offering.

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[3] Exemption of Limited Offers and Sales by Qualified Issuers, 45 Fed. Reg. 6362, 6362 (Jan. 28, 1980) (to be codified at 17 C.F.R. pts. 230 and 239).

[4] *Id*. at 6363 ("Some commentators recommended that the class of institutional investors which paragraph (a)(l)(i) defines as accredited persons be expanded. It was proposed that venture capitalists or other entities with either a specified minimum net worth or asset value, or both, be deemed to be accredited persons. The Commission, however, has determined to adopt paragraph (a)(l)(i); substantially as proposed.").

[5] *See* Mark A. Sargent, *The New Regulation D: Deregulation, Federalism and the Dynamics of Regulatory Reform* 68 Wash. U. L. R. 226, 290 (1990).

[6] *SEC v. Ralston Purina Co.*, 346 U.S. 119, 125 (1953).

B. Natural persons with specific professional or academic credentials (Question 1)

Expanding the "accredited investor" definition to individuals with specific professional or academic credentials would alienate less-sophisticated investors from participating in security offerings and increase the likelihood of fraud.

As noted by the Commission, establishing a credential-based category for the accredited investor definition would cause a significant increase in the pool of eligible investors for a private offering. But the Commission continued stating: "for the purposes of updating the accredited investor definition, we believe it is less relevant to focus on the number of individuals that would qualify and more relevant to consider whether the proposed criteria adequately capture the attributes of financial sophistication that is a touchstone of the definition." I would argue that the new number of individuals potentially able to invest without the full remedies of the securities laws should be one of the driving factors of the Commission's rulemaking process on this issue.

As noted by the Commission, exempt offering channels raised $2.9 trillion of new capital in 2018, compared to $1.4 trillion through registered offerings.[7] And, the private market should be anticipated to continue growing. This trend should be alarming to the Commission. An unchecked expansion of the private market does not advance the Commission's mission to "protect investors." By making private offerings even more accessible to issuers, the Commission is removing incentives for a company to issue a registered offering. Although the Commission is rightfully considering the knowledge of the newly targetable investors, it must also consider the effect on less-sophisticated investors who rely on registered offerings. While it may seem that expanding the accredited investor definition is opening the door to a new pool of investors; to the less-sophisticated investor, it looks like the government is locking them out of a market that encompasses more than half of revenue raised through securities.

The proposed wide expansion of the private market also would increase the likelihood of bad actors to take advantage of the newly available funds. Because brokers have a financial incentive to sell private funds, often at a high commission, by expanding their customer base, the Commission has the potential to enable an unsustainable private market bubble predicated on sale instead of return on investment.[8] While anti-fraud protections are still in place for accredited investors, the Commission should consider whether it wants to facilitate the growth of market that increases the potentiality of fraud. Of course, not every fraudster will be caught nor will every fraudulent scheme be prosecutable. Thus, the registration and disclosure liability imposed on issuers remains one of the Commission's most effective tools to protect investors. The Commission should seriously consider whether it wants to continue to chip away from the availability of these remedies

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[7] Chairman Jay Clayton, *Remarks to the Economic Club of New York,* SEC. EXCH. COMM'N. (Sept. 9, 2019), https://www.sec.gov/news/speech/speech-clayton-2019-09-09#_ftnref9.

[8] For a recent example, consider the Woodbridge real estate investment Ponzi scheme. Sarah O'Brien, *Brokers are banned or suspended in fallout from $1.2 billion Ponzi scheme,* CNBC (Apr. 18, 2019), https://www.cnbc.com/2019/04/18/1point2-billion-ponzi-scheme-fallout-more-brokers-banned-or-suspended.html.

It is my opinion that the current framework of Regulation D should not be disturbed with respect to an individual who may qualify as an accredited investor based on professional or academic credentials. Currently, a non-accredited investor is still able to take advantage of a Regulation D offering so long as they can prove they are able to evaluate "the merits and risks of the prospective investment."[9] If an issuer is making a Rule 506 offering that includes non-accredited investors, it may not advertise or solicit generally. This limitation requires a potential non-accredited investor in a 506 offering to show some initiative and seek out opportunities to invest in or be deemed sophisticated enough to be contacted individually by the issuer.[10] Under the 506(b) standard, many investors with the aforementioned credentials will be deemed sophisticated depending on the facts and circumstances of the investment – a new category is not necessary. This fluid standard, although difficult to arbitrarily categorize, is easily adaptable to specific offerings and investors.

Attempting to create a uniform definition of one's sophistication based on a certification or some other degree would certainly help facilitate capital formation. However, this formation will be an unchecked expansion of the private market that can be considered irresponsible and a direct violation of the Commission's mission to protect investors. If the definition is expanded, this new pool of investors will become valid targets for general solicitation by issuers, and because investors of Regulation D offerings do not have the registration-process-based legal remedies – these investors will have a harder time protecting their interests. If the Commission wants to effect positive capital formation while still protecting investors, it should simplify the registration process for the sale of securities. Instead of creating new categories for investors to participate in the purchase of unregistered securities, the Commission should address the arduous nature of the registration process itself.

C. Family offices and their family clients (Questions 34-37)

1. The treatment of "family offices" within the securities laws deserves meaningful harmonization. Thus, it should be included as an accredited investor definition with limitations.

Family offices are entities established by wealthy families to manage that family's wealth as well as provide certain services to the family. In 2011, the Commission adopted the Family Office Rule, which excluded "family offices" from the definition of an investment adviser under the Investment Advisers Act of 1940. This exclusion can be attributed, in part, to the policy argument: family members are presumed to act in the best interest of the family, meaning, the clients of the family office likely will not need the full protections of the Act.[11] The lack of a uniform definition for family offices results in their disparate treatment in the securities laws. This presumption that family office managers will act in the best interest of their family members should rationally be extended to investing in unregistered securities. Further, under the current regulatory scheme,

[9] 17 C.F.R. § 230.506(b).

[10] If the issuer is contacting the investor for a Regulation D offering, the issuer obviously considers them sophisticated enough to participate because including an improper investor in the offering would remove the exempt status of the transaction.

[11] *See* letter from Martin E. Lybecker, Perkins Coie LLP (on behalf of Private Investor Coalition) at 3 (August 8, 2016).

depending on their organizational structure, many family offices, but not all, are already able to meet some definition of an accredited investor. Establishing a clear standard would allow family offices to manage the assets of the family more prudently and make issuers more comfortable working with them knowing they are square within the law.

As mandated by the Family Office Rule, the carve-out for "investment advisers" is only entitled to family offices that are "exclusively controlled, directly or indirectly, by one or more family members and/or family entities."[12] Although the Commission is proposing to enact the same family office definition found in the Family Office Rule (thus incorporating the control requirement), it is important for the Commission to explicitly emphasize the need of family control in its final ruling. Doing so would bolster the rationale that these offices do not need all available protections under the securities laws, because of the presumption that family members will act in each other's best interest. Additionally, the Commission should emphasize that this definition of family office does not apply to multi-family offices – as it did in its final posting for the Family Office Rule.[13] The rationale for this exclusion being that many clients of a multi-family office lack a direct familial relationship to the manager. These offices' clients need the full protections of the securities laws to ensure the manager will not treat different families discriminatorily or fraudulently.

I agree with the proposed requirement of $5 million in assets for a family office to meet the definition of accredited investor. The asset requirement is not arbitrary, as Rule 506 similarly defines a trust managing at least $5 million in assets. The trustee-beneficiary relationship is fairly comparable to the family manager-family client relationship in a family office. Although not equal in the eyes of the law, both relationships create a confidence that the assets will be legitimately managed.

One of the concerns expressed by the Commission is whether and/or how to impose a sophistication requirement for the family member, members, or entity in charge of the family office. Adding a sophistication requirement for family office managers is integral to the rationale of the accredited investor definition. Instead of trying to explicitly define what it means to be sophisticated in this definition, the Commission should use the same language found in Rule 506(b) for evaluating the sophistication of non-accredited investors. The manager should have "such knowledge and experience in financial and business matters that [the manager] is capable of evaluating the merits and risks of the prospective investment." This definition is not overbearing for a family office manager to meet. The fact that the individual, members, or entity was chosen to lead the office, already suggests some level of financial sophistication.

Alternatively, if the Commission did not wish to provide the aforementioned sophistication definition, I would propose that the Commission require the family office to be in existence for at least 3 years prior to being considered an accredited investor. This would establish a floor, albeit a modest one, to ensure that the office is being managed in a financially competent way – thus presuming some level of sophistication on behalf of the manager. This requirement would not impose an exhaustive administrative burden on behalf of the Commission, nor intrude into the

[12] 17 CFR § 275.202(a)(11)(G)-1 - Family offices(b)(2).
[13] *See* SEC, Family Offices Final Rule [Release No. IA-3220; File No. S7-25-10] at 33 (2011).

privacy of family offices – a concern the Commission expressed when adopting the Family Office Rule.[14]

2. "Family clients" should not be included as a definition of an accredited investor because the addition would not be in line with the factors Congress mandated the Commission to consider when creating new definitions.

Family clients of family offices include (but are not limited to): current and former family members, certain employees of the family office, charities funded exclusively by family clients, and trusts existing for the sole benefit of a family client. The Commission's proposal to expand the definition of an accredited investor to "family clients of family offices" lacks an assurance of sufficient investor protection and lessens the understanding of what it means to be a sophisticated investor to a test of familial relationships.

Under a plain reading of the proposal as it stands: "any family member" of a family office will be considered an accredited investor. This definition is at odds with the general understanding of why an accredited investor does not need the investor protections of registration. For example, under this rule, an eighteen-year-old family client with minimal assets and an insufficient understanding of the securities laws would meet the definition of accredited investor – and be able to invest in unregistered securities solely on their own, unrelated to the management of the family office's assets.

The family client definition does not have a rational basis in any of the congressionally mandated factors the Commission is to consider when adding a new category to the accredited investor definition: financial sophistication, net worth, knowledge and experience in financial matters, and the amount of assets under management.

There is no assurance that these clients have the assets or net worth to be able to survive a failed risky investment. So, the Commission asks whether there should be a "financial threshold for family clients to qualify?" However, there are already sufficient financial thresholds in the accredited investor definition (i.e. $1 million net worth or $200,000 salary). This definition is also insufficient to provide a presumption of sophisticated knowledge to understand the risks of an unregistered security. If adopted, would the Commission be presuming one has sophisticated knowledge through their familial relationships? Does the government do this in any other context?

Part of the rationale of this new proposed definition is certain family clients meet the definition of an accredited investor while others do not, even though they are all equity owners in the family office, which is investing a large amount of money.[15] So, those family clients who do not meet the definition should be added when you consider the assets managed by the family office. I am not swayed by this argument. The assets in a family office are categorically not being managed by the clients (unless they are so designated). If the Commission adopts the previously discussed "family office" definition, then these non-accredited-investor family clients do not need their own

[14] Family Offices, Release No. IA-3098 (Oct. 12, 2010) [75 FR 63753 (Oct. 18, 2010)] ("We also were concerned that application of the Advisers Act would intrude on the privacy of family members.")

[15] *See* Private Investor Coalition letter at 4 (September 24, 2019).

category. They would indirectly be able to benefit from the new opportunity of investments available to the office. For these reasons, family clients of family offices should not be included as a new category of an accredited investor.

D. Rational updates to the definition (Questions 40 & 50)

1. The Commission should allow spousal equivalents to pool their finances to meet the household financial thresholds in the accredited investor definition

The composition of American households has changed dramatically since 1982. Marriage is now legal for same-sex couples, and more young people are living together in committed relationships without marrying. For example, in 2018, 9% of 18 to 24 year-olds were living with an unmarried partner – compared to 7% living with a spouse.[16] Further, 15% of 25-34 year-olds were living with an unmarried partner. The Commission should adopt the proposed "spousal equivalent" definition to reflect this trend and permit these couples to participate in private offerings, provided they meet the financial thresholds.

2. Updates to the financial thresholds of the accredited investor definition should be made to reflect inflation

As the Commission notes, 13% of American households currently meet the accredited investor definition's financial thresholds with respect to net worth and annual income. When the thresholds were first adopted, only 1.6% of American households satisfied the definition. As the private market continues to grow, the Commission should take reasonable steps to protect these investors. The Commission should adjust these financial parameters reflecting inflation to get back to the original intent of the category. Further, changes made with respect to inflation should be updated every four years. This interval makes the most logistical sense, as it coincides with the congressional mandate to review the securities laws pursuant to the Dodd-Frank Act.

This update is needed, especially as some commenters have critiqued the use of financial status as an indicator of sophistication, generally. If the Commission remains committed to using household financial thresholds as a category, it should update those limits to strengthen its position as to why this category is valid. Any potential disruption in the Regulation D market would be done in furtherance of the goal to protect individual investors – facilitating capital formation is not the only purpose of the Commission.

E. Conclusion

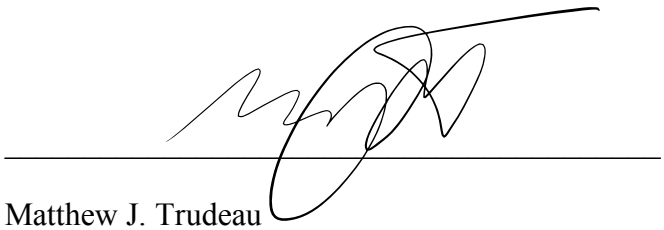
When considering whether to expand the accredited investor definition, it is important to appreciate the impact it will have on the private and public markets. I fear that while the private market continues to grow becoming more profitable for issuers, the Commission's reach to protect investors will wane and the potentiality for fraud will increase. Thus, I suggest that the

[16] Benjamin Gurrentz, *Living with an Unmarried Partner Now Common for Young Adults,* U.S. CENSUS BUREAU (Nov. 15, 2018), https://www.census.gov/library/stories/2018/11/cohabitaiton-is-up-marriage-is-down-for-young-adults.html.

Commission not extend the accredited investor definition to individuals based on professional or academic credentials. Further, I support the Commission's adoption of clear rules governing family offices and family clients, as well as, rational amendments to the definition with respect to inflation and treatment of spousal equivalents. These updates

I want reiterate my appreciation of the Commission's continued commitment to advancing the securities laws. I hope the Commission holds the mission of protecting investors central while it considers changes to the accredited investor definition. I sincerely thank the Commission for the opportunity to share my thoughts included herein.

Sincerely,



Matthew J. Trudeau
Hofstra Law Class of 2020