



March 13, 2020

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

RE: Release Nos. 33-10734; 34-87784; File No. S7-25-19 (Amending the “Accredited Investor” Definition)

Dear Mr. Fields,

The Cornell Securities Law Clinic (the “Clinic”) submits this comment opposing and supporting certain sections of the rule proposal (the “Proposed Rule”) of the Securities and Exchange Commission (“SEC”) to amend the definition of “accredited investor” contained in Rule 501(a) of Regulation D. The Clinic is a Cornell Law School curricular offering in which students provide representation to public investors and public education as to investment fraud in the “Southern Tier” region of New York. For more information, please see <http://securities.lawschool.cornell.edu/>.

Rule 501(a) of Regulation D defines the term “accredited investor.”¹ Attaining accredited investor status is significant because accredited investors may participate in offerings exempt from the registration requirements under the federal securities laws.² Currently, a natural person obtains this status by meeting certain financial thresholds, which ensure that the investor can bear the risk of the investment.

In contemplation of an update to the rule, the SEC released a Staff Report in 2015 (the “Staff Report”). After reviewing comments on the Staff Report, the SEC has released the Proposed Rule. Given the significance of accredited investors, the Clinic has commented on proposed rules relating to them before, including on the Staff Report.³

The Clinic accordingly submits this letter for your consideration.

¹ 17 C.F.R. § 230.501(a).

² *Id.* § 230.251(2)(C).

³ *See, e.g.*, Letter from the Cornell Law School Securities Law Clinic (Apr. 30, 2016), <https://www.sec.gov/comments/4-692/4692-28.pdf>.



I. THE SEC SHOULD ADJUST FINANCIAL THRESHOLDS FOR INFLATION AND NOT ALLOW SPOUSAL EQUIVALENTS IN DETERMINING ACCREDITED INVESTOR STATUS

A. The Clinic supports adjusting the current financial thresholds for inflation.

The SEC requested comment on whether the current financial thresholds should be adjusted for inflation.⁴

The SEC introduced the current financial thresholds in 1982 to identify sophisticated investors who do not need the protections of the registration requirements of the federal securities laws. However, because the thresholds have not been re-examined since their adoption, accredited investors today are not as wealthy as they would have been in 1982, adjusted for inflation. The Clinic believes that the financial thresholds should be adjusted for inflation because the SEC uses wealth as a proxy for financial sophistication.

The SEC expressed its concerns about the effect this adjustment would have on the number of investors who would qualify as accredited investors. While it is important to maintain an adequate pool of investors, capital formation should not be the primary factor the SEC considers in implementing possible changes to the definition. A pool consisting of investors who lack sophistication or adequate financial resources serves no legitimate capital-raising purpose.

In addition to the adjustment of the financial thresholds, the Clinic also supports grandfathering issuers' current investors who meet and continue to meet the current financial thresholds. If the SEC did not grandfather these investors, it would be taking away the investments that the investors purchased in reliance on the current rule. However, this should only apply to the securities currently owned by the investors.

The Clinic believes that the grandfathering provision would provide protection from investment dilution for any person who would no longer be an accredited investor because of the changes to the definition. It would also help to mitigate the disruptive effects on the Regulation D market.

In conclusion, the Clinic supports adjusting the thresholds for inflation because it would more accurately identify investors who have the ability to sustain the loss from an investment.

B. The Clinic opposes the SEC's proposal to permit spousal equivalents to pool their finances for the purpose of qualifying as accredited investors.

The SEC proposes adding spousal equivalents to the accredited investor definition for the purpose of qualifying accredited investors. The Commission states that there is no reason to distinguish between different types of relationship structures, such as marriages, civil unions, and

⁴ Amending the "Accredited Investor" Definition [hereinafter "Proposed Rule"] 84 (proposed Jan. 15, 2020), <https://www.sec.gov/rules/proposed/2019/33-10734.pdf>.

domestic partnerships.⁵ However, the Clinic believes that the rationale is not clear enough to justify this change.

Civil unions and domestic partnerships differ from marriage in that they are not recognized by federal law. For instance, for federal tax purposes, “the term marriage does not include registered domestic partnerships, civil unions, or other similar formal relationships recognized under state law that are not denominated as a marriage under that state’s law.”⁶ Therefore, permitting spousal equivalents to pool their finances may cause inconsistency in the treatment of spousal equivalents.

The Clinic previously pointed out that this might encourage tax shifting because individuals who are taxed separately could be taxed less than a married couple due to different tax brackets between the two taxable units.⁷ In addition, one of the benefits of the current definition of accredited investor is that it is a bright-line standard that is easy to understand and administer. Adding a flexible term such as “spousal equivalent” to its definition would add administrative costs and complexity.

In conclusion, the Clinic opposes the SEC’s proposal to permit spousal equivalents to pool their finances for the foregoing reasons.

II. IF THE SEC DOES ALLOW CERTAIN PROFESSIONAL CREDENTIALS TO SERVE AS THE BASIS FOR AN INVESTOR BEING CONSIDERED AN ACCREDITED INVESTOR, THE SEC SHOULD RESTRICT THEM TO VERY FEW, SELECTIVE CRITERIA

The SEC asked for comment on certain professional credentials serving as the basis for an investor qualifying as an accredited investor.

If the SEC uses professional credentials to serve as the basis of an investor being an accredited investor, it should restrict them to a select few. These select few should be limited to professional credentials that ensure an investor has received an adequate education or has sufficient experience with investing.

A. The Clinic opposes the SEC’s recommendation to use a single FINRA-developed and FINRA-administered exam as the sole means to qualify for accredited investor status.

The SEC proposed that individuals who have passed one or a combination of the FINRA-administered examinations and received their certifications or designations could satisfy the criteria of an accredited investor.⁸ Specifically, the SEC proposed that an investor who has

⁵ Proposed Rule at 67.

⁶ Rev. Rul. 2013-17, 2013-2 C.B. 201.

⁷ Letter from the Cornell Law School Securities Law Clinic, *supra* note 3.

⁸ Proposed Rule at 33–39.

passed the Series 7, Series 65 (Uniform Investment Adviser Law Exam), or Series 82 (Private Securities Offerings Representative Exam) could satisfy the accredited-investor requirements.

The Clinic does not believe that one of these examinations alone is enough to test an individual's financial sophistication. Instead, the SEC should require an investor to pass all three of these exams.

The Series 7 exam is the general representative exam that is required for entry-level registered representatives and is considered the most rigorous of the exams. Yet the recommended study time for the exam is a mere 80-100 hours with an average pass rate of 65%.⁹

Although the Series 65 and 82 are substantively more relevant to the accredited investor status, they require even less study time and have higher pass rates than the Series 7.

In conclusion, if the SEC wants to use these examinations to test an investor's financial sophistication, the Clinic believes that the SEC should require that the investor pass all three.

B. The Clinic opposes the SEC allowing advanced degrees in law or business qualify an investor for accredited-investor status.

The SEC proposed that advanced degrees in either law or business could qualify an investor as an accredited investor.¹⁰ For the foregoing reasons, the Clinic opposes these degrees serving as the basis for determining accredited-investor status.

Holding a juris doctorate ("JD"), the professional law degree, does not guarantee that an investor has had any exposure to investment education. Many law schools do not require any sort of investment, accounting, or business course to graduate.¹¹

For a similar reason, allowing a JD to qualify an investor presents a uniformity issue. Due to the autonomy that many law students have in creating their schedules, the SEC cannot be sure that all people holding JDs have the same—or even comparable—levels of financial sophistication.¹²

Advanced business degrees, such as a master's in business administration ("MBA") present the same problems. MBA programs similarly often do not require any sort of investment education to graduate.¹³ MBAs also have the same uniformity issue as JDs. While MBA students

⁹ <https://www.nrs-inc.com/insights/nrs-insights-blog/series-7-exam-guide/>.

¹⁰ Proposed Rule at 38.

¹¹ See *Cornell Law School: JD*, CORNELL LAW SCHOOL, <https://www.lawschool.cornell.edu/admissions/degrees/jd/index.cfm>.

¹² See *id.*

¹³ See, e.g., *Curriculum*, HARVARD BUSINESS SCHOOL, <https://www.hbs.edu/mba/academic-experience/curriculum/Pages/default.aspx> (last visited Mar. 2, 2020).

may not have as much autonomy as JD students usually do, their degrees are often quite specialized in terms of concentration.¹⁴

These exposure and uniformity deficiencies would ultimately serve to undermine the goal of investor protection. Thus, the SEC should not allow them to serve as the basis for a determination that an investor is an accredited investor.

C. The Clinic supports the SEC allowing advanced degrees in finance to satisfy the criteria.

The SEC has also proposed to use advanced degrees in finance to determine whether an investor is an accredited investor.¹⁵ If the SEC accepts professional credentials as part of the criteria, the Clinic supports using this to determine accredited investor status.

Unlike advanced degrees in law or business, advanced degrees in finance ensure that the investor has some baseline knowledge of the financial industry and investment strategies. While finance degrees can be specialized, these specializations all provide some common knowledge of the investment industry.

In conclusion, the Clinic supports using this criterion in determining an investor is an accredited investor.

D. The Clinic supports the SEC's recommendation to add a category of "knowledgeable employees" of a private fund into the definition of "accredited investor".

The SEC additionally requested comment on the addition of a category of "knowledgeable employees" which would satisfy the requirements of the accredited investor definition.¹⁶ This would mirror the definition of "knowledgeable employee" in Rule 3c-5(a)(4), which includes employees in a managerial or supervisory capacity over funds (e.g., directors, executive officers, general partners).

The Clinic believes that knowledgeable employees of private funds have high levels of financial sophistication due to their positions and will be able to make informed investment decisions because of this. So, the Clinic does not believe that the federal securities registration process is needed to protect these investors.

In conclusion, the Clinic supports adding the "knowledgeable employee" category.

¹⁴ See *Areas of Focus*, CORNELL SC JOHNSON COLLEGE OF BUSINESS, <https://www.johnson.cornell.edu/programs/full-time-mba/two-year-mba/curriculum/immersion-learning/>.

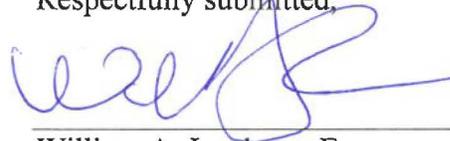
¹⁵ Proposed Rule at 38.

¹⁶ Proposed Rule at 44.

Conclusion

The Clinic appreciates the opportunity to comment on the proposed amendments to the definition of "Accredited Investor." We hope the SEC considers our concerns in making any possible changes to the definition.

Respectfully submitted,



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