March 16, 2020

By Internet https://www.sec.gov/rules/concept.shtml

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

pfm

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Re: Amending the "Accredited Investor" Definition
File Number S7-25-19

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 Commission's proposal to amend the definitions of "accredited investor" and "qualified institutional buyer" ("QIB").[1] 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 commends the Commission's initiative in addressing longstanding and widespread concerns raised by the current definitions as they apply to institutional investors and strongly supports the two key aspects of the Commission's proposals that would remedy these concerns. These are: (i) the proposal to add a new category in the accredited investor definition for any entity owning investments in excess of $5 million that is not formed for the specific purpose of acquiring the securities being offered ("Accredited Investor Proposal") and (ii) the proposal to make conforming changes to the QIB definition, so that entities that qualify for accredited investor status may also qualify for QIB status when they meet the existing QIB threshold of

[1] Amending the "Accredited Investor" Definition, Release Nos. 33-10734, 34-87784 (Dec. 18, 2019), 85 Fed. Reg. 2574 (Jan. 15, 2020) ("Proposing Release"). The Proposing Release is an outgrowth of the Commission's solicitation of comments on a broader set of issues relating to the offering exemptions framework under the federal securities laws. 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) ("Concept Release").

$100 million in securities owned and invested ("QIB Proposal"; collectively, "Proposals").

I. Executive Summary

A. Substance of the Proposals

1. Accredited Investor Proposal

Rule 501(a) under the Securities Act of 1933 ("1933 Act") defines "accredited investor," for purposes of Regulation D under the 1933 Act, as any person who comes within any of certain specified categories, or who the issuer reasonably believes comes within any of those categories, at the time of the sale of the securities to that person. Any entity not covered specifically by one of the enumerated categories is not an accredited investor under Regulation D.[2] The Commission believes that an expansion of the types of entities that qualify as accredited investors may reduce uncertainty and legal costs and promote more efficient private capital formation.[3]

The Commission therefore proposes to add a new category in the accredited investor definition for any entity owning investments in excess of $5 million that is not formed for the specific purpose of acquiring the securities being offered. This provision, which would be embodied in proposed Rule 501(a)(9), is intended to capture all existing entity forms not already included within Rule 501(a), such as Indian tribes and governmental bodies, as well as those entity types that may be created in the future.[4] "Investments" would have the definition set forth in Rule 2a51-1(b) under the Investment Company Act of 1940 ("1940 Act").

2. QIB Proposal

Rule 144A(a)(1) under the 1933 Act defines "QIB" for purposes of Rule 144A. Like the accredited investor definition, Rule 144A(a)(1) sets forth various specific types of entities that are QIBs if they meet certain standards. To avoid inconsistencies between the entity types that are eligible for accredited investor status and QIB status, the Commission proposes to make a conforming change to Rule 144A by adding new paragraph (J) to Rule 144A(a)(1)(i). This provision would permit institutional accredited investors under Rule 501(a), of an entity type not already included in Rule

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2 Proposing Release, 85 Fed. Reg. at 2586

3 *Id.*

4 *Id.* at 2588.

144A(a)(1), to qualify as QIBs if they own and invest on a discretionary basis at least $100 million in securities of issuers that are not affiliated with the entity.

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, instrumentalities, and investment pools ("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.

PFM previously filed a comment letter with the Commission recommending changes to the accredited investor and QIB definitions in response to the Concept Release.[5] We note that the Proposals would generally put PFM's recommendations into effect for the corresponding advancement of the investment interests of governmental entities.

C. Summary of PFM's Recommendations

PFM strongly supports both the Accredited Investor Proposal and the QIB Proposal. As more fully set forth below, we believe that the Proposals would appropriately enable entities meeting the respective standards, including governmental entities, to participate in private placements and to acquire resales of restricted securities, without raising investor protection concerns. The Proposals would implement a long-standing consensus that the existing definitions are too restrictive with respect to the forms of entity taken by institutional investors, including governmental entities, and we recommend that the Commission move quickly to adopt the Proposals.

We do suggest certain minor clarifying adjustments to the Proposals, which we summarize as follows:

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[5] Letter from Marty Margolis, Managing Director, PFM, to Vanessa A. Countryman, Secretary, SEC (Dec. 6, 2019), https://www.sec.gov/comments/s7-08-19/s70819-6513329-200267.pdf.

- We recommend that the Commission clarify that the term "entity" is intended to extend to all persons that may make investments, other than natural persons.

- We recommend that the Commission clarify that the term "institutional accredited investor" in the QIB Proposal includes all accredited investors as defined in revised Rule 501(a) that are not natural persons.

- We recommend that the Commission eliminate the phrase "of a type not listed" elsewhere in the QIB definition, in order to avoid confusion as to the entities eligible to rely on Paragraph (J) of the definition.

PFM notes that the Proposals were issued as part of a broader set of proposed changes to the accredited investor and QIB definitions, including changes that are not directly relevant to PFM's business, and that this comment letter therefore does not address. If for any reason the Commission decides not to go forward with the amendments addressed in the Proposing Release other than the Proposals at the present time, we believe that the clear advantages of the Proposals would justify taking prompt action on them, without the need to await a resolution of the other issues addressed by the Proposing Release.

II. The Accredited Investor Proposal

A. Current Definition – the Exclusionary "List-Based" Approach

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.

As the Proposing Release notes, any entity not covered specifically by one of the enumerated categories is not an accredited investor under Rule 501.[6]

B. The Commission's Proposal

The Accredited Investor Proposal would add a new paragraph (a)(9) to the definition of "accredited investor" in Rule 501(a). Under this new provision, an accredited investor would include any person who comes within the following category, or who the issuer reasonably believes comes within the following category, at the time of the sale of the securities to that person:

> (9) Any entity, of a type not listed in paragraphs (a)(1), (a)(2), (a)(3), (a)(7), or (a)(8), not formed for the specific purpose of acquiring the securities offered, owning investments in excess of $5,000,000;
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> **Note 1 to paragraph (a)(9):** For the purposes this paragraph (a)(9), "investments" is defined in rule 2a51-1(b) under the Investment Company Act of 1940 (17 CFR 270.2a51-1(b)).

The Accredited Investor Proposal would represent a notable move away from the existing list-based approach, a change that is needed based on the realities of market participants, including governmental entities, and that would not compromise investor protections. While the accredited investor definition would continue to be set forth in list-based form that would take the type of entity into account, entities would no longer be barred from accredited investor status simply because they are not in one of the recognized categories of entities. Instead, entities would be eligible for a "catch-all" category that would remove impediments to accredited investor status based on the form of entity.[7]

C. Considerations Supporting the Accredited Investor Proposal

1. Advantages of Revising 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

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6 Proposing Release, 85 Fed. Reg. at 2586.

7 *Id.* at 2606.

unnecessary.[8] 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. Some entities are currently excluded even though they are among the most sophisticated investors in the marketplace.

- Exclusion of entities that are not specifically identified has proven to be problematic and has required staff attention and regulatory relief on a case-by-case basis. 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,[9] this is indicative of the limitations of an enumeration approach. No enumeration approach can anticipate future changes to forms of entity. The Commission's staff provided extensive examples of the need for interpretive guidance in its 2015 Report on the Review of the Definition of "Accredited Investor" ("2015 Report").[10]

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8 *Id.* at 2577; Regulation D Revisions; Exemption for Certain Employee Benefit Plans, Release No. 33-6683 (Jan. 16, 1987), 52 Fed. Reg. 3015, 3017 (Jan. 30, 1987).

9 *Wolf, Block, Schorr and Solis-Cohen*, SEC No-Action Letter (Dec. 11, 1996). The Proposing Release includes a proposal to include limited liability companies expressly in Rule 501(a)(3), without the need to rely on the Accredited Investor Proposal.

10 *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

- As further discussed below, private placements under Regulation D frequently are limited to accredited investors.[11] 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 an exclusionary 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.

- An exclusionary 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.[12] The "qualified purchaser" definition identifies financially sophisticated investors

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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").

SEC Staff, Report on the Review of the Definition of "Accredited Investor" 76 n.273 (2015), http://www.sec.gov/corpfin/reportspubs/special-studies/review-definition-of-accredited-investor-12-18-2015.pdf.

[11] *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.

[12] 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").

> that are in a position to appreciate the risks associated with private investment funds and do not need the protections of the 1940 Act.[13] 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."

2. Evolution of the Relevant Markets to the Disadvantage of Governmental Entities

While the exclusion of sophisticated institutional investors from accredited investor status harms issuers and capital formation by reducing the available pool of investment capital, it has a more immediate and adverse effect on governmental entities and other types of institutional investors that cannot qualify as accredited investors under the current definition.

In the last decade it has become more difficult for entities that are not accredited investors 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

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[13] 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.
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> 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.

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 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).[14] 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 bond 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.[15] 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 of 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.

3. Consensus Recognizing Need To Expand or Replace the List-Based Approach

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[14] Source: PFM analysis of Bloomberg offerings in May 2019. The remaining 9% rely on other provisions of the 1933 Act and the rules thereunder.

[15] Source: PFM analysis of ICE BofAML Corporate Investment Grade Bond Index as of April 2019.

It has long been recognized that the exclusionary list-based entity approach to the accredited investor definition 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 exclusionary list-based approach will inevitably become outdated as new forms of entities emerge.

The Commission or its staff has remedied the restrictions of the exclusionary list-based approach in specific situations by interpretive or no-action relief,[16] but such an approach continues to leave gaps, with many sophisticated investors unable to participate in private placements that are restricted to accredited investors, and leaves uncertainty that introduces inefficiencies into the capital formation process.

Over the past thirteen years, a consensus has emerged recognizing the need to expand or replace the current list-based approach. 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.[17] 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.[18] Response to the 2007 proposal was generally favorable, and commenters specifically supported moving away from an exclusionary list-based approach.[19]

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16 *See supra* note 10 and accompanying text.

17 Revisions of Limited Offering Exceptions in Regulation D, Release Nos. 33-8828, IC-27922 (Aug. 3, 2007), 72 Fed. Reg. 45116 (Aug. 10, 2007).

18 *Id.* at 45127.

19 *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

In 2010, Congress in the Dodd-Frank Act directed the Commission to review the accredited investor definition periodically 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.[20] In connection with this review, the 2015 Report recommended the replacement of the entities list with a principles-based approach that would include all

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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").

[20] 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 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?
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> 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.

entities (not limited to those on a specific list) as long as the entity in question met a $5 million investments test.

The adoption of the Accredited Investor Proposal would conclude this sequence of support for a more appropriate and open-ended standard.

D. Other Recommendations

PFM agrees with the Commission that $5 million in investments is an appropriate threshold for the proposed new category. As the Proposing Release notes, an assets test is less suitable, because assets include non-investment assets such as land, buildings, and vehicles. The existing definition of "investments" in Rule 2a51-1(b) under the 1940 Act is appropriate and has the advantage that the market is already familiar with it. We do not see any need at this time to revisit the test for existing entity accredited investors.

While we believe the Commission's intent in using the term "entity" is clear, the Proposing Release does not include a definition of "entity." We believe it would be helpful and would eliminate any potential source of confusion for market participants if the Commission were to state explicitly that "entity" refers to any person that can make an investment, other than natural persons. As noted above, the Commission requested comment on a similar approach in the 2007 proposal.[21]

III. The QIB Proposal

A. Current Definition – the "List-Based" Approach

The definition of "QIB" in Rule 144A(a)(1) is intended to capture investors "that can be conclusively assumed to be sophisticated and in little need of the protection afforded by the Securities Act's registration provisions."[22] The current form of the definition was modeled on the list-based approach reflected in the Regulation D definition of "accredited investor." Qualifying entities include insurance companies, registered investment companies, business development companies, Small Business Investment Companies, state and local employee benefit plans, ERISA employee benefit plans, trust funds whose participants are employee benefit plans, 501(c)(3) organizations, corporations, partnerships, Massachusetts or similar business trusts, registered investment advisers, registered dealers, banks, and savings and loan associations. The Commission specifically looked to the Regulation D list of entities

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[21] *See supra* note 18 and accompanying text.

[22] Proposing Release, 85 Fed. Reg. at 2597.

when it proposed Rule 144A.[23] As with Regulation D, entities that are not on the list are not considered to be QIBs.

In general, if an entity is a QIB it must own and invest on a discretionary basis at least $100 million in securities of unaffiliated issuers. However, banks and other financial institutions specified in Rule 144A(a)(1)(vi) must also have an audited net worth of at least $25 million.[24]

B. The Commission's Proposal

The Commission proposes to add a new paragraph (J) to the QIB definition in Rule 144A(a)(1)(i). Under this new provision, a QIB would include any of the following entities, acting for its own account or the accounts of other QIBs, that in the aggregate owns and invests on a discretionary basis at least $100 million in securities of unaffiliated issuers:

> (J) Any institutional accredited investor, as defined in rule 501(a) under the Act (17 CFR 230.501(a)), of a type not listed in paragraphs (a)(1)(i)(A) through (I) or paragraphs (a)(1)(ii) through (vi).

The Proposing Release expressly states that eligible purchasers under Rule 144A(a)(1)(i) would continue to include entities formed solely for the purpose of acquiring restricted securities under Rule 144A, provided that they satisfy the test for QIB status.[25]

C. Considerations Supporting the QIB Proposal

PFM strongly supports the QIB Proposal. The considerations that weigh against an exclusionary list-based approach to the accredited investor definition similarly weigh against excluding entities from QIB status based solely upon their type of entity. In particular, there is no investor protection or other regulatory

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[23] *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).

[24] Rule 144A(a)(1)(vi). In addition, a registered dealer may be a QIB if it owns and invests on a discretionary basis at least $10 million of securities of unaffiliated issuers, or if it is acting in a riskless principal transaction on behalf of a QIB.

[25] Proposing Release, 85 Fed. Reg. at 2598.

rationale supporting the exclusion of investors such as governmental entities. A governmental entity that owns and invests on a discretionary basis at least $100 million in securities of unaffiliated issuers certainly qualifies as an investor "that can be conclusively assumed to be sophisticated and in little need of the protection afforded by the Securities Act's registration provisions."[26]

We also observe that the changes in the composition of the bond market, discussed above in Section II.C.2, are relevant to the desirability of adopting the QIB Proposal. As with accredited investors, the evolution of the market has increased the number of offerings that are only available to QIBs. There is no justification for this reduction of investment opportunities for sophisticated governmental entities that fail to qualify as QIBs only because they are not among the currently acceptable forms of entity.

We see no reason for concern that there would be a greater likelihood of Rule 144A securities flowing into the public market. The additional QIBs would meet a standard that is just as high as that applicable to existing QIBs. In addition, Rule 144A securities generally are subject to provisions intended to limit their after-market purchasers to appropriate persons.

D. Request for Clarification

We understand that the proposed amendment to the QIB definition is intended to include all categories of entities that are accredited investors and meet the $100 million threshold but are not otherwise expressly covered by the existing categories in the definition. We believe that there are two areas where this intent could be clarified.

First, the proposed language for the amended QIB definition refers to any "institutional accredited investor, as defined in rule 501(a)." However, there is no definition of "institutional accredited investor" in Rule 501(a). PFM recommends clarifying, either in the final adopting release or the rule itself, that the term institutional accredited investor means all accredited investors other than natural persons.[27]

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[26] *Id.* at 2597.

[27] This intent is stated indirectly – new paragraph (J) is proposed "to ensure that **entities that qualify for accredited investor status** may also qualify for qualified institutional buyer status when they meet the [QIB] $100 million in securities owned and invested threshold," *id.* at 2597(emphasis added) – but PFM believes a more explicit and prominent statement to that effect would be helpful in eliminating the potential for confusion and uncertainty.

Second, the proposed amendment refers to institutional accredited investors "of a type" not listed elsewhere in the QIB definition. We believe that this language – of a type not listed – is overly broad and confusing, and could mistakenly be read to exclude categories of entities from the definition that the Commission intends to include.[28] It appears from the Proposing Release that the "of a type not listed" phrase is intended to mean that banks and other specified financial institutions that are expressly covered in Rule 144A(a)(1)(iv), which imposes on these entities an additional minimum audited net worth requirement of $25 million not applicable to other entities, cannot avoid this additional requirement by relying on new paragraph (J).[29] To avoid the potential for ambiguity and confusion, PFM recommends that the language be revised to reflect this intent – that that paragraph (J) is not available for banks and other financial institutions specified in Rule 144A(a)(1)(vi) – in place of the proposed more general "of a type not listed" language.[30]

IV. Conclusion

In summary, we commend the Commission for issuing the Proposals, which embody pragmatic, consensus reforms that will strengthen the markets and more fully realize the concepts underlying Regulation D and Rule 144A. We strongly support the

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[28] To give a specific example, as stated in the Proposing Release, the Commission intends that proposed paragraph (J) "would encompass bank-maintained collective investment trusts that include as participants individual retirement accounts or H.R. 10 plans that are currently excluded from the qualified institutional buyer definition pursuant to Rule 144A(a)(1)(i)(F), so long as the collective investment trust satisfies the $100 million threshold." *See* Proposing Release, 85 Fed. Reg. at 2598 n.241. Since collective investment trusts could be a viewed as "a type" of entity otherwise addressed in the rule (*i.e.*, in paragraph (i)(F)), market participants reading the language of the rule could be confused as to whether collective investment trusts generally could be a "type" of entity listed in Rule 144A(a)(1)(i), and thus unable to rely on paragraph (J).

[29] *See* Proposing Release at 2597 & n.229.

[30] We also think it would be helpful to clarify that QIBs relying on new paragraph (J), like those relying on all other paragraphs of Rule 144A(a)(1)(i), would include entities formed solely for the purpose of acquiring restricted securities under Rule 144A, provided that they satisfy the test for qualified institutional buyer status, notwithstanding the requirement in the accredited investor definition that certain entities – specifically the entities described in rule 501(a)(3) and the new proposed catch-all category -- be "formed for the specific purpose of acquiring the securities offered." The Proposing Release states that "[e]ligible purchasers under Rule 144A(a)(1)(i) would continue to include entities formed solely for the purpose of acquiring restricted securities under Rule 144A, provided that they satisfy the test for qualified institutional buyer status," but does not expressly acknowledge that this overrides the similar "formed for the specific purpose" language in Rule 501(a).

Accredited Investor Proposal, pursuant to which the Commission would amend Rule 501(a) of Regulation D to add a new category in the accredited investor definition for any entity owning investments in excess of $5 million that is not formed for the specific purpose of acquiring the securities being offered. In addition, we strongly support the QIB Proposal, pursuant to which the Commission would amend Rule 144A(a)(1) to add a new catch-all category that would permit entities to qualify as QIBs if they own and invest on a discretionary basis at least $100 million in securities of issuers that are not affiliated with the entity. We believe these changes would have the following benefits:

- 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.
- 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,

Marty Margolis
Managing Director