



**BY ELECTRONIC TRANSMISSION**

March 16th, 2020

Vanessa Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

**Re: Amending the “Accredited Investor Definition” File No. S7-25-19; Release No. 33-10734; 34-87784**

Dear Ms. Countryman:

The Small Business Investor Alliance (“SBIA”) appreciates the opportunity to comment on the rule proposal issued by the Securities and Exchange Commission (“SEC” or “Commission”) to amend the definition of an “accredited investor” under Rule 501 of Regulation D (“Proposal”).

SBIA is a national association that develops, supports, and advocates on behalf of policies that benefit investment funds that finance small and mid-size businesses in the lower middle market, as well as the investors that provide capital to these funds. Our membership consists of the advisers of traditional 3(c)(1) and 3(c)(7) private funds, funds and their advisers that have been licensed by the Small Business Administration (“SBA”) as Small Business Investment Companies (“SBICs”), funds registered as business development companies (“BDCs”) under the Investment Company Act of 1940, and the investors that invest in these funds including banks, family offices, and fund of funds.

The SBIA previously submitted comments regarding the accredited investor definition in response to the Commission’s 2019 concept release on private offerings<sup>1</sup> as well as the 2015 SEC staff report on the definition of accredited investor.<sup>2</sup> As our previous comment stated, SBIA supports the adoption of alternative methods to establish accredited investor status for Americans. We believe doing so will enhance the flow of capital into emerging businesses and create more opportunities for households to invest and build sustainable wealth.

SBIA largely supports the Proposal and we appreciate the continued work of the SEC to modernize our nation’s securities laws for the benefit of Main Street investors and our capital markets. In particular, we support the proposed alternative methods for individuals to qualify as accredited, as well as the

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<sup>1</sup> Small Business Investor Alliance, *SBIA Comments on the SEC Concept Release on Harmonization of Securities Offering Exemptions*, September 25, 2019, available at <https://www.sec.gov/comments/s7-08-19/s70819-6195200-192528.pdf>

<sup>2</sup> Small Business Investor Alliance, *SBIA Comments on the SEC Report on the Review of the Definition of Accredited Investor*, March 7, 2016, available at: <https://www.sec.gov/comments/4-692/4692-15.pdf>.

inclusion of rural business investment companies (RBICs) in the definitions of accredited investor and “qualified institutional buyer.” Our thoughts on these issues as well as recommendations to improve the Proposal are discussed in greater detail below.

## I. Current Accredited Investor Definition

Individuals are eligible to meet the accredited investor definition if they have a net worth exceeding \$1 million (excluding a primary residence), earn at least \$200,000 in annual income (\$300,000 jointly with a spouse), or are a director or executive officer of an issuer that is conducting a private offering. The current income and net worth thresholds were established in 1982, and the SEC added the condition for joint income in 1988. Congress excluded the value of a primary residence from the net worth prong as part of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. Absent meeting one of these financial thresholds or being an officer of an issuer, there is no way for an individual to be deemed accredited. In other words, the rules effectively equate investor “sophistication” with having a minimum level of assets or annual income.

As many commentators have pointed out, the current criteria can be both overinclusive and underinclusive at the same time. An individual who receives a large inheritance – but possesses no expertise whatsoever of the financial markets – would automatically be deemed accredited. Meanwhile, someone that has an advanced degree in economics or extensive knowledge of investing and the markets – but happens to fall below either \$200,000 in income or \$1 million in net worth – would be prohibited from investing in many private securities offerings.

Financial thresholds alone are a poor indicator of whether an individual can understand the risks and rewards inherent in the private securities markets. According to the Proposal, only 13% of U.S. households currently meet either the income or net worth threshold, leaving the vast majority of Americans ineligible from participating in private offerings.<sup>3</sup>

The need for modernization of the accredited investor definition is all the more urgent given the increased importance of the Regulation D (“Reg D”) private offering market. According to SEC data, over \$1.7 trillion was raised under Reg D in 2018 (largely through 506(b) and 506(c) offerings), compared to \$1.1 trillion in 2009.<sup>4</sup> The Reg D market has also frequently outpaced the amount of money raised through public offerings over the last decade. Given the overall decline in the IPO market over the last two decades, it is critical that the SEC open avenues for Main Street investors to diversify their portfolios and invest in privately-operated businesses.

Contrary to criticisms that opening the private markets to more households will weaken investor protections, allowing investors to have a mix of both private and public companies in their portfolios can actually *reduce* their long-term investment risk. Then-SEC Commissioner Mike Piowar made this point in 2016 when he stated that “by holding a diversified portfolio of assets, investors reap the benefits of diversification...when adding higher-risk, higher-return securities to an existing portfolio, as long as the returns from the new securities are not perfectly positively correlated with the existing portfolio, investors can reap higher portfolio returns.”<sup>5</sup> In other words, modernizing the accredited investor definition as envisioned under the Proposal is entirely consistent with the SEC’s statutory mission to protect investors and facilitate capital formation.

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<sup>3</sup> Proposal at 77

<sup>4</sup> SEC Concept Release on Harmonization of Securities Offering Exemptions, June 18<sup>th</sup>, 2019, at 19.

<sup>5</sup> Remarks at the Meeting of the SEC Advisory Committee on Small and Emerging Companies. Commissioner Michael S. Piowar (May 18, 2016).

## **II. The Impact on SBIA Members of Changing the Accredited Investor Definition**

As noted in our previous letters, SBIA's members overwhelmingly rely on Rule 506 of Regulation D and on sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940 for exemption from investment company registration requirements when offering and selling interests in their funds. Accordingly, these funds generally restrict their offerings to natural persons and entities that qualify as accredited investors under Rule 501 of Regulation D. As a result, we have previously expressed our concerns over proposals to limit the pool of potential investors that qualify as accredited. Instead we have supported maintaining the current income and net worth thresholds but creating alternative methods for individuals to achieve accredited status.

## **III. SBIA Supports Many Facets of the Proposal**

The Proposal would provide alternative methods for individuals to qualify as accredited under Rule 501. The most impactful of these methods be for individuals that can demonstrate themselves to be credentialed by holding a certain professional certification, or for being "knowledgeable employees" of private funds.

### **Professional certification**

The Proposal would amend the accredited investor definition to include individuals that hold one or more professional certifications related to the securities markets, or other credentials issued by an "accredited educational institution." The SEC preliminarily expects that holders of certain Financial Industry Regulatory Authority licenses – such as the Series 7, 65, 66, and 82 licenses – would meet the definition. The Proposal also contemplates that holders of certain titles, such as Chartered Financial Analyst (CFA), Certified Public Accountant (CPA), and Master of Business Administration (MBA), amongst others, could also be deemed accredited in a final rule.

SBIA supports inclusion for holders of these FINRA licenses and professional certifications in the definition of accredited investor. These designations are a much more accurate indication of whether an individual is able to comprehend the unique nature of private offerings and perform basic due diligence tasks such as analyzing balance sheets, income statements, and general information provided by private issuers.

However, we believe the Proposal can and should be expanded to include individuals that can demonstrate their financial sophistication in other ways. For example, Question 4 of the Proposal asks whether individuals that pass the FINRA "Securities Industry Essentials" exam – which is open to any individual 18 or over – should be eligible to be an accredited investor. We believe they should, even if they do not work in the securities industry or have some type of advanced degree or certification. For example, someone who works in and has deep knowledge of a particular field (e.g. engineering or biotechnology) may not possess an advanced business degree but is better positioned than most to understand the investment opportunities present in their area of expertise. We support providing a pathway for such individuals to demonstrate their ability to understand the financial risks and rewards involved in such investments.

### **"Knowledgeable employee" of a private fund**

The proposal also seeks to allow a "knowledgeable employee" (as defined under Rule 3c-5 of the Investment Company Act) of a private fund to become accredited for purposes of investing in that fund. Such individuals would not be eligible to invest outside of the fund in which they are affiliated unless

they otherwise met the definition of an accredited investor. A “knowledgeable employee” of such a fund would include executive officers, board members, general partners, as well as individuals that have participated in the investment activities of the fund for at least 12 months.

SBIA strongly supports the adoption of this provision in a final rule as we believe such individuals are well-positioned to invest alongside their shareholders in private funds.

### **Other provisions of the Proposal**

SBIA supports the modifications in the Proposal related to spousal income. In cases where an investor relies on his or her joint net worth with a spouse to meet the accredited investor definition, the Proposal would allow that investor to take ownership in private securities (i.e. if joint income is used to qualify as accredited, ownership of the securities need not be taken jointly). We believe this is more of a technical clarification but will facilitate investment by those who rely on the joint income prong of the accredited investor definition.

We also strongly support the inclusion of RBICs as accredited investors and qualified institutional buyers. This will bring RBICs in line with the treatment of small businesses investment companies (SBICs) which currently qualify as accredited. RBICs are a critical source of capital in rural communities across the country and this will reduce a significant burden that has limited their ability to invest in private businesses.

We also support the inclusion of investment advisers (both state and federally registered), as well as Indian tribes, LLCs (so long as they are not established for sole purpose of investing in securities), and family offices in the accredited investor definition. These inclusions will increase the economic freedom for a number of entities and provide small and have a positive impact on capital formation.

Additionally, the “catch-all” provision that includes entities with at least \$5 million of investments (but which may not fall into one of the other categories, is well-designed. As the Proposal notes, an entity that already has \$5 million in investments “may better demonstrate that the investor has experience in investing and is therefore more likely to have a level of financial sophistication similar of other institutional accredited investors.”<sup>6</sup> We agree, and believe this catch-all category should be included in a final rulemaking.

The Proposal is by and large consistent with several recommendations made by the SBIA over the last several years. We appreciate the SEC once again addressing the needs of small businesses and Main Street investors and look forward to working with the Commission on this important initiative.

Sincerely,



Brett Palmer  
President  
Small Business Investor Alliance

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<sup>6</sup> Proposal at 57