Institute for Portfolio Alternatives

March 16, 2020

VIA ELECTRONIC DELIVERY

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

Re: Amending the "Accredited Investor" Definition, File No. S7-25-19 Release Nos. 33-10734; 34-87784; RIN 3235-AM19

Dear Ms. Countryman:

The Institute for Portfolio Alternatives ("IPA") is pleased to submit this comment letter in response to the above-referenced release ("Release") by the U.S. Securities and Exchange Commission (the "Commission"). The IPA strongly supports the Commission's proposal to expand the types of entities that qualify as accredited investors under Regulation D.

For over 30 years, the IPA has raised awareness of portfolio diversifying investment ("PDI") products among stakeholders and market participants, including investment professionals, policymakers and the investing public. We support increased access to investment strategies with low correlation to the equity markets: net asset value REITs (NAV REITs), lifecycle real estate investment trusts (Lifecycle REITs), business development companies (BDCs), interval funds and direct participation programs (DPPs). IPA member firms support individual investor access to a wide variety of asset classes that have historically been available only to institutional investors. These investment products have been held in the accounts of more than 3 million individual investors. With over $135 billion in capital investments, they remain a critical component of an effectively balanced investment portfolio and serve an essential capital formation function for national, state and local economies. Through advocacy and industry-leading education, the IPA is committed to ensuring that all investors have access to real assets and the opportunity to effectively balance and diversify their investment portfolios.

The "accredited investor" definition is intended to encompass those individuals and entities "whose financial sophistication and ability to sustain the risk of loss of investment or ability to fend for themselves render the protections of the Securities Act's registration process unnecessary."[1] The Commission defined "accredited investor" in Rule 501 of Regulation D in 1982. With the exception of limiting the pool to

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1 *See*, e.g., Rel. No. 33-6683 (Jan. 16, 1987) [52 FR 3015] (Regulation D Revisions; Exemption for Certain Employee Benefit Plans).

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exclude the value of one's permanent residence in 2011,[2] the definition has remained largely unchanged at $200,000 of income for an individual, $300,000 for a couple or $1 million in net worth, excluding the value of the investors' primary residence. Market experience has shown that these thresholds exclude sophisticated and other investors who do not require the protections of the Securities Act from pursuing opportunities currently available only to accredited investors.

IPA member firms offer investments in both publicly registered, non-listed REITS and BDCs as well as other direct participation programs that offer securities in reliance on Rule 506 of Regulation D. Accordingly, sales are restricted to natural persons and entities that qualify as accredited investors. The IPA believes that the Commission's proposed amendments to add new categories of natural persons that qualify based on certain professional certifications, designations or other credentials or their status as a private fund's "knowledgeable employee" is an appropriate and long-overdue expansion of the definition.

The IPA strongly supports the Commission's decision to retain the current dollar limits and not include an inflation adjustment.[3] As we noted in our recent comment letter to the Commission,[4] one of the greatest areas of concern in changing the definition of accredited investor is how it will impact persons engaged in like-kind exchanges under Section 1031 of the Internal Revenue Code. If the definition is narrowed, an investor who previously met the accredited investor standard and engages in a Section 1031 exchange may not be able to reinvest sales proceeds in a new investment when the original investment is sold. This could cause the investor to recognize significant unanticipated tax liability, in some cases, potentially in excess of their invested equity. Retaining the current dollar thresholds maintains an investor's ability to utilize a subsequent Section 1031 exchange from a current investment.

We believe that the Commission's proposed initial order to include individuals who have Series 7, 65, 82 licenses is the correct first step in expanding the definition to include licensed individuals but we also believe that the initial order should include the Series 66, Series 3, Series 6, CPA, and CFA designations. Excluding similarly qualified and sophisticated individuals would unnecessarily limit the definition without commensurate investor benefit. The IPA also strongly supports including "knowledgeable employees" as defined by Rule 3c-5 of the Investment Company Act of 1940 ("1940 Act") under the new definition. As it currently stands, a "knowledgeable employee" of the issuer would be a qualified purchaser under the 1940 Act, but potentially not an accredited investor, which is an illogical result.

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2 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, § 413(b), 124 Stat. 1376, 1577-78 (2010); Jumpstart Our Business Startups Act, Pub. L. No. 112-106, § 201(a), 126 Stat. 306, 313–15 (2012).

3 As an example of the difficulty and uncertainty of determining accredited investor status after completion of an offering, see the discussion of the practical challenges for issuers under amended Rule 12g-1. IPA Comment Letter to Commission on Concept Release on Harmonization of Securities Offering Exemptions, Sept. 24, 2019, pgs. 6-7, available at https://www.sec.gov/comments/s7-08-19/s70819-6193369-192518.pdf.

4 Id. at 3.

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The Commission asks if it should include additional expansions or limitations to the definition in a final rulemaking. The IPA continues to oppose recommendations further restricting investor choice by, for example, adding investment limitations to the current dollar thresholds or replacing the $5 million assets test with a $5 million investments test.

The IPA suggests two areas where the Commission can expand the definition while balancing its interest in investor protection. First, we believe that the Commission should amend the definition to include natural persons or entities that are advised by a financial professional, such as a registered investment adviser and their representatives, that acts as a fiduciary in making the investment. We believe that this change can be made without compromising investor protection.[5]

Second, we encourage the Commission to not only expand the definition of "accredited investor" but also to take additional steps to harmonize how defined contribution plans and defined benefit plans are treated under the Commission's "qualified purchaser" guidance. Harmonization is appropriate because the Employee Retirement Income Security Act of 1974 ("ERISA") imposes the same fiduciary standards on individuals managing defined contribution plans (e.g., 401(k) plans) as it does on those that manage defined benefit plans (e.g., traditional pension plans). Plan fiduciaries choose the investment lineups for both defined benefit and defined contribution plans. Plan fiduciaries monitor the lineup for defined contribution plans. Plan fiduciaries select the default investment options in defined contribution plans. Both plan fiduciaries of defined benefit and defined contribution plans are subject to a standard of care that has been described as "the highest known to the law."[6]

Under current Commission rules, both defined benefit and defined contribution plans with $5 million in assets can qualify as "accredited investors." However, for a defined contribution plan to qualify as a "qualified purchaser", the plan must look through to its participants and determine that each plan participant is herself or himself a "qualified purchaser." This "look through" requirement has effectively prohibited defined contribution plan participants from investing in any vehicle that relies upon Section 3(c)(1) to avoid investment company registration. This effective prohibition remains in place despite the Commission creating exceptions in the 1990s and early 2000s. In a handful of no-action letters, the Commission provided relief from the "look through" requirement for funds that are designed in an opaque

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5 We similarly believe that the Commission should include natural persons or entities based on a recommendation by a registered broker-dealer. SEC Chairman Jay Clayton has stated that Regulation Best Interest provides many of the same fiduciary principles to broker-dealers, except for differences in business model such as the ongoing nature of the relationship and payment structure. *See, e.g.,* Jay Clayton, "Regulation Best Interest and the Investment Adviser Fiduciary Duty: Two Strong Standards that Protect and Provide Choice for Main Street Investors," July 8, 2019, and Melanie Wadell, ThinkAdvisor, "SEC's Clayton Explains 'Best Interest' vs. 'Fiduciary' Duty," June 6, 2019. Moreover, private offerings by their nature are illiquid and largely long-hold investments. Paying a one-time commission to a broker-dealer is more cost effective than paying an ongoing advisory fee to an investment adviser to hold the same investment. For example, a $50,000 investment would amount to a one-time commission of approximately $2,500 through a brokerage account assuming a one-time average commission of 5%, versus $750 *per year* for a fee-based account assuming 1.5% per year as the standard rate for smaller accounts. If the fee-based account is maintained for 7 years, an investor would pay $5,250 for making the one-time investment, which is more than double the one-time brokerage fee.

6 *Donovan v. Bierworth*, 680 F.2d 263, 272 n.8 (2d Cir. 1982).

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manner. These no-action letters appear to be premised on a recognition that private funds could help retirement savers best save for retirement combined with a fear that participants would be too quick to invest in private funds if plans could transparently disclose who the asset managers are, what types of products they invest in, and the exact allocation of assets among the various managers.

In response, a handful of plan fiduciaries designed private funds (typically target-date funds) for their plan participants. Unfortunately, those plans have found themselves the target of litigation because the constraints the Commission has required lead to the creation of investment options that plaintiff-side law firms allege are "opaque".[7]

ERISA, by itself, provides defined contribution plan participants with strong protections. By eliminating the "look through" requirement, the Commission would put plan fiduciaries in a better position to evaluate private funds and to provide clear and meaningful disclosure to plan participants. By allowing for clearer disclosure, the Commission could help plan fiduciaries who prudently consider private funds avoid unnecessary litigation risks. As a result, more plan fiduciaries would likely consider investment options containing private funds, and defined contribution plan participants would be able to compete with defined benefit plans, foundations, and endowments for the best investment opportunities for long-term institutional investors.

If the IPA may be of any assistance, please do not hesitate to contact me or Anya Coverman, IPA's Senior Vice President, Government Affairs and General Counsel, at (202) 548-7190.

Sincerely,

Anthony Chereso
President & CEO, Institute for Portfolio Alternatives

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7 *See*, *e.g.*, *Intel Corporation Investment Policy Committee v. Sulyma*, Case (U.S., No. 18-1116).