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4 May 2020

Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
By Email: (rule-comments@sec.gov)

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

Dear Ms. Countryman:

CFA Institute[1] appreciates the opportunity to respond to the US Securities and Exchange Commission (the "SEC" or the "Commission") on its rule proposal, *Amending the "Accredited Investor" Definition* (the "Proposal").[2] CFA Institute speaks on behalf of its members and advocates for investor protection and market integrity before standard setters, regulatory authorities, and legislative bodies worldwide. We focus on issues affecting the profession of financial analysis and investment management, education and competencies for investment professionals, and on issues of fairness, transparency and accountability of global financial markets.

Executive Summary

Our view of the Proposal is decidedly mixed. On the positive side, we support the proposed addition of a category based on investor sophistication. This will fill a gap in the current Accredited Investor Definition. The current near-exclusive reliance on financial thresholds prevents individuals from qualifying as accredited investors based on their investing knowledge, certifications and experience, even if these individuals are capable of fending for themselves. The proposal would address this shortcoming by adding new categories to permit natural persons to qualify as accredited investors based on certain professional certifications and designations or other credentials. We offer three recommendations in setting standards for qualifying credentials.

[1] CFA Institute is a global, not-for-profit professional association of nearly 171,400 investment analysts, advisers, portfolio managers, and other investment professionals in 165 countries, of whom more than 164,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 154 member societies in 77 countries and territories.
[2] SEC, Amending the Accredited Investor Definition, Proposed Rule, Rel. No. 33-10734 (Dec. 18, 2019) ("Proposal"), https://www.sec.gov/rules/proposed/2019/33-10734.pdf.

In addition, in the Appendix we provide information about the CFA Charter, which represents a global standard in professional investing.

At the same time, we urge the Commission to revise the Proposal to adjust and index the financial thresholds for inflation. Nearly four decades of accumulated inflation have eroded the original thresholds and rendered them ineffective in ensuring that all individuals in the class of accredited investors can fend for themselves. Moreover, the twin public health and economic crises we are currently experiencing have not only highlighted, but also have exacerbated risks to investors that are already inherent in private markets. We recommend that the Commission reevaluate the financial thresholds in light of the impact of pandemic and economic crisis on private markets.

Discussion

Improving the Accredited Investor Definition: Recognizing Investor Sophistication

In general, the definition of accredited investor turns on three tests: 1) the ability to bear financial risks, including those of illiquidity and investment losses; 2) access to timely information needed to make the investment decision; and 3) the ability to analyze that information and to assess the investment opportunity.[3]

We acknowledge that the proposed category of investor sophistication, as demonstrated by certain credentials, speaks only to the third of these tests. Nonetheless, we believe that investors meeting this third test will be able to assess their abilities to take on financial risks and to access material information. As a result, such investors will be able to protect their interests and fend for themselves. We concur with the following statement in the Proposal:

> …we believe that the concept of financial sophistication encompasses not only an ability to analyze the risks and rewards of an investment but also the capacity to allocate investments in a way to mitigate or avoid risks of unsustainable loss.[4]

It is our view that an appropriate definition of an accredited investor should include considerations of competence such as described in the above-cited statement. As noted in our September 2019 response to the Commission on Harmonization,[5] we do not believe the current definition based on financial thresholds meets this test.

An effective investor sophistication test must be based on high standards. We believe the Release articulates sound principles in its non-exclusive list of attributes that it would consider in

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[3] *See* Proposal, *supra* note 2, at 14-15, and SEC Investor Advisory Committee, "Recommendation of the Investor Advisory Committee: Accredited Investor Definition (October 9, 2014)," at 2, available at https://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-advisor-accredited-definition.pdf (citing Rule 146, the predecessor to Rule 506).

[4] Proposal, *supra* note 2, at 22.

[5] *See* CFA Institute response to the US SEC's proposal, *Harmonization of Securities Offering Exemptions* (September 24, 2019), available at https://www.cfainstitute.org/-/media/documents/comment-letter/2015-2019/20190924.ashx.

determining which professional certifications and designations or other credentials qualify for accredited investor status.[6] These include the following:

- The certification, designation, or credential arises out of an examination or series of examinations administered by a self-regulatory organization or other industry body or is issued by an accredited education institution;
- The examination or series of examinations is designed to reliably and validly demonstrate an individual's comprehension and sophistication in the areas of securities and investing;
- Persons obtaining certification, designation, or credential can reasonably be expected to have sufficient knowledge and experience in financial and business matters to evaluate the merits and risks of a prospective investment; and
- An indication that an individual holds the certification or designation is made publicly available by the relevant self-regulatory organization or other industry body.

The challenge will be to determine the specific credentials that meet these precepts. We offer two recommendations in that regard.

First, acceptable credentials should be limited strictly to those that 1) display uniformly high standards, and 2) focus specifically on investment decision-making and analysis. These criteria should not automatically include general business degrees, such as an MBA degree, from qualifying. We believe business schools display too wide a variability in the quality and rigor of the education and the content of the curriculum. For example, a business degree may offer a broad understanding of business functions such as marketing, management, or strategy, or may allow students to specialize in any one of those topics. Such an education, in our view, would provide an insufficient understanding of the investment process for the purposes of the accredited investor definition. Likewise, we believe the definition should exclude credentials that relate to investing only incidentally or tangentially.

Second, individuals should not be permitted to self-certify that they have the requisite financial sophistication to be an accredited investor. Behavioral science has long recognized overconfidence bias in general and has specifically documented individuals' overconfidence in their investing skills and financial knowledge.[7]

Finally, we provide information in the Appendix about our own credentialing program. We hope that the Commission will find this information useful as it deliberates on the policy issues of

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[6] Proposal, *supra* note 2, at 27-28.

[7] For just a few titles in an extensive literature, *see* 1) Daniel Kahneman, *Thinking Fast and Slow*, (2011), at 261-265; 2) International Organization of Securities Commissions, "The Application of Behavioural Insights to Retail Investor Protection: Final Report" (2019), available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD626.pdf (last checked April 24, 2020); 3) K. Jeremy Ko and Steven Rapkin, "The Financial Illiteracy and Overconfidence of Margin Traders," (March 2018), available at https://www.sec.gov/files/dera_wp_fin_illiteracy_and_overconfidence_margin_traders.pdf; 4) Carlo de Bassa Scheresberg and Annamaria Lusardi, "Gen Y Personal Finances: A Crisis of Confidence and Capability," Filene Research Institute (May 2014), available at https://gflec.org/research/?item=782 (last visited April 23, 2020); and 5) CFA Program Curriculum, Level III, Vol. 2, (2016) at 73-76.

expanding the accredited investor definition.[8] Please note that the CFA charter, or in many cases passing just the first of the three CFA Program exam levels, is sufficient to qualify for waivers from various examinations required by 27 financial services regulatory bodies globally, including FINRA's Series 65 exam. The UK National Academic Recognition Information Centre has benchmarked the CFA Program and CFA Charter as comparable to a Qualification and Credit Framework Master's Level 7. And the Global Investment Performance Standards, which CFA Institute and its members developed nearly 30 years ago, is recognized in 41 global markets as a market solution to firms' reporting of investment performance, including the U.S.

The addition of a sophistication test will help to correct one shortfall in the Accredited Investor Definition: unnecessary exclusion of those individuals who should qualify based on their investment knowledge. But the current Accredited Investor Definition also suffers the converse shortcoming: the financial thresholds, eroded by inflation, allow individuals to qualify as accredited investors despite their inability to fend for themselves. We consider this second shortcoming next.

Need to Raise and Index the Wealth and Income Thresholds

The wealth and income thresholds serve a critical function in ensuring that all individuals in the class of accredited investors are capable of fending for themselves in private markets. Unfortunately, nearly four decades of inflation have eroded the effectiveness of these thresholds. Since they were first set in 1982, the financial thresholds have seen just one material adjustment; i.e., the 2011 exclusion of the value of the investor's primary residence from the $1 million net worth calculation. As a result, the number of individuals who meet those thresholds has increased dramatically.

According to the Proposing Release, the overall number of households that qualify as accredited investors jumped from an estimated 1.31 million in 1983 to 16.0 million in 2019.[9] Over the same period, the share of qualifying households as a percentage of U.S. households leapt from 1.6% to 13.0%.[10] Absent strong empirical evidence to the contrary, one cannot help but conclude that a significant number of individuals have joined the class of accredited investors, not because they can fend for themselves, but solely because inflation has pushed them into that status.

The Proposal argues:

> "…in evaluating the effectiveness of the current thresholds, it is appropriate to consider changes beyond the impact of inflation, such as changes over the years in the availability of information and advances in technologies. Given the rise of the internet, social media, and other forms of communication, information about issuers and other participants in the exempt markets is more readily available to a wide range of market participants. Technologies such as powerful home computers and mobile computing devices, as well

[8] The Proposal solicits comments on whether the CFA Charter should qualify under the proposed definition. We believe that the CFA Charter demonstrates that an investor has the requisite level of financial sophistication and abilities to render the protections of the Securities Act unnecessary. Therefore, the Commission should designate the CFA Charter as qualifying for accredited investor status. *See* Proposal, *supra* note 2, at 34.

[9] *Id*. at 27.

[10] *Id.* at 27.

> software-based tools with which to evaluate investment opportunities, were not available to investors at the time the accredited investor definition was promulgated."[11]

The Proposing Release offers no evidence, however, to show how these advances have compensated for the substantial level of inflation over nearly four decades. Nor does the Release consider the role of the internet as a means of spreading misinformation and fraud, and the resulting impact on investors in Regulation D markets.

The Proposal also fails to index the financial thresholds to inflation on a going-forward basis. The Commission expresses a concern that automatic indexing could fail to account for any future developments that might counteract the impact of inflation. We recommend that the Commission index the thresholds while stipulating that it could override the indexing should future developments or conditions warrant.

Finally, we recommend that any final rule release include language emphasizing that investment advisers and broker-dealers, in making any recommendations to their customers regarding exempted offerings, remain bound by their respective fiduciary duty and best-interest standards.

Heightened Investor Risks as Indirect Consequences of the Pandemic

The need to raise and index the financial thresholds takes on new urgency in light of the heightened risks facing retail investors in private markets. Three risks in particular stand out: fraud, illiquidity, and vulnerability of retirement savings.

First, the Commission itself has emphasized the heightened risk of "Frauds Targeting Main Street Investors." Scams and other forms of misleading presentations pose special risks to investors in private markets, precisely because these markets lack the fundamental protections of public markets.[12]

Second, liquidity risks have seen significant increases, both in capital markets and at the household and individual level. Current conditions heighten the illiquidity risks that are inherent in private markets.[13] Now more than ever, it is imperative for investors to understand the illiquidity risks before investing in private markets. Likewise, it is imperative to adjust the

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[11] The Proposal follows those sentences with one more consideration: "In addition, we are not aware of widespread problems or abuses associated with Regulation D offerings to accredited investors that would indicate that an immediate and/or significant adjustment to the rule's financial thresholds is warranted." *Id.* at 79. See our comments below noting the discrepancy between the SEC statement and observations of state securities regulators.

[12] SEC, Office of Investor Education and Advocacy and the Division of Enforcement's Retail Strategy Task Force, *Frauds Targeting Main Street Investors – Investor Alert*, (April 10, 2020, updated Apr. 22, 2020), https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-alerts/frauds (warning, "Fraudsters often seek to use national crises and periods of uncertainty to lure investors into scams. They may play off investors' hopes and fears, as well as their charity and kindness, and may try to exploit confusion or rumors in the marketplace.")

[13] As the Proposal observes, illiquidity arises in private markets from a variety of causes, including limited secondary markets, legal restrictions on the transferability of securities, and standard contractual terms. Proposal, *supra* note 2, at 126.

financial thresholds to ensure their effectiveness in limiting accredited investors solely to those who can fend for themselves.

Third, economic necessity may compel individuals to withdraw significant sums from their retirement accounts. Recently enacted provisions for tax waivers may further induce individuals to make such withdrawals.[14] We cannot ignore the risk that individuals may invest at least some of their distributions in private markets – perhaps in desperate bids to recover losses, or perhaps induced by fraudulent claims that are too good to be true. Moreover, the cash withdrawals may make individuals special targets of scams and fraudsters. And these fraudulent activities may take place under the cover of private markets, precisely because they are exempt from the protections embedded in public markets.

We therefore urge the Commission to reevaluate the need to raise and index the financial thresholds in light of these heightened risks that the pandemic has brought in its wake.

Conclusion

We appreciate this opportunity to respond to the Proposal and to voice our support for the proposed addition of a category for natural persons to qualify as accredited investors based on certain professional certifications and designations or other credentials that indicate an appropriate level of financial sophistication. Adding such a category will fill a gap in the Accredited Investor Definition.

At the same time, we urge the Commission to raise the financial thresholds for inflation and index them on a going-forward basis. This action is needed to protect retail investors and to ensure that all accredited investors can fend for themselves. Furthermore, we urge the Commission to reevaluate the financial thresholds in the current crisis conditions, which heighten risks to investors in private markets.

Should you have any question about our positions, please do not hesitate to contact James C. Allen, CFA, at [redacted] or [redacted].

Sincerely,

/s/ Jim Allen

James C. Allen, CFA

Head, Capital Markets Policy

CFA Institute

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[14] The Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020 allows qualified individuals to take up to $100,000 in distributions from their qualified retirement plans in calendar 2020. The law waives the 10 percent early withdrawal tax penalty on such distributions. In addition, the Act exempts the distribution from income tax if the individual pays back the funds to a qualified retirement plan over a three-year period.

Appendix: **The CFA Charter Program**

The Chartered Financial Analyst® (CFA®) designation is the gold standard for the investment industry.[15] The CFA program provides a deep knowledge of investment analysis, portfolio management, and ethics. To earn the CFA designation, individuals must pass three levels of exams and meet professional work experience requirements.

The CFA Charter represents a uniform standard that is accepted throughout the world. More than 160,000 individuals, or Charterholders, hold the CFA designation. Exams are administered twice per year[16] in more than 150 locations globally. The CFA Institute membership also includes 155 member societies in 77 countries and territories.

The status of the CFA Charter is reflected in the careers of Charter holders. Approximately 35% to 40% of portfolio managers globally hold the CFA designation. The top five global Charterholder job titles are: 1) Portfolio Manager; 2) Research Analyst; 3) Chief Level Executive; 4) Consultant; and 5) Risk Manager.

On average, it takes more than 4 years to complete the CFA program. Candidates spend more than 300 hours of study per exam level, or a total of more than 900 hours for the full program. One in seven candidates pass the exams, producing a pass rate of 14 percent.

The CFA curriculum consists of approximately 150 readings covering a total of 9,000 pages in 10 topic areas including among others, economics; accounting; fixed-income, equity, and derivatives analysis; portfolio management; statistics; and ethical practices. To produce the material, we draw on a diverse team of 80 experts, including dozens of investment professionals and senior professors.

It takes a continuous and intensive commitment to keep the curriculum fresh and up to date with new products, strategies, processes and technological developments in the fields of finance, investing, and economics. We update about 10 percent of the page count each year. The accompanying table shows the evolution of the curriculum through the decades.

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[15] *See, e.g.*, the website Investopedia.com (saying, "The CFA Charter is one of the most respected designations in finance and is widely considered to be the gold standard in the field of investment analysis.") Available at https://www.investopedia.com/terms/c/cfa.asp, last checked April 22, 2020.

[16] The global exams scheduled for June 2020 exams have all been cancelled out of concern for the safety of the more than 250,000 candidates sitting for the three levels of the exams, and in respect of local government social-distancing rules. The next exams are scheduled to take place in December 2020.

EXAMPLE CFA PROGRAM INNOVATIONS BY DECADE

Competency	1960s	1970s	1980s	1990s	2000s	2010s
Industry & co analysis	Impact of price controls	Labor unions	Porter's five forces	Industry classifications	IFRS	Alternative data
Ethics	Nepotism	Insider trading	Front running	Corporate governance	Enron	Stewardship
Financial analysis	Time value of money	Capital budgeting	Leveraged buyouts	Modelling	Shenanigans	Data visualization
Valuation	Capital asset pricing model	Black-Scholes Merton	Yield to maturity	EVA	Enterprise value multiples	Factors
Inv strategy & process	Yield calculations	Anomalies	Factor investing	Hedge funds	Multi-asset investing	Passive investing
Portfolio execution & execution	Stock picking	Mean variance optimization	Screening	Portfolio optimization	Electronic and high frequency trading	Market fragmentation
Perf. Measurement & risk management	Sharpe ratios	Portfolio insurance	Performance attribution	Value at Risk	Global Investment Performance Standards	Risk budgeting
Client management	Investment policy statement	Finance education	Values	Portfolio reports	Client list ethics	Social network updates
Financial planning	Defined benefit plans	401k	Defined contribution plans	Monte carlo simulation	Economic balance sheet	Robo-advisory
Wealth & risk management	Concentrated positions	Precious metals	Executive stock options	Stress testing	Risk attribution	Scenario analysis
Data analytics & visualization inc AI/ML	Mathematics in finance	Regression in finance	Data vendor references	Excel shortcut references	Model testing techniques	Machine learning/AI
The world economy	Trade deals	Oil dependence	FDI	Emerging markets	QE	GFC
Instruments & products	Convertibles	Municipal bonds	MBS	ETFs	Credit default swaps	Cryptocurrencies
ESG integration	n/a	n/a	Negative screening	SRI	Activism	Green bonds
Behavioral awareness	Anomalies	Loss aversion	Black Monday	Dotcom mania	Behavioral finance	Paradox of passive investing and EMH
Regulatory compliance	Securities law	ERISA	Consumer protection	Anti money laundering	Sarbanes-Oxley	KYC

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It also takes substantial effort to maintain the fairness and accuracy of both the exam and grading processes. We rely on hundreds of investment professionals and experts to volunteer to grade the essay portion of the exams.

Once a candidate passes all three levels of exams, he or she must meet additional requirements to earn the CFA Charter. First, the candidate must have 4,000 hours of qualified work experience in or related to the investment process. Second, the candidate must submit letters of reference to the CFA Institute. Third, the candidate must agree to follow the CFA Code of Ethics and Standards of Professional Conduct. On an annual basis, all CFA Charterholders must affirm that they have abided by the Code and Standards. We place particular emphasis on the ethics and standards in both the curriculum and continuing requirements for membership. This emphasis flows from our mission to advance professional standards in the investment industry. As an added benefit, the Code and Standards help Charterholders to recognize when others in the investment field fail to measure up to those ethical and professional standards. (We have also developed a separate Asset Manager Code for asset management firms.)

We assign each CFA candidate a number that serves as a unique identifier. The public can call the CFA Institute to verify that a individual is a Charterholder.

A total of 27 countries provide waivers from licensing exams for CFA Charterholders. In the U.S., FINRA and states provide the following exemptions:[17]

- Applicants who have passed the CFA Level I and Level II exams are eligible for a FINRA exemption from Part I (Series 86), the Analysis section, of the Research Analyst Qualification Examination.
- Applicants who have passed Level I of the CFA Exam are allowed to request a FINRA exemption from the securities analysis portion (Part II) of FINRA's Supervisory Analyst Qualification Exam (Series 16).
- CFA Charterholders who must register as investment advisers or representatives through the Investment Adviser Registration Depository (IARD) may work with CFA Institute to claim a waiver from state competency exams.
- Some states require the Series 65 exam for investment advisers and investment adviser representatives. CFA Charterholders are exempt from this exam.

In the UK, the UK National Academic Recognition Information Centre (UK NARIC) has benchmarked the CFA Program and the CFA Charter as comparable to a Qualifications and Credit Framework (QCF) Master's Level 7.[18]

We believe that the CFA program and designation represent a successful market solution that assures the highest levels of integrity and professional investing standards.

[17] *See* FINRA, Qualification Exam Waivers and Exemptions, at https://www.finra.org/registration-exams-ce/qualification-exams/exam-waivers-and-exemptions (last visited April 27, 2020); and CFA Institute, Waivers, at https://www.cfainstitute.org/en/membership/benefits/waivers#f:_6896E616-1594-4290-A66D-E1D9A40E3D5F=[Licensing%20Exam%20Waiver]&f:coveoddb4bd08=[United%20States].

[18] UK NARIC is a National Agency managed on behalf of the UK Government that provides the only official source of information on international education and training systems and other international qualifications and skills attained from outside the UK. *See* CFA Institute, Benchmarking & Accreditation, https://www.cfainstitute.org/en/advocacy/benchmarking; and UK NARIC, https://www.naric.org.uk/naric/About%20Us.aspx (last visited April 27, 2020).