

SECURITIES AND EXCHANGE COMMISSION
ADVISORY COMMITTEE ON
SMALL AND EMERGING COMPANIES

Washington, DC 20549-3628

March 9, 2015

The Honorable Mary Jo White
Chair
U. S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1070

Dear Chair White:

As you know, the Securities and Exchange Commission organized the Advisory Committee on Small and Emerging Companies to provide the Commission with advice on the Commission's rules, regulations, and policies with regard to its mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation, as they relate to the following:

- (1) capital raising by emerging privately held small businesses and publicly traded companies with less than \$250 million in public market capitalization;
- (2) trading in the securities of such businesses and companies; and
- (3) public reporting and corporate governance requirements to which such businesses and companies are subject.

On behalf of the Advisory Committee, we are pleased to submit the enclosed recommendations regarding the definition of "accredited investor." These recommendations were discussed at a meeting held on December 17, 2014 and unanimously approved by the members of the Advisory Committee present and voting at a meeting held on March 4, 2015.

We and the other members of the Advisory Committee are prepared to provide any additional assistance that the Commission or its staff may request with respect to these recommendations.

Respectfully submitted on behalf of the Committee,



Stephen M. Graham
Committee Co-Chair



M. Christine Jacobs
Committee Co-Chair

Members of the Committee

Charles Baltic
David A. Bochnowski*
John J. Borer, III
Dan Chace
Milton Chang*
Stephen M. Graham
Shannon L. Greene
Sara Hanks
John Hempill
M. Christine Jacobs
Richard L. Leza**
Sonia Luna
Catherine V. Mott
David J. Paul
Timothy Reese
Timothy Walsh**
Gregory C. Yadley

Official Observers

Michael Pieciak*
Javier Saade

* Not present at the meeting held on December 17, 2014.

**Not present at the meeting held on March 4, 2015.

Enclosure

cc: Commissioner Luis Aguilar
Commissioner Daniel M. Gallagher
Commissioner Kara M. Stein
Commissioner Michael S. Piwowar
Keith Higgins
Elizabeth Murphy
Sebastian Gomez
Julie Davis

U.S. Securities and Exchange Commission
Advisory Committee on Small and Emerging Companies

Recommendations Regarding the Accredited Investor Definition

From the December 17, 2014 and March 4, 2015 Meetings

AFTER CONSIDERING THAT:

1. The Committee’s objective is to provide the U.S. Securities and Exchange Commission (the “Commission”) with advice on its rules, regulations and policies with regard to its mission of protecting investors, maintaining fair, orderly and efficient markets, and facilitating capital formation, as they relate to, among other things, capital raising by emerging privately held small businesses (“emerging companies”) and publicly traded companies with less than \$250 million in public market capitalization (“smaller public companies”).
2. Smaller public companies and emerging companies play a significant role as drivers of U.S. economic activity, innovation and job creation. The majority of net new jobs in the United States are from companies less than five years old, with these companies continuing to add jobs as they mature. Their ability to raise capital in the private markets is critical to the economic well-being of the United States.
3. The most widely used private offering exemption is Rule 506 of the Commission’s Regulation D. In 2013, issuers utilizing Rule 506 raised over \$1 trillion, comparing favorably to the \$1.3 trillion raised in public offerings in 2013.
4. Most early-stage companies utilize Rule 506 when offering their securities. In 2013, angel investors alone invested approximately \$25 billion in 71,000 companies in Rule 506 offerings.
5. With the exception that in Rule 506(b) offerings up to 35 persons who are not “accredited investors” may participate, all investors in Rule 506 offerings must be “accredited investors.” Under Rule 501, a natural person is accredited if that person:
 - earned income that exceeded \$200,000 (or \$300,000 together with a spouse) in each of the prior two years, and reasonably expects the same for the current year, or
 - has a net worth over \$1 million, either alone or together with a spouse (excluding the value of the person’s primary residence).
6. The Dodd-Frank Act requires the Commission to undertake a review of the accredited investor definition to determine whether the thresholds “should be adjusted or modified for the protection of investors, in the public interest, and in light of the economy.”

7. In connection with this review, some commentators have urged that the accredited investor thresholds be increased in order to prevent fraud against investors who may be unable to fend for themselves. The Committee is not aware of any substantial evidence suggesting that the current definition of accredited investor has contributed to the ability of fraudsters to commit fraud or has resulted in greater exposure for potential victims. The connection between fraud and the current accredited investor thresholds seems tenuous at best.
8. Certain commentators have taken the view that when calculating net worth for accredited investor purposes, retirement assets should be excluded. While the underlying premise of this idea is understandable, it fails to take into consideration the following realities:
 - The concept of “retirement assets” does not refer to a specific asset class, but rather usually refers to the tax treatment of many different asset classes.
 - This tax treatment can be applied to many types of assets, from conservative to speculative. For example, a self-directed IRA may include racehorses, gold, bitcoin and equity in start-ups. Tax-protected accounts are not by definition a “safe nest-egg” that an investor will always be able to fall back on.
 - Many experienced investors put assets that are most likely to appreciate into tax-protected accounts. Some very wealthy accredited investors would not be accredited if their holdings in tax-protected accounts were to be excluded from the accredited definition. To change the definition to exclude such assets would likely distort the tax planning of those investors for a non-tax related reason.
 - Alternatively, if tax treatment is ignored, then as an investor gets closer to retirement everything he or she owns is “retirement savings” and it would be very difficult, if not impossible, for a regulator to say what assets should belong in that category.
9. While there is little or no evidence to suggest that the existing definition of accredited investor has led to widespread fraud or other harm to investors, there is substantial evidence to suggest that the current system works and is critical to the support of smaller public companies and emerging companies.
10. If the income and net worth requirements underlying the definition of accredited investor are raised significantly, it will materially decrease the pool of capital available for smaller businesses. This decrease would have a disparate impact on those areas having a lower cost of living, which areas often coincide with regions of lower venture capital activity. The Committee also is concerned that a decrease in the accredited investor pool would have a disproportionate effect on women and minority entrepreneurs.

THE COMMITTEE RECOMMENDS THAT:

1. As the Commission reviews the definition of “accredited investor” in Rule 501 under the Securities Act of 1933, the primary goal should be to “do no harm” to the private offering ecosystem. Accordingly, any modifications to the definition should have the effect of expanding, not contracting, the pool of accredited investors. For example, we would recommend including within the definition of accredited investor those investors who meet a sophistication test, regardless of income or net worth. As a further example, the tax treatment of assets included in the calculation of net worth should be disregarded.
2. To take into account the effect of future inflation, on a going forward basis the Commission should adjust the accredited investor thresholds according to the consumer price index.
3. Rather than attempting to protect investors by raising the accredited investor thresholds or excluding certain asset classes from the calculation to determine accredited investor (which we believe are measures of dubious utility), the Commission should focus on enhanced enforcement efforts and increased investor education.
4. The Commission should continue to gather data on this subject for ongoing analysis.