

SECURITIES AND EXCHANGE COMMISSION

17 CFR PARTS 230 and 240

[Release Nos. 33-10824; 34-89669; File No. S7-25-19]

RIN 3235-AM19

Accredited Investor Definition

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: We are adopting amendments to the definition of “accredited investor” in our rules to add new categories of qualifying natural persons and entities and to make certain other modifications to the existing definition. The amendments are intended to update and improve the definition to identify more effectively investors that have sufficient knowledge and expertise to participate in investment opportunities that do not have the rigorous disclosure and procedural requirements, and related investor protections, provided by registration under the Securities Act of 1933. We are also adopting amendments to the “qualified institutional buyer” definition in Rule 144A under the Securities Act to expand the list of entities that are eligible to qualify as qualified institutional buyers.

DATES: This final rule is effective December 8, 2020.

FOR FURTHER INFORMATION CONTACT: Jennifer Zepralka, Office Chief, or Charlie Guidry, Special Counsel, Office of Small Business Policy, at (202) 551-3460, Division of Corporation Finance; Jennifer Songer, Branch Chief, or Lawrence Pace, Senior Counsel, at (202) 551-6999, Investment Adviser Regulation Office, Division of

Investment Management; U.S. Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION: We are adopting amendments to 17 CFR 230.144A (“Rule 144A”), 17 CFR 230.163B (“Rule 163B”), 17 CFR 230.215 (“Rule 215”), and 17 CFR 230.501 (“Rule 501”) of 17 CFR 230.500 through 230.508 (“Regulation D”) under the Securities Act of 1933 (“Securities Act”);¹ and 17 CFR 240.15g-1 (“Rule 15g-1”) under the Securities Exchange Act of 1934 (“Exchange Act”).²

TABLE OF CONTENTS

- I. Introduction and Background
- II. Final Amendments to the Accredited Investor Definitions
 - A. Proposed Amendments
 - B. Final Amendments
 - 1. Natural Persons
 - a. Natural Persons Holding Professional Certifications and Designations or Other Credentials
 - b. Knowledgeable Employees of Private Funds
 - 2. Entities
 - a. Registered Investment Advisers
 - b. Rural Business Investment Companies
 - c. Limited Liability Companies
 - d. Other Entities Meeting an Investments-Owned Test
 - e. Certain Family Offices and Family Clients
 - 3. Permitting Spousal Equivalents to Pool Finances for the Purposes of Qualifying as Accredited Investors
 - 4. Notes to 501(a)
 - a. Note to Rule 501(a)(5)
 - b. Note to Rule 501(a)(8)
 - 5. Amendment to Rule 215
 - 6. Other Comments
- III. Amendments to Securities Act Rule 163B and Exchange Act Rule 15g-1
- IV. Discussion of the Final Amendments to the Qualified Institutional Buyer Definition
 - A. Proposed Amendments
 - B. Final Amendments
- V. Other Matters

¹ 15 U.S.C. 77a *et seq.*

² 15 U.S.C. 78a *et seq.*

- VI. Economic Analysis
 - A. Introduction and Broad Economic Considerations
 - B. Baseline and Affected Parties
 - C. Anticipated Economic Effects
 - 1. Potential Benefits to Issuers
 - a. More Efficient Capital Raising Process in Exempt Offerings
 - b. Facilitate Capital Formation by Expanding the Pool of Investors in Exempt Offerings
 - c. Increase Liquidity of Securities Issued in Unregistered Offerings
 - d. Other Benefits
 - 2. Potential Benefits to Investors
 - 3. Potential Costs to Issuers
 - 4. Potential Costs to Investors
 - 5. Variation in Economic Effects
 - 6. Efficiency, Competition, and Capital Formation
 - 7. Alternatives
 - a. Inflation Adjustment of Financial Thresholds
 - b. Investment Limits
 - c. Geography-Specific Thresholds
 - d. Including Additional Categories of Natural Persons and Entities
- VII. Paperwork Reduction Act
- VIII. Final Regulatory Flexibility Analysis
- IX. Statutory Authority

I. Introduction and Background

On December 18, 2019, the Commission proposed amendments to the definition of “accredited investor” in Securities Act Rules 215 and 501(a) and to the definition of “qualified institutional buyer” in Rule 144A.³ The proposed amendments were intended to update and improve the definitions to identify more effectively institutional and individual investors that have sufficient knowledge and expertise to participate in investment opportunities that do not have the rigorous disclosure and procedural requirements, and related investor protections, provided by registration under the Securities Act.

³ Amending the “Accredited Investor” Definition, Release Nos. 33–10734; 34–87784 (Dec. 18, 2019) [85 FR 2574 (Jan. 15, 2020)] (“Proposing Release”).

The Proposing Release and the amendments we are adopting are part of a broader effort to simplify, harmonize, and improve the exempt offering framework under the Securities Act to promote capital formation and expand investment opportunities while maintaining and enhancing appropriate investor protections.⁴ As we noted in the Proposing Release, these amendments will provide a foundation for our ongoing efforts to assess whether the exempt offering framework, in its component parts and as a whole, is consistent, accessible, and effective for both issuers and investors. The Securities Act contains a number of exemptions from its registration requirements and authorizes the Commission to adopt additional exemptions. As the Commission has previously noted, the regulatory framework for exempt offerings has evolved, and the significance of the exempt securities markets has increased both in terms of the absolute amount raised and relative to the public registered markets.⁵ In 2019, registered offerings accounted for \$1.2 trillion (30.8 percent) of new capital, compared to approximately \$2.7 trillion (69.2 percent) that we estimate was raised through exempt offerings.⁶ Of this, the estimated amount of capital reported as being raised in offerings under Rule 506(b) and 506(c) of Regulation D was approximately \$1.56 trillion.

The accredited investor definition is a central component of the Rule 506 exemptions from registration and plays an important role in other exemptions and other

⁴ See Concept Release on Harmonization of Securities Offering Exemptions, Release No. 33-10649 (June 18, 2019) [84 FR 30460 (June 26, 2019)] (“Concept Release”) and Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets, Release Nos. 33-10763; 34-88321 (Mar. 4, 2020) [85 FR 17956 (Mar. 31, 2020)] (“Access to Capital Proposing Release”).

⁵ See Concept Release at 30465. See also Access to Capital Proposing Release at 17957.

⁶ Unless otherwise indicated, information in this release on offering amounts is based on analyses by staff in the Commission’s Division of Economic Risk and Analysis (“DERA”) of data collected from SEC filings.

federal and state securities law contexts. Qualifying as an accredited investor, as an individual or an institution, is significant because accredited investors may, under Commission rules, participate in investment opportunities that are generally not available to non-accredited investors, including certain investments in private companies and offerings by certain hedge funds, private equity funds, and venture capital funds. The final rules are tailored to permit investors with reliable alternative indicators of financial sophistication to participate in such investment opportunities, while maintaining the safeguards necessary for investor protection and public confidence in investing in areas of the economy that disproportionately create new jobs, foster innovation, and provide for growth opportunities.

Historically, the Commission has stated that the accredited investor definition is “intended to encompass those persons whose financial sophistication and ability to sustain the risk of loss of investment or fend for themselves render the protections of the Securities Act’s registration process unnecessary.”⁷ Prior to the adoption of these final rules, in the case of individuals, the accredited investor definition has used wealth—in the form of a certain level of income or net worth—as a proxy for financial sophistication. However, as stated in the Proposing Release, we do not believe wealth should be the sole means of establishing financial sophistication of an individual for purposes of the accredited investor definition. Rather, the characteristics of an investor contemplated by the definition can be demonstrated in a variety of ways. These include the ability to

⁷ See Regulation D Revisions; Exemption for Certain Employee Benefit Plans, Release No. 33-6683 (Jan. 16, 1987) [52 FR 3015 (Jan. 30, 1987)]. See also *SEC v. Ralston Purina Co.*, 346 U.S. 119, 125 (1953) (taking the position that the availability of the Section 4(a)(2) exemption “should turn on whether the particular class of persons affected needs the protection of the Act. An offering to those who are shown to be able to fend for themselves is a transaction ‘not involving any public offering’”).

assess an investment opportunity—which includes the ability to analyze the risks and rewards, the capacity to allocate investments in such a way as to mitigate or avoid risks of unsustainable loss, or the ability to gain access to information about an issuer or about an investment opportunity—or the ability to bear the risk of a loss.⁸ Accordingly, the final rules create new categories of individuals and entities that qualify as accredited investors irrespective of their wealth, on the basis that such investors have demonstrated the requisite ability to assess an investment opportunity.

The amendments we are adopting are the product of years of efforts by the Commission and its staff to consider and analyze possible approaches to revising the accredited investor definition. A number of the amendments are consistent with those recommended by the Commission staff in a 2015 report on the accredited investor definition,⁹ while some of the amendments are substantially similar to those the Commission proposed in 2007.¹⁰ Many of the amendments have been recommended, in

⁸ The accredited investor standard is similar to, but distinct from, other regulatory standards in Commission rules that are used to identify persons who are not in need of certain investor protection features of the federal securities laws. For example, Section 3(c)(7) of the Investment Company Act exempts from the definition of investment company 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 securities. Congress defined qualified purchasers as: (i) natural persons who own not less than \$5 million in investments; (ii) family-owned companies that own not less than \$5 million in investments; (iii) certain trusts; and (iv) persons, acting for their own accounts or the accounts of other qualified purchasers, who in the aggregate own and invest on a discretionary basis, not less than \$25 million in investments (*e.g.*, institutional investors). Each of these regulatory standards serves a different regulatory purpose. Accordingly, an accredited investor will not necessarily meet these other standards and these other regulatory standards are not designed to capture the same investor characteristics as the accredited investor standard. *See also* Report on the Review of the Definition of “Accredited Investor” (Dec. 18, 2015) (“2015 Staff Report”), *available at* <https://www.sec.gov/corpfin/reportspubs/special-studies/review-definition-of-accredited-investor-12-18-2015.pdf>.

⁹ *See* 2015 Staff Report.

¹⁰ Revisions of Limited Offering Exemptions in Regulation D, Release No. 33-8828 (Aug. 3, 2007) [72 FR 45116 (Aug. 10, 2007)] (“2007 Proposing Release”).

one form or another, by the Small Business Capital Formation Advisory Committee, the former Advisory Committee on Small and Emerging Companies, the Investor Advisory Committee, and a wide array of public commenters.

The definition of “qualified institutional buyer” in Rule 144A is similarly intended to “identify a class of investors that can be conclusively assumed to be sophisticated and in little need of the protection afforded by the Securities Act’s registration provisions.”¹¹ With the exception of registered dealers, a qualified institutional buyer must in the aggregate own and invest on a discretionary basis at least \$100 million in securities of issuers that are not affiliated with such a qualified institutional buyer.¹² The final rules expand the list of entities eligible for qualified institutional buyer status to be consistent with the amendments to the accredited investor definition, maintaining the \$100 million threshold for these entities to qualify for qualified institutional buyer status. In this way, the final rules avoid inconsistencies between the entity types eligible for each status while continuing to ensure that these entities have sufficient financial sophistication to participate in investment opportunities that do not have the additional protections provided by registration under the Securities Act.

¹¹ 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 FR 44016 (Nov. 1, 1988)]. Rule 144A provides a non-exclusive safe harbor exemption from the registration requirements of the Securities Act for resales to qualified institutional buyers of certain restricted securities. Any person other than the issuer or a dealer who offers or sells securities in compliance with Rule 144A is deemed not to be engaged in a distribution of the securities and therefore not an underwriter of the securities within the meaning of Section 2(a)(11) of the Securities Act, such that the Section 4(a)(1) exemption is available for the resales of the securities.

¹² Rule 144A(a)(1)(i). A registered dealer is a qualified institutional buyer if it owns and invests in the aggregate at least \$10 million of securities of non-affiliated issuers on a discretionary basis or if it is acting in a riskless principal transaction on behalf of a qualified institutional buyer. Rules 144A(a)(1)(ii) and (iii).

We received more than 200 unique comment letters on the Proposing Release.¹³ Many commenters supported expanding the accredited investor definition,¹⁴ while some commenters did not.¹⁵ Other commenters recommended eliminating the definition altogether so that anyone could invest in exempt offerings.¹⁶ We also received comments

¹³ Unless otherwise indicated, comments cited in this release are to comment letters received in response to the Proposing Release, which are *available at* <https://www.sec.gov/comments/s7-25-19/s72519.htm>.

¹⁴ *See, e.g.*, letters from Matt Langford dated Dec. 18, 2019 (“M. Langford”); Ben Peterman dated Dec. 18, 2019 (“B. Peterman Letter”); SAF Financial Securities LLC dated Dec. 18, 2019 (“SAF Financial Letter”); Calfee, Halter & Griswold LLP dated Jan. 15, 2020 (“Calfee, Halter & Griswold Letter”); Blake Delaplane dated Jan. 13, 2020 (“B. Delaplane Letter”); Nexus Private Capital dated Jan. 9, 2020 (“Nexus Private Capital Letter”); Private Investor Coalition dated Mar. 9, 2020 (“PIC Letter”); Securities Intermediary and Financial Markets Association dated Mar. 11, 2020 (“SIFMA Letter”); Morningstar dated Mar. 16, 2020 (“Morningstar Letter”); Investment Company Institute dated Mar. 12, 2020 (“ICI Letter”); Native American Finance Officers Association dated Mar. 16, 2020 (“NAFOA Letter”); ALTI LLC dated Mar. 13, 2020 (“ALTI Letter”); Committee on Securities Laws of the Business Law Section of the Maryland State Bar Association dated Mar. 16, 2020 (“Md St. Bar Assn. Comm. on Sec. Laws Letter”); Center for Capital Markets Competitiveness dated Mar. 16, 2020 (“CCMC Letter”); Teachers Insurance and Annuity Association of America dated Mar. 16, 2020 (“TIAA Letter”); Rep. J. French Hill, Sen. Thom Tillis, Sen. Pat Toomey, Rep. David Schweikert, Rep. Bryan Steil, Rep. Anthony Gonzalez, and Rep. Warren Davidson dated Mar. 16, 2020 (“Rep. J. French Hill et al. Letter”); Investment Adviser Association dated Mar. 18, 2020 (“IAA Letter”); Small Business Investor Alliance dated Mar. 16, 2020 (“SBIA Letter”); North American Securities Administrators Association, Inc. dated Mar. 16, 2020 (“NASAA Letter”) (NASAA does not support the proposals for natural persons but does generally support the proposals for entities); eShares, Inc. (d/b/a Carta) dated Mar. 16, 2020 (“Carta Letter”); OpenDeal, Inc. (d/b/a Republic) dated Mar. 16, 2020 (“Republic Letter”) (preferring a “principles-based approach to assessing certain factors of an individual’s sophistication and ability to tolerate risk”); and Federal Regulation of Securities Committee of the Business Law Section of the American Bar Association dated May 22, 2020 (“ABA Fed. Reg. of Sec. Comm. Letter”).

¹⁵ *See, e.g.*, letters from Mike L. dated Dec. 19, 2020 (“M. L. Letter”); Consumer Federation of America dated Mar. 9, 2020 (“CFA Letter”); Healthy Markets Association dated Mar. 16, 2020 (“Healthy Markets Letter”); Securities Arbitration Clinic at St. John’s University School of Law dated Mar. 16, 2020 (“St. John’s Sec. Arbitration Clinic Letter”); Better Markets dated Mar. 16, 2020 (“Better Markets”); Xavier Becerra, Attorney General of the State of California et al. dated Mar. 16, 2020 (“CA Attorney General et al.”); Public Investors Arbitration Bar Association dated Mar. 16, 2020 (“PIABA Letter”); and Matthew J. Trudeau dated Mar. 13, 2020 (“M. Trudeau Letter”).

¹⁶ *See, e.g.*, letters from Ryan Carpel dated Dec. 18, 2019 (“R. Carpel Letter”); Joseph Peter dated Dec. 20, 2019 (“J. Peter Letter”) (elimination of accredited investor / non-accredited investor distinction in Reg D offerings); Amrik Mann dated Dec. 20, 2019 (“A. Mann Letter”); Guenadi Jilevski dated Dec. 21, 2019 (“G. Jilevski Letter”); Samuel dated Dec. 23, 2019 (“S. Letter”); Conduit Investment Advisers, LLC dated Dec. 30, 2019 (“Conduit Letter”); Stuart Kuzik dated Apr. 24, 2020 (“S. Kuzik” Letter) (elimination of the definition); Bhavin Shah dated June 30, 2020 (“B. Shah Letter”); Kelly Wilson dated July 19, 2020 (“K. Wilson Letter”) (replacement of the definition with an acknowledgement-of-risk form); and Gary Freedman dated July 19, 2020 (“G. Freedman Letter”); and working paper *Abandon the Concept of Accredited Investors in Private Securities Offerings* submitted as comment letter from Andrew Vollmer, Mercatus Center at George Mason University, Aug. 21, 2020.

from several commenters in general support of expanding the definition of qualified institutional buyer in Rule 144A.¹⁷ In addition, in response to the Concept Release, the SEC’s Small Business Capital Formation Advisory Committee adopted a recommendation regarding changes to the accredited investor definition,¹⁸ and the 2019 SEC Government-Business Forum on Small Business Capital Formation (“SEC Small Business Forum”) provided a recommendation on the accredited investor definition.¹⁹ Prior to the Concept Release, the SEC’s Investor Advisory Committee adopted a recommendation regarding changes to the accredited investor definition.²⁰ After considering the public comments received and these recommendations, we are adopting

¹⁷ See, e.g., Better Markets Letter; ICI Letter; and letter from Fidelity Investments dated Mar. 16, 2020 (“Fidelity Letter”).

¹⁸ See U.S. Sec. and Exch. Comm’n Small Bus. Capital Formation Advisory Comm., *Recommendation* (Dec. 11, 2019) (“SBCFAC Recommendations”), available at <https://www.sec.gov/spotlight/sbcfac/recommendation-accredited-investor.pdf>. The SBCFAC recommended that the Commission: (i) “[l]eave the current financial thresholds in place, subject to possibly adjusting such thresholds downwards for certain regions of the country;” (ii) “[g]oing forward, index the financial thresholds for inflation on periodic basis;” and (iii) “[r]evise the definition to allow individuals to qualify as accredited investors based on measures of sophistication. In doing so, the Commission should create bright line rules for qualifying as an accredited investor by sophistication, which could include professional credentials, work experience, education, and/or a sophistication test.”

¹⁹ See U.S. Sec. and Exch. Comm’n Gov’t-Bus. Forum on Small Bus. Capital Formation, *Report on the 38th Annual Government-Business Forum on Small Business Capital Formation* (Aug. 14, 2019) (“SEC Small Business Forum Report”), available at <https://www.sec.gov/files/small-business-forum-report-2019.pdf>. The SEC Small Business Forum Report recommended that the Commission: (i) “[f]or natural persons, in addition to the income and net worth thresholds in the definition, add a sophistication test as an additional way to qualify;” (ii) “[p]rovide tribal governments parity with state governments;” and (iii) “[r]evise the dollar amounts to scale for geography, lowering the thresholds in states/regions with a lower cost of living.”

²⁰ See Recommendation of the Investor Advisory Committee: Accredited Investor Definition (Oct. 9, 2014) (“IAC Recommendations”), available at <http://www.sec.gov/spotlight/investor-advisorycommittee-2012/accredited-investor-definitionrecommendation.pdf>. The IAC recommended that the Commission (i) “evaluate whether the accredited investor definition, as it pertains to natural persons, is effective in identifying a class of individuals who do not need the protections afforded by the [Securities] Act;” (ii) “revise the definition to enable individuals to qualify as accredited investors based on their financial sophistication;” (iii) “consider alternative approaches to setting such thresholds—in particular limiting investments in private offerings to a percentage of assets or income—which could better protect investors without unnecessarily shrinking the pool of accredited investors;” and (iv) “take concrete steps [to] encourage development of an alternative means of verifying accredited investor status that shifts the burden away from issuers who may, in some cases, be poorly equipped to conduct that verification, particularly if the accredited investor definition is made more complex.”

the amendments substantially as proposed but with certain modifications in response to commenters' feedback. Commenters' views on different aspects of the proposal, as well as its effects, are discussed topically below.

II. Final Amendments to the Accredited Investor Definitions

A. Proposed Amendments

In the Proposing Release, the Commission proposed to amend the accredited investor definition to add categories of both natural persons and entities. For natural persons, the Commission proposed to add new categories to the definition that would permit natural persons to qualify as accredited investors based on certain professional certifications or designations or other credentials or, with respect to investments in a private fund, based on the person's status as a "knowledgeable employee" of the fund. Specifically, the Commission proposed to add the following natural persons:

- natural persons holding in good standing one or more professional certifications or designations or other credentials from an accredited educational institution that the Commission has designated as qualifying an individual for accredited investor status; and
- natural persons who are "knowledgeable employees," as defined in Rule 3c-5(a)(4) under the Investment Company Act of 1940 (the "Investment Company Act"), of the private-fund issuer of the securities being offered or sold.²¹

For entities, the Commission proposed to add:

- SEC- and state-registered investment advisers and rural business investment

²¹ A private fund is an issuer that would be an investment company, as defined in Section 3 of the Investment Company Act, but for Sections 3(c)(1) or 3(c)(7) of that Act. *See* Section 202(a)(29) of the Investment Advisers Act of 1940 (the "Advisers Act").

- companies to the list of entities specified in Rule 501(a)(1);
- limited liability companies to the list of entities specified in Rule 501(a)(3);
 - entities, of a type not listed in Rule 501(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;
 - “family offices,” as defined in Rule 202(a)(11)(G)–1 under the Advisers Act: (i) with assets under management in excess of \$5,000,000, (ii) that are not formed for the specific purpose of acquiring the securities offered, and (iii) whose prospective investment is directed by a person who has such knowledge and experience in financial and business matters that such family office is capable of evaluating the merits and risks of the prospective investment; and
 - “family clients,” as defined in Rule 202(a)(11)(G)–1 under the Advisers Act, of a family office meeting the requirements in new Rule 501(a)(12).

In the Proposing Release, the Commission also proposed to amend the accredited investor definition to allow spousal equivalents to pool finances for the purpose of qualifying as accredited investors. Finally, the Commission proposed to codify several staff interpretations by adding notes to Rule 501 to clarify that:

- the calculation of “joint net worth” for purposes of Rule 501(a)(5) can be the aggregate net worth of an investor and the investor’s spouse (or spousal equivalent if “spousal equivalent” is included in Rule 501(a)(5));²²
- the securities being purchased by an investor relying on the joint net worth test of

²² Throughout this release, references to an investor’s spouse include a spousal equivalent, as applicable, in light of the adoption of the amendments to Rule 501(a)(5) and Rule 501(a)(6).

Rule 501(a)(5) need not be purchased jointly; and

- when determining the accredited investor status of an entity under Rule 501(a)(8), one may look through various forms of equity ownership to natural persons.

B. Final Amendments

1. Natural Persons

a. Natural Persons Holding Professional Certifications and Designations or Other Credentials

In the Proposing Release, the Commission proposed to designate by order certain professional certifications and designations and other credentials from an accredited educational institution as qualifying for accredited investor status, with such designation to be based upon consideration of all the facts pertaining to a particular certification, designation, or credential. The proposed amendment included the following non-exclusive list of attributes that the Commission would consider in determining which professional certifications and designations or other credentials qualify a natural person for accredited investor status:

- 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 educational 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 such 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 Commission indicated that it preliminarily expected that the initial Commission order accompanying the final rule would include the following certifications or designations administered by the Financial Industry Regulatory Authority, Inc. (FINRA): the Licensed General Securities Representative (Series 7), Licensed Investment Adviser Representative (Series 65), and Licensed Private Securities Offerings Representative (Series 82).

i. Comments

Many commenters supported adding some form of professional certifications and designations or other credentials.²³ Some of these commenters noted that attaining

²³ See letter from Jeff LaBerge dated Jan. 17, 2020 (“J. LaBerge Letter”); letter from Alex Naegele dated Jan. 9, 2020 (“A. Naegele Letter”); letter from Kevin Gebert dated Mar. 4, 2020 (“K. Gebert Letter”); letter from Adam Moehn dated Mar. 8, 2020 (“A. Moehn Letter”); letter from Davis Treybig dated Dec. 20, 2019 (“D. Treybig Letter”); letter from Michael Seng dated Dec. 19, 2019 (“M. Seng Letter”); letter from Corey Wangler dated Feb. 26, 2020 (“C. Wangler Letter”); letter from Mercer Global Advisors, Inc. dated Mar. 11, 2020 (“Mercer Advisors Letter”); Morningstar Letter; ALTI Letter; Md St. Bar Assn. Comm. on Sec. Laws Letter; letter from National Association of Manufacturers dated Mar. 16, 2020 (“NAM Letter”); letter from Chartered Market Technicians Association dated Mar. 16, 2020 (“CMT Letter”); letter from High Level Working Group on Cryptocurrency and Digital Assets Self-Regulation dated Mar. 16, 2020 (“HLWG Letter”); SBIA Letter; Republic Letter; letter from Riley T. Maud dated Mar. 6, 2020 (“R. Maud Letter”); letter from Investments & Wealth Institute dated Mar. 13, 2020 (“IWI Letter”); letter from Managed Funds Association and Alternative Investment Management Association dated Mar. 13, 2020 (“MFA and AIMA Letter”); letter from Cornell Securities Law Clinic dated Mar. 13, 2020 (“Cornell Sec. Clinic Letter”); Fidelity Letter; Carta Letter; CFA Letter; Rep. J. French Hill et al. Letter; letter from Tron Black dated Dec. 24, 2019 (“T. Black Letter”); letter from Seyed Arab dated Dec. 18, 2019 (“S. Arab Letter”); letter from Malcolm Douglas dated Dec. 18, 2019 (“M. Douglas Letter”); letter from James J. Angel dated Mar. 3, 2020 (“J. Angel Letter”); letter from Crowdwise, LLC dated Mar. 1, 2020 (“Crowdwise Letter”); letter from Geraci LLP dated Mar. 9, 2020 (“Geraci Letter”) and letter from American Association of Private Lenders submitted May 27, 2020 (“AAPL Letter”) (the Geraci Letter and the AAPL Letter are essentially identical); letter from Leonard A. Grover dated Dec. 21, 2019 (“L. Grover Letter”); letter from Ryan L. Doyal dated Dec. 23, 2019 (“R. Doyal Letter”); letter from Kathreek Pulavarthi dated Dec. 29, 2019 (“K. Pulavarthi Letter”); letter from G. Philip Rutledge dated Jan. 31, 2020 (“P. Rutledge Letter”); letter from

credentials may signal a level of sophistication exceeding that of investors who currently qualify as accredited investors under the income or net worth thresholds.²⁴ In addition, a few commenters supported the proposal to add professional certifications or designations to the definition, but suggested that the Commission also require professional experience.²⁵ Another commenter opposed the proposal, raising a concern that

Inportal dated Feb. 21, 2020 (“Inportal Letter”); CCMC Letter; letter from Institute for Portfolio Alternatives dated Mar. 16, 2020 (“IPA Letter”); letter from Karen Salay dated Dec. 19, 2019 (“K. Salay Letter”); letter from Gordon Hodge dated Dec. 21, 2019 (“G. Hodge Letter”); letter from Graham Gintz dated Mar. 6, 2020 (“G. Gintz Letter”); letter from CityVest dated Jan. 7, 2020 (“CityVest Letter”); letter from Bryan M. Crane dated Dec. 19, 2019 (“B. Crane Letter”); letter from National Introducing Brokers Association dated Mar. 3, 2020 (“NIBA Letter”); M. Langford Letter; letter from Timothy E. Messenger dated Dec. 19, 2019 (“T. Messenger Letter”); letter from Ruthlynn E. Black dated Dec. 30, 2019 (“R. Black Letter”) (the R. Doyal Letter and the R. Black Letter are essentially identical); letter from Chris Lakumb dated Dec. 18, 2019 (“C. Lakumb Letter”); letter from Ashley Wunderlich dated Feb. 7, 2020 (“A. Wunderlich Letter”); letter from Kurt Wunderlich dated Feb. 7, 2020 (“K. Wunderlich Letter”); letter from Kevin King dated Jan. 23, 2020 (“K. King Letter”); letter from Michael Bernstein dated Dec. 19, 2019 (“M. Bernstein Letter”); letter from Luke Denlinger dated Dec. 22, 2019 (“L. Denlinger Letter”); CFA Letter; B. Peterman Letter; letter from American Bankers Association dated Mar. 16, 2020 (“Am. Bankers Assn. Letter”); letter from Raymond Wu dated Feb. 21, 2020 (“R. Wu Letter”); letter from Joseph Caruso dated Jan. 28, 2020 (“J. Caruso Letter”); letter from Cody L. West dated Feb. 23, 2020 (“C. West Letter”); letter from American Investment Council dated Mar. 16, 2020 (“AIC Letter”); letter from Jared Smith dated Feb. 10, 2020 (“J. Smith Letter”); letter from Angel Capital Association dated Mar. 9, 2020 (“ACA Letter”); letter from Rudolph Langenbach dated Jan. 10, 2020 (“R. Langenbach Letter”); letter from Association of Trust Organizations, Inc. dated Apr. 15, 2020 (“ATO Letter”); letter from Brian Seelinger dated Dec. 18, 2019 (“B. Seelinger Letter”); letter from Artinvest dated Apr. 23, 2020 (“Artinvest Letter”); letter from David R. Burton dated May 1, 2020 (“D. Burton Letter”); letter from CFA Institute dated May 4, 2020 (“CFA Institute Letter”); ABA Fed. Reg. of Sec. Comm. Letter; letter from Biotechnology Innovation Organization dated June 16, 2020 (“BIO Letter”); and letter from Brandon Andrews et al. dated May 4, 2020 (“B. Andrews et al. Letter”).

²⁴ See Morningstar Letter (indicating that “[p]utting an emphasis on allowing investors with knowledge and expertise to participate in private capital markets is sensible. These investors, by definition, should be better able to cope with the opacity and limited availability of comparable measures in our private markets”); M. Seng Letter (positing that “someone who has professional certification(s) is far more qualified to determine if the investment is right for them or not far better than someone who doesn’t understand the investment but has money looking to invest”); and C. Wangler Letter (stating that “professional licensing is more indicative of investment knowledge than how much money one has”).

²⁵ See NASAA Letter (noting that a level of years of experience should be required); letter from Nasdaq, Inc. dated May 18, 2020 (“Nasdaq Letter”) (noting that “most professional designations or certifications alone [do not] suffice to establish the financial sophistication and independent judgment required to evaluate private investments that are inherently risky and illiquid. An examination of knowledge, without an additional requirement of industry experience, is not a satisfactory means to determine whether an investor can bear the risk of and evaluate a potential investment in an exempt offering without the benefit of a registration statement or similar disclosure”); and Geraci Letter and AAPL Letter (supporting inclusion of Series 7, 65, and 82 license holders without an experience requirement, but conditioning support for the inclusion of CPAs, JDs, CFAs, and CAIAs on having three years of experience, and noting that the

individuals qualifying as accredited investors solely under such criteria would not have the financial capacity to be able to bear the financial risk of private investments.²⁶

Another commenter opposed the proposal and the existence of the accredited investor concept, arguing that “educational tests” are inherently discriminatory.²⁷

A number of commenters specifically responded on the use of FINRA-administered exams. Several commenters expressed support for inclusion of the Series 7,²⁸ Series 65,²⁹ and/or Series 82 exams.³⁰ One commenter noted that these exams test important investing concepts,³¹ while another stated that individuals qualified to advise

experience requirement “protect[s] newly licensed individuals, who may not be familiar with the real world applications of their education, from partaking in inappropriate investment opportunities”).

²⁶ See St. John’s Sec. Arbitration Clinic Letter.

²⁷ See B. Shah Letter (stating that income and wealth requirements are also discriminatory).

²⁸ See T. Black Letter; S. Arab Letter; M. Douglas Letter; J. Angel Letter; Crowdwise Letter; L. Grover Letter; R. Doyal Letter and R. Black Letter; K. Pulavarthi Letter; P. Rutledge Letter; Inportal Letter; Md St. Bar Assn. Comm. on Sec. Laws Letter; NAM Letter; CCMC Letter; IPA Letter; HLWG Letter; SBIA Letter; R. Maud Letter (indicating that “professional certifications such as the [Series 7], [Series 65], and [Series 82] are exactly the types of certifications that indicate financial sophistication which in turn would satisfy the accredited investor definition”); Artinvest Letter; ABA Fed. Reg. of Sec. Comm. Letter; and Geraci Letter and AAPL Letter (noting that “those who hold a Series 7, 65, or 82 license should be permitted to qualify as accredited investors without any additional approval by the Commission as obtaining such a license enables them to evaluate investments on behalf of third parties, thus qualifying them to effectively evaluate investment opportunities on their own behalf as well”).

²⁹ See T. Black Letter; S. Arab Letter; M. Douglas Letter; J. Angel Letter; Crowdwise Letter; K. Salay Letter; G. Hodge Letter; L. Grover Letter; R. Doyal Letter and R. Black Letter; K. Pulavarthi Letter; P. Rutledge Letter; Inportal Letter; Md St. Bar Assn. Comm. on Sec. Laws Letter; NAM Letter; CCMC Letter; IPA Letter; HLWG Letter; SBIA Letter; R. Maud Letter; Artinvest Letter; ABA Fed. Reg. of Sec. Comm. Letter; and Geraci Letter and AAPL Letter.

³⁰ See M. Douglas Letter; Crowdwise Letter; L. Grover Letter; R. Doyal Letter and R. Black Letter; K. Pulavarthi Letter; P. Rutledge Letter; Inportal Letter; Md St. Bar Assn. Comm. on Sec. Laws Letter; NAM Letter; CCMC Letter; IPA Letter; HLWG Letter; SBIA Letter; R. Maud Letter; Artinvest Letter; ABA Fed. Reg. of Sec. Comm. Letter; and Geraci Letter and AAPL Letter.

³¹ See HLWG Letter (noting that the Series 7, 65, and 82 exams “are sufficiently rigorous, effectively assess the degree of knowledge and understanding of key investment subjects and concepts, and result in the development of competent and capable investment professionals. Thus, they render the protections of the Securities Act unnecessary”).

others on whether to invest in private offerings should be able to invest themselves.³² One commenter opposed the inclusion of these exams,³³ while another stated that a person should be required to pass all three exams to be considered an accredited investor.³⁴

One commenter supported including all FINRA exams.³⁵ A number of commenters also specifically supported including the following examinations: Series 3 (National Commodities Futures Examination),³⁶ Series 6 (Investment Company and Variable Contracts Products Representative Examination),³⁷ Series 22 (Direct Participation Programs Limited Representative Examination),³⁸ Series 66 (Uniform Combined State Law Examination),³⁹ Series 79 (Investment Banking Representative Examination),⁴⁰ and Series 86 and 87 (Research Analyst Examination).⁴¹ A few

³² See J. Angel Letter (stating that “[i]t certainly makes sense that licensed people in the securities industry who are allowed to sell private offerings to their clients should also be allowed to invest in those same offerings as accredited investors”).

³³ See letter from Al Hemmingsen dated Dec. 29, 2019 (“A. Hemmingsen Letter”).

³⁴ See Cornell Sec. Clinic Letter (positing that “one of these examinations alone is [not] enough to test an individual’s financial sophistication. Instead, the SEC should require an investor to pass all three of these exams”).

³⁵ See P. Rutledge Letter (noting that “[i]f the SEC and relevant state securities regulators think [FINRA license holders] sufficiently qualified to render investment-related services to the public, those individuals should be able to purchase investments of their choice”).

³⁶ See P. Rutledge Letter; NIBA Letter; IPA Letter; Artivest Letter; and ABA Fed. Reg. of Sec. Comm. Letter.

³⁷ See P. Rutledge Letter; IPA Letter; Artivest Letter; and ABA Fed. Reg. of Sec. Comm. Letter.

³⁸ See P. Rutledge Letter and ABA Fed. Reg. of Sec. Comm. Letter

³⁹ See P. Rutledge Letter; A. Naegele Letter; IPA Letter; Artivest Letter; D. Burton Letter; and ABA Fed. Reg. of Sec. Comm. Letter.

⁴⁰ See P. Rutledge Letter and CCMC Letter.

⁴¹ See P. Rutledge Letter; R. Wu Letter; CCMC Letter; CMT Letter (86 only); and ABA Fed. Reg. of Sec. Comm. One commenter specifically did not support including the Series 86 and 87 examinations. See A. Naegele Letter.

commenters supported inclusion of the FINRA “Securities Industry Essentials” (SIE) examination,⁴² while a few other commenters opposed its inclusion.⁴³

Commenters also responded to the Proposing Release’s request for comment on what other professional certifications and designations or other credentials should be included in a Commission order designating qualifying credentials. We received a diverse range of comments relating to the inclusion of certain professional credentials, educational experience, and professional experience. With respect to professional credentials, several commenters expressed support for including certified public accountants (CPAs),⁴⁴ while a few commenters were opposed to their inclusion.⁴⁵ One commenter noted its support for including CPAs was based on the commenter’s view that the exam process is “rigorous” and requires “extensive” education and that the license is

⁴² See J. Angel Letter (noting its belief that “[w]hile the SIE is clearly less rigorous than the CFA, CFP®, Series 7, or Series 65 exams,” Regulation Best Interest reduces the risk of bad products being marketed to unsophisticated investors); Crowdwise Letter; SBIA Letter; and D. Burton Letter (indicating that it “probably” should be included but noting that “[t]he sample test, however, seems more concerned with the regulation of investment professionals than investment knowledge. Moreover, the investment knowledge tested for appears to be primarily the nature of various public securities other than common stock and investment products rather than an understanding of business, enterprise, accounting or finance”).

⁴³ See A. Naegle Letter; NASAA Letter; and HLWG Letter (supporting consideration of the exam but stating that “since this exam is not particularly rigorous or tailored to private fund investments, additional training and education may be required, such as investment-related courses from an accredited institution”).

⁴⁴ See M. Langford Letter; S. Arab Letter (noting that the designation is “issued through a rigorous examination process” and is “licensed by state regulatory bodies,” which may mean the CPA is subject to “more oversight than many other types of certifications”); CityVest Letter; Geraci Letter and AAPL Letter (these commenters would also require three years of experience and good standing); T. Messenger Letter; G. Hodge Letter; R. Doyal Letter and R. Black Letter; B. Crane Letter; IPA Letter; HLWG Letter; Carta Letter; Artinvest Letter; and D. Burton Letter.

⁴⁵ See P. Rutledge Letter; Md St. Bar Assn. Comm. on Sec. Laws Letter (noting that “[w]e do not believe that even the most thorough understanding of accounting and auditing standards provides the individual who possesses such knowledge with any degree of financial sophistication in the sense of being able to make knowledgeable investment decisions”); NASAA Letter; and CFA Letter.

granted by the states.⁴⁶ Commenters who were opposed expressed their view that the CPA credential is not focused on investing,⁴⁷ and does not reliably demonstrate an individual's comprehension and sophistication in the areas of securities and investing.⁴⁸ Some commenters also supported including Chartered Financial Analyst (CFA),⁴⁹ Chartered Alternative Investment Analyst (CAIA),⁵⁰ Certified Financial Planner (CFP),⁵¹ Certified Trust and Financial Advisor (CTFA),⁵² and Certified Investment Management Analyst (CIMA) and Certified Private Wealth Advisor (CPWA) certifications.⁵³ One commenter expressed concern with such an approach, noting that “private designation conferring organizations are not subject to [C]ommission oversight.”⁵⁴

Commenters also responded on whether the Commission should include certain educational attributes. We received several comments in support of including law

⁴⁶ See S. Arab Letter (noting that “CPA certifications are not only issued through a rigorous examination process and require extensive education, they are also licensed by state regulatory bodies and are under more oversight than many other types of certifications”).

⁴⁷ See NASAA Letter.

⁴⁸ See CFA Letter.

⁴⁹ See C. Lakumb Letter; A. Wunderlich Letter; K. Wunderlich Letter; P. Rutledge Letter; K. King Letter; J. Angel Letter; A. Naegele Letter; CityVest Letter; A. Moehn Letter; Geraci Letter and AAPL Letter (these commenters would also require three years of experience and good standing); M. Bernstein Letter; L. Denlinger Letter; CFA Letter; IPA Letter; Mercer Advisors Letter; HLWG Letter; Fidelity Letter; Carta Letter; ATO Letter; B. Seelinger Letter; Artinvest Letter; D. Burton Letter; and CFA Institute Letter (the CFA designation is awarded by the CFA Institute).

⁵⁰ See B. Peterman Letter; C. Lakumb Letter; A. Wunderlich Letter; K. Wunderlich Letter; CityVest Letter; Geraci Letter and AAPL Letter (these commenters would also require three years of experience and good standing); HLWG Letter; Fidelity Letter; Carta Letter; and Artinvest Letter.

⁵¹ See C. Lakumb Letter; P. Rutledge Letter; J. Angel Letter; Mercer Advisors Letter; HWLG Letter; CFP Letter; Carta Letter; ATO Letter; and D. Burton Letter (positing that “[t]he CFA Charter and CFP certification generally require the mastery of a broader range of material at a deeper level than the series 7 exam and, therefore, better equip a person to evaluate investments”).

⁵² See Am. Bankers Assn. Letter (the CTFA designation is awarded by the Am. Bankers Assn.) and ATO Letter.

⁵³ See IWI Letter (the CIMA and CPWA designations are awarded by the Investments & Wealth Institute).

⁵⁴ See A. Hemmingsen Letter.

degrees,⁵⁵ and a similar number of comments opposing their inclusion.⁵⁶ Two commenters supported the inclusion of lawyers with legal experience,⁵⁷ while another noted that some level of financial experience should be required.⁵⁸ Several commenters supported including a master's degree in business administration from an accredited educational institution,⁵⁹ while others were opposed.⁶⁰ Similarly, several commenters supported including various graduate degrees,⁶¹ while a few commenters expressed opposition.⁶² Commenters also expressed support for including various other educational

⁵⁵ See CityVest Letter; Geraci Letter and AAPL Letter (positing that “[t]hese individuals have received significant training on evaluating complex legal and financial concepts, and given experience practicing in their given fields, we believe they are more than capable of making complex investment decisions on their own behalf,” but also stating that the Commission should include a three year experience and licensing requirement); A. Naegele Letter; J. Caruso Letter (supporting inclusion of concentrations, legal certifications, and master of laws programs in securities law); C. West Letter; and AIC Letter.

⁵⁶ See P. Rutledge Letter; CFA Letter (noting that “[a]bsent some additional investment-specific experience or expertise, individuals with [a law degree] cannot reasonably be expected to have sufficient knowledge or experience to evaluate the merits and risks of a prospective investment absent the protections afforded in the public markets (access to comprehensive and reliable information about the offering)”; letter from Sarah H. Moller dated Mar. 13, 2020 (“S. Moller Letter”); Md St. Bar Assn. Comm. on Sec. Laws Letter (noting that “[e]ven a thorough understanding of the federal securities laws and how they operate in practice does not provide a person with such sophistication and knowledge when applied to evaluating ‘the merits and risks of a prospective investment’”); NASAA Letter; and Cornell Sec. Clinic Letter.

⁵⁷ See Geraci Letter and AAPL Letter.

⁵⁸ See A. Naegele Letter.

⁵⁹ See G. Gintz Letter; CityVest Letter; J. Angel Letter; B. Crane Letter; Artinvest Letter; and Geraci Letter and AAPL Letter. The Geraci Letter and AAPL Letter would also require “verification of graduation from a nationally accredited university.”

⁶⁰ See S. Arab Letter; P. Rutledge Letter; A. Naegele Letter; Md St. Bar Assn. Comm. on Sec. Laws Letter; CMT Letter; NASAA Letter; Cornell Sec. Law Clinic Letter; and CFA Letter.

⁶¹ See CityVest Letter (supporting masters level degree in business, accounting, economics, or law); J. Smith (supporting advanced finance degrees); J. Angel Letter (supporting Master of Science in Finance); B. Crane Letter (supporting PhD in a “business related discipline”); CCMC Letter (supporting doctoral degrees in accounting, finance, or economics); Cornell Sec. Clinic Letter (supporting advanced degrees in finance); AIC Letter (supporting mathematics, science (e.g., physics or computer science), business, accounting, finance, economics, or law); and D. Burton Letter (supporting advanced degrees in business, business administration or business management, entrepreneurship, economics, finance, or accounting).

⁶² See CFA Letter and S. Moller Letter.

programs.⁶³ One commenter did not support including any educational experience, citing disparities in educational quality.⁶⁴

Commenters also responded to a request for comment in the Proposing Release on whether the Commission should include professional experience in areas such as finance and investing, apart from professional certifications and designations, as another means for qualifying for accredited investor status. Several commenters supported using professional experience,⁶⁵ some of whom also recommended including investing experience.⁶⁶ No commenters specifically opposed including professional experience.

The Proposing Release also solicited comment on whether the Commission

⁶³ See ACA Letter (certifications from Angel Capital Association’s ACA University); J. Angel Letter (undergraduate degree in business); letter from Christy Logan dated Dec. 20, 2019 (“C. Logan Letter”) (“reasonable education”); R. Langenbach Letter (“some certain education/certification”); AIC Letter (bachelor’s, bachelor’s equivalent, or higher degree (such as a master’s or J.D.) from an accredited educational institution in a discipline that requires a significant amount of statistical or quantitative analysis or acquaintance with business and legal issues); D. Burton Letter (medical and advanced scientific, engineering, or technology degrees); BIO Letter (proposing to include “Doctor of Philosophy (PhD) in the hard sciences, Medical Doctor degrees (MD), or Master of Science (MS) in hard sciences for the specific purpose of participating in the seed and early stage funding of biotechnology companies”).

⁶⁴ See S. Arab Letter.

⁶⁵ See ABA Fed. Reg. of Sec. Comm. Letter (stating that expanding the accredited investor definition to include investors with relevant experience in respect of the particular investment “would increase investment opportunities with little or no impact on investor protection”); letter from Hunter Todd dated Dec. 19, 2019 (“H. Todd Letter”), letter from Omar Plummer dated Dec. 20, 2019 (“O. Plummer Letter”) (would extend accredited investor status to individuals who “have participated in investment banking and can prove they did, or do in fact, still have a license”); letter from Jeffrey P. Jacobson dated Feb. 7, 2020 (“J. Jacobson Letter”); letter from Andrew Rea dated Jan. 2, 2020 (“A. Rea Letter”) (would extend accredited investor status to “people with a certain amount of years working in venture-backed startups or venture capital funds themselves”); letter from Dar’shun Kendrick dated Dec. 19, 2019 (“D. Kendrick Letter”); letter from Timo Muro dated Dec. 19, 2019 (“T. Muro Letter”); letter from Thomas Englis dated Dec. 19, 2019 (“T. Englis Letter”) (noting that “[h]aving worked in the venture capital industry for 4 years, I have a very high level of knowledge of technology startups . . . [t]he existing law does not accurately measure an individual’s knowledge of risk”); CCMC Letter; AIC Letter; Artinvest Letter; BIO Letter (stating that “[s]cientific professionals are uniquely knowledgeable and experienced in [early stage biotechnology companies] and can more accurately assess the risks of a scientific endeavor than the vast majority of investors”); and K. Wilson Letter.

⁶⁶ See letter from Matthew Youngs dated Feb. 4, 2020, (“M. Youngs Letter”); A. Naegle Letter; letter from Michael Penn Smith dated Dec. 20, 2019 (“M. Smith Letter”) (positing that “there’s no good reason to deny knowledgeable retail investors access to venture investments”); letter from Matthew M. Peterson dated Dec. 26, 2019; SIFMA Letter; ABA Fed. Reg. of Sec. Comm.; and K. Wilson Letter.

should develop an accredited investor examination and whether the Commission should allow individuals to self-certify that they have the requisite financial sophistication to be an accredited investor. Of the commenters responding to the request for comment on an accredited investor examination, most supported an accredited investor examination,⁶⁷ while a few did not.⁶⁸ One commenter expressed a preference for an accredited investor exam due to concerns about the cost of the Series 7, 65, and 82 exams.⁶⁹ Regarding self-certification, although some commenters were in favor,⁷⁰ some were opposed.⁷¹ One commenter cited the difficulty of procuring necessary documentation for foreign nationals to prove net worth as a reason to allow self-certification of financial sophistication.⁷² Another supported self-certification only as a component of a broader

⁶⁷ See T. Black Letter; letter from Einar Vollset dated Dec. 18, 2019 (“E. Vollset Letter”); B. Delaplane Letter; letter from Mark Headrick dated Feb. 7, 2020 (“M. Headrick Letter”); M. Youngs Letter; Crowdwise Letter; letter from Josh Kelner dated Jan. 10, 2020 (“J. Kelner Letter”); A. Naegele Letter; letter from Wiebke Zuch dated Jan. 8, 2020 (“W. Zuch Letter”); letter from Tony Sparks dated Jan. 2, 2020 (“T. Sparks Letter”) (supporting an accredited investor exam because “it’s wise for people to be somewhat informed on how investments work before they invest”); letter from Bruce A. Wallick dated Dec. 19, 2019 (“B. Wallick Letter”) (positing that “[w]hat’s really needed to evaluate various investments and avoid endangering one’s wealth is adequate analytical skill . . . [p]erhaps requiring some case study investment analysis as part of the test would be sufficient to determine level of understanding”); letter from Patrick Poole dated Dec. 20, 2019 (“P. Poole Letter”); A. Hemmingsen Letter; Mercer Advisors Letter; Md St. Bar Assn. Comm. on Sec. Laws Letter; Carta Letter; R. Doyal Letter and R. Black Letter; letter from Ben Lawrence dated Apr. 15, 2020 (“B. Lawrence Letter”); and D. Burton Letter.

⁶⁸ See P. Rutledge Letter (preferring FINRA-administered exams because “FINRA is subject to SEC oversight and has existing mechanisms for making examination-related information publicly available”) and J. Angel Letter.

⁶⁹ See E. Vollset Letter (noting that the Series 7, 65, and 82 exams “likely would cost more to obtain than a lot of people are willing to invest”).

⁷⁰ See M. Douglas Letter; J. Angel Letter; K. Pulavarthi Letter; D. Burton Letter; letter from Gregory S. Fryer dated March 16, 2020 (“G. Fryer Letter”) (supporting self-certification for investors investing less than \$15,000); and G. Freedman Letter.

⁷¹ See P. Rutledge Letter; Crowdwise Letter; Mercer Advisors Letter; Md St. Bar Assn. Comm. on Sec. Laws Letter; NASAA Letter; R. Maud Letter; and CFA Institute Letter (noting that “[b]ehavioral science has long recognized overconfidence bias in general and has specifically documented individuals’ overconfidence in their investing skills and financial knowledge”).

⁷² See K. Pulavarthi Letter.

certification regime that would also include a qualifying examination and attaining sufficient private market and/or early-stage investing experience.⁷³ One commenter who opposed self-certification argued that it would not be subject to any standards,⁷⁴ while another commenter argued that “the average investor will be in no position to make unbiased determinations regarding their own financial sophistication.”⁷⁵

Under the proposed approach, individuals with certain professional certifications and designations or other credentials would qualify as accredited investors regardless of their net worth or income. The Proposing Release requested comment on whether additional conditions, such as investment limits, for individuals with these certifications, designations, or credentials should be considered. A few commenters supported investment limits,⁷⁶ while others did not.⁷⁷ One commenter who recommended imposing investment limits expressed the view that individuals who do not meet the current net worth or income thresholds, “while possibly financially sophisticated, could not sustain larger losses from these types of investments,” and favorably noted the investment limits in place under Regulation A and Regulation Crowdfunding.⁷⁸ Conversely, another commenter expressed concern about the administrative burden of investment limits and stated that it would “substantially reduce the attractiveness of this approach (as it has for Regulation A and Regulation CF).”⁷⁹ Another commenter stated that such limits may

⁷³ See Crowdwise Letter.

⁷⁴ See NASAA Letter.

⁷⁵ See Md St. Bar Assn. Comm. on Sec. Laws Letter.

⁷⁶ See A. Naegle Letter; Mercer Advisors Letter; and Artinvest Letter.

⁷⁷ See L. Glover Letter; HLWG Letter; CCMC Letter; and D. Burton Letter.

⁷⁸ See Mercer Advisors Letter.

⁷⁹ See D. Burton Letter.

“continue to propagate the disparate impact that the current standards have on women, minority and rural investors.”⁸⁰

As proposed, individuals who obtain the designated professional credentials would be required to maintain these certifications or designations in good standing in order to qualify as accredited investors. Several commenters supported a good-standing requirement.⁸¹ One of these commenters based its support of a good-standing requirement on the need to maintain up-to-date knowledge.⁸² In contrast, another commenter opposed such a requirement, suggesting that a good standing requirement would impose a “needless barrier” to investment.⁸³

The Proposing Release also requested comment on whether individuals who obtain the designated professional credentials should also be required to practice in the fields related to the certifications or designations, or to have practiced for a minimum number of years. A few commenters suggested that the Commission require professional experience,⁸⁴ with one expressing the view that the “ability to pass a test is no substitute

⁸⁰ See CCMC Letter.

⁸¹ See letter from Da Kui dated Jan. 10, 2020 (“D. Kui Letter”); A. Naegele Letter; Mercer Advisors Letter; HLWG Letter; R. Maud Letter; letter from Jiixin Na dated Mar. 13, 2020 (“J. Na Letter”); and Geraci Letter and AAPL Letter.

⁸² See D. Kui Letter (noting that, without a good standing requirement “the investor may no longer have up-to-date knowledge and information about the related fields, especially when considering the increasingly changing world of finance and investment”).

⁸³ See D. Burton Letter (stating that “[t]he general investment knowledge imparted by these programs will not materially dissipate or decline, particularly if the person is making investments. The Commission should not erect needless barriers reducing access to these investments. It should not actively create an advantage for those it regulates (*i.e.* those in the securities industry) by requiring that a person be associated with a broker-dealer”).

⁸⁴ See NASAA Letter (noting that a level of years of experience should be required); letter from Nasdaq, Inc. dated May 18, 2020 (“Nasdaq Letter”) (noting that “most professional designations or certifications alone [do not] suffice to establish the financial sophistication and independent judgment required to evaluate private investments that are inherently risky and illiquid. An examination of knowledge, without an additional requirement of industry experience, is not a satisfactory means to determine whether an investor can bear the risk of and evaluate a potential investment in an exempt offering without the benefit

for demonstrable investing or financial services experience.”⁸⁵ One commenter opposed a work experience requirement for individuals who pass the Series 7 and 65 exams, noting that such individuals “can practice as securities professionals without an apprenticeship or relevant experience.”⁸⁶

The proposed amendments included a mechanism by which the Commission would designate qualifying professional credentials by order and noted that the Commission “anticipate[d] that the Commission generally would provide public notice and an opportunity for public comment before issuance of such order.”⁸⁷ Two commenters raised Administrative Procedure Act (“APA”) concerns with this approach.⁸⁸ Both commenters indicated that the Commission should provide the public with the opportunity to comment on any additional categories of qualifying professional credentials before issuing a final order. Another commenter similarly encouraged the Commission to provide public notice and an opportunity for public comment before issuance of such an order.⁸⁹ Other commenters were generally supportive of the proposal

of a registration statement or similar disclosure”). *See also* Geraci Letter and AAPL Letter (supporting inclusion of Series 7, 65, and 82 license holders without an experience requirement, but conditioning support for the inclusion of CPAs, JDs, CFAs, and CAIAs on having three years of experience, and noting that the experience requirement “protect[s] newly licensed individuals, who may not be familiar with the real world applications of their education, from partaking in inappropriate investment opportunities”).

⁸⁵ *See* NASAA Letter.

⁸⁶ *See* L. Grover Letter.

⁸⁷ *See* Proposing Release at 2581.

⁸⁸ *See* NASAA Letter (suggesting that the “policy would also potentially violate the Administrative Procedure Act, as the new accredited investor standards would likely constitute legislative rules, for which public notice and comment are required”) and CA Attorney General et al. Letter (“[t]he proposed process fails to afford stakeholders an opportunity to provide valuable insight on proposed changes and violates the Administrative Procedures Act”). *See also* 5 U.S.C. § 551 *et seq.*

⁸⁹ *See* IWI Letter.

to designate the professional credentials by order.⁹⁰

We also requested comment on the proposed non-exclusive list of attributes that the Commission would consider in determining which professional certifications and designations or other credentials qualify for accredited investor status. A few commenters expressed support for the proposed list.⁹¹ One proposed attribute was an indication that an individual holds the certification or designation is made publicly available by the relevant self-regulatory organization or other industry body. One commenter expressed support for this attribute but suggested that it be broadened to include not only publicly available certifications, but also those relevant certifications that may be “otherwise independently verifiable.”⁹² In addition, one commenter urged the Commission to establish a routine review of the defined list of eligible designations, certifications, and licenses.⁹³

ii. Final Amendments

After considering the comments, we are adopting the amendment substantially as proposed. We continue to believe that certain professional certifications and designations or other credentials provide a reliable indication that an investor has a sufficient level of

⁹⁰ See ABA Fed. Reg. of Sec. Comm. Letter and D. Burton Letter.

⁹¹ See Fidelity Letter; CFA Institute Letter (noting that “[w]e believe the Release articulates sound principles in its non-exclusive list of attributes that it would consider in determining which professional certifications and designations or other credentials qualify for accredited investor status”); and ABA Fed. Reg. of Sec. Comm. Letter (“[t]he Committee supports this approach, which would be based on criteria that are verifiable and provide ongoing flexibility for the Commission to add further appropriate investor categories”).

⁹² See Fidelity Letter (noting that such approach “[p]rovides the SEC flexibility as it considers additions to the list of professional certifications that meet its specified criteria in the future, which may not necessarily be searchable on a public website, but would be otherwise verifiable, such as on an access-controlled website”).

⁹³ See Carta Letter (“[t]he final rule should provide the Commission with flexibility to reevaluate previously designated certifications, designations, or credentials if they change over time, and also designate other, possibly new, certifications, designations, or credentials that meet specified criteria”).

financial sophistication to participate in investment opportunities that do not have the additional protections provided by registration under the Securities Act. We note that many commenters agreed with our conclusion in this regard. Further, we continue to believe that relying solely on financial thresholds as an indication of financial sophistication is suboptimal, including because it may unduly restrict access to investment opportunities for individuals whose knowledge and experience render them capable of evaluating the merits and risks of a prospective investment—and therefore funding for themselves—in a private offering, irrespective of their personal wealth. While certain of these individuals may have fewer financial resources and, as a result, be less able to bear the financial risk of private investments, as one commenter suggested,⁹⁴ we believe their professional credentials and experience should enable these investors to assess investment opportunities, appropriately allocate capital based on their individual circumstances, including whether to reallocate investment capital between private investments and other equivalent-sized investments, and otherwise make appropriately informed decisions regarding their financial interests, including their ability to bear the financial risk.

As proposed, the final amendment provides that the Commission may designate qualifying professional certifications, designations, and other credentials by order, with such designation to be based upon consideration of all the facts pertaining to a particular certification, designation, or credential. Also as proposed, the final amendment includes a nonexclusive list of attributes that the Commission will consider in determining which professional certifications and designations or other credentials qualify a natural person

⁹⁴ See *supra* note 26.

for accredited investor status. As noted in the Proposing Release, given the evolving nature of market and industry practices, this approach will provide the Commission with flexibility to reevaluate previously designated certifications, designations, or credentials if they change over time, and also to designate other certifications, designations, or credentials if new certifications, designations, or credentials develop or are identified that are consistent with the specified criteria and that the Commission determines are appropriate. Although a few commenters questioned this approach, we believe that designating credentials by order is consistent with the APA. The rules provide specific standards by which the Commission will evaluate additional qualifying credentials. Moreover, consistent with commenters' suggestions, we are revising the final rules to clarify that, in connection with any future designations of qualifying credentials, the Commission will provide notice and an opportunity for public comment before issuing any final order. To assist members of the public, the professional certifications and designations and other credentials currently recognized by the Commission as satisfying the adopted criteria will be posted on the Commission's website.

We agree with the commenter's suggestion that the non-exclusive attribute requiring that an indication that the individual holds the certification or designation be made publicly available by the relevant self-regulatory organization or other industry body should be expanded to include that the certification or designation could also be otherwise independently verifiable.⁹⁵ This addition will provide the Commission with flexibility as it considers whether to add future certifications or designations that are not publicly available but would be independently verifiable.

⁹⁵ See *supra* note 92.

We are also adopting a good-standing requirement, which was supported by many commenters addressing the requirement, but are not requiring that the individual practice in the fields related to the certification, except to the extent that continued affiliation with a firm is required to maintain the certification, designation, or credential.⁹⁶ We continue to believe that passing the requisite examinations and maintaining an active certification, designation, or license is sufficient to demonstrate the individual's financial sophistication to invest in exempt offerings, even when the individual is not practicing in an area related to the certification or designation. We also continue to believe that an inactive certification, designation, or license, particularly when the certification or designation has been inactive for an extended period of time, could lessen the validity of the certification or designation as a measure of financial sophistication. We are not, however, adopting a requirement that individuals holding qualifying credentials must practice in the fields related to the certifications or designations or that such individuals have practiced for a minimum number of years. We are concerned that adding such additional criteria would make it more difficult for financially sophisticated investors to demonstrate, and issuers and other market professionals to verify, accredited investor status, but would not provide significant additional protection for investors.

In connection with the adoption of this amendment, in a separate order, we are designating the General Securities Representative license (Series 7), the Private Securities Offerings Representative license (Series 82), and the Licensed Investment Adviser Representative (Series 65) as the initial certifications, designations, or credentials

⁹⁶ For example, an individual's registration as a general securities representative will lapse two years after the date that his or her employment with a FINRA member has been terminated. *See* FINRA Rule 1210.08. An individual who ceases to be employed by a FINRA member but whose registration remains current will continue to qualify as an accredited investor until such registration lapses.

designated by the Commission under Rule 501(a)(10). Of the various professional certifications, designations, and credentials on which we received comment, these received significant support. The Series 7 license qualifies a candidate “for the solicitation, purchase, and/or sale of all securities products, including corporate securities, municipal securities, municipal fund securities, options, direct participation programs, investment company products, and variable contracts.”⁹⁷ The Series 65 exam is designed to qualify candidates as investment adviser representatives and covers topics necessary for adviser representatives to understand to provide investment advice to retail advisory clients.⁹⁸ The Series 82 license qualifies candidates seeking to effect the sales of private securities offerings.⁹⁹

In light of the subject matter encompassed by these exams, and for the reasons stated above and in the Proposing Release, we believe that individuals who have passed these examinations and hold their certifications or designations in good standing have demonstrated a sufficient level of financial sophistication to participate in investment opportunities that do not have the additional protections provided by registration under the Securities Act. In this regard, we note that these certifications and designations are

⁹⁷ FINRA developed and administers the Series 7 examination. An individual must be associated with a FINRA member firm or other applicable self-regulatory organization member firm to be eligible to take the exam and be granted a license. *See* <https://www.finra.org/registration-exams-ce/qualification-exams/series7>.

⁹⁸ NASAA developed the Series 65 examination, and FINRA administers it. An individual does not need to be sponsored by a member firm to take the exam, and successful completion of the exam does not convey the right to transact business prior to being granted a license or registration by a state. *See* <https://www.nasaa.org/exams/study-guides/series-65-study-guide>.

⁹⁹ FINRA developed and administers the Series 82 examination. An individual must be associated with and sponsored by a FINRA member firm or other applicable self-regulatory organization member firm to be eligible to take the exam. *See* <https://www.finra.org/registration-exams-ce/qualification-exams/series82>.

required in order to represent or advise others in connection with securities market transactions.¹⁰⁰ To comply with the good standing requirement, the General Securities Representative license holder, the Private Securities Offerings Representative license holder,¹⁰¹ and the Licensed Investment Adviser Representative must have passed the required examinations and must maintain the individual's license or registration, as applicable, in good standing.¹⁰²

Issuers must take reasonable steps to verify whether an investor in a Rule 506(c) offering is an accredited investor. As a result, readily available information on whether an individual actively holds a particular certification or designation is useful in determining accredited investor status under Rule 501(a)(10). These certifications and designations have the advantage of being relatively easy to verify, while some other certifications and designations may be more difficult to verify. Issuers and other market participants will be able to obtain registration and licensing information about registered representatives and investment adviser representatives easily through FINRA's BrokerCheck¹⁰³ or the Commission's Investment Adviser Public Disclosure database.¹⁰⁴

The following table sets out an estimate of the number of individuals that may

¹⁰⁰ See Geraci Letter and AAPL Letter (noting that "such a [Series 7, 65, or 82] license enables them to evaluate investments on behalf of third parties, thus qualifying them to effectively evaluate investment opportunities on their own behalf as well").

¹⁰¹ To maintain their certifications and designations in good standing, General Securities Representatives and Private Securities Offerings Representatives are subject to continuing education requirements under FINRA rules.

¹⁰² As noted in note 98, the successful completion of the Series 65 exam does not convey the right to transact business prior to being granted a license or registration by a state. See also Proposing Release at 2581. To qualify as an accredited investor, a Licensed Investment Adviser Representative must maintain, in good standing, the individual's state-granted license or registration.

¹⁰³ See <https://brokercheck.finra.org>.

¹⁰⁴ See <https://www.adviserinfo.sec.gov/IAPD/Default.aspx>.

hold the certifications and designations described above:

Table 1 Estimated number of individuals holding specified certifications and designations

Certification/Designation	Number of Individuals
Registered Securities Representative	691,041 ¹⁰⁵
State Registered Investment Adviser Representative	17,543 ¹⁰⁶

The final rules will initially result in an increase in the number of individuals that qualify as accredited investors. However, we cannot estimate how many individuals that hold the relevant certifications and designations may already qualify as accredited investors under the current financial thresholds, and therefore we are unable to predict how many individuals will be newly eligible under the final rules.¹⁰⁷ As discussed below in Section VI.B, (1) we do not expect that number of newly eligible individual accredited investors to be significant compared to the number of individual investors that currently are eligible to participate in private offerings, and (2) we expect the amount of capital invested by such newly eligible individual investors to have minimal effects on the private offering market generally.¹⁰⁸ Moreover, as we stated in the Proposing Release, for purposes of updating the accredited investor definition, we believe it is less relevant

¹⁰⁵ As of December 2019. Of this number, 334,860 individuals were registered only as broker-dealers, 294,684 were dually registered as broker-dealers and investment advisers, and 61,497 were registered only as investment advisers. Because FINRA-registered representatives can be required to hold multiple professional certifications, this aggregation likely overstates, potentially significantly, the actual number of individuals that hold a Series 7 or Series 82, and we have no method of estimating the extent of overlap.

¹⁰⁶ As of December 2019.

¹⁰⁷ We also are not able to estimate how many newly-eligible individuals will seek to make investments as accredited investors.

¹⁰⁸ We note that new investment from newly eligible individual accredited investors may be significant in certain small offerings. See discussion in Section VI.C.5.

to focus on the number of individuals that will qualify and more relevant to consider whether the criteria applied appropriately capture the attributes of financial sophistication that is a touchstone of the definition.

Although other professional certifications, designations, and credentials, such as other FINRA exams, a specific accredited investor exam, other educational credentials, or professional experience received broad commenter support, we are taking a measured approach to the expansion of the definition and including only the Series 7, 65, and 82 in the initial order. While we recognize that there may be other professional certifications, designations, and credentials that indicate a similar level of sophistication in the areas of securities and investing, we believe it is appropriate to consider these other credentials after first gaining experience with the revised rules. However, as described above, the process we are adopting, by which the Commission may designate qualifying professional certifications, designations, and credentials by order, will provide the Commission with flexibility to designate other certifications, designations, or credentials if new certifications, designations, or credentials develop or are identified that are consistent with the specified criteria and that the Commission determines are appropriate. As a result, if an accredited educational institution, self-regulatory organization, or other industry body believes that it has a program of study or credential that fulfills the non-exclusive list of attributes enumerated in 501(a)(10), such institution or body may apply to the Commission for consideration as a qualifying professional certification or designation or credential under 501(a)(10). Similarly, members of the public may wish to propose to the Commission that a specific degree or program of study should be

included in the accredited investor definition.¹⁰⁹ Any such proposal does not need to be limited to a degree or program of study at a specific educational institution. Any such request for Commission consideration must address how a particular certification, designation, or credential satisfies the nonexclusive list of attributes set forth in the new rule, and may include additional information that the requestor believes the Commission may wish consider.

In addition, we are not adopting an amendment that would permit individuals to self-certify that they have the requisite financial sophistication to be an accredited investor. We agree with some of the concerns raised by commenters with respect to the lack of standards applicable to such an approach. We note that the Commission will have an opportunity to evaluate its experience with the revised rules in connection with its quadrennial review of the accredited investor definition.¹¹⁰

We expect that such reviews will examine not only professional certifications, designations, and credentials, but also the Commission's existing wealth tests. In this regard, to the extent that these certifications, designations, and credentials prove to be effective at capturing the attributes of financial sophistication that is the touchstone of the accredited investor definition, they may influence future consideration of any appropriate adjustment to the wealth tests.

b. Knowledgeable Employees of Private Funds

¹⁰⁹ In addition, the Commission's Investor Advisory Committee, Small Business Capital Formation Advisory Committee, and other advisory committees might assess the effectiveness of our approach and make further recommendations, including additional certifications, designations, or credentials that further the purpose of the accredited investor definition.

¹¹⁰ Section 413(b)(2)(A) states that this Commission review must be conducted not earlier than four years after the enactment of the Dodd-Frank Act and not less frequently than once every four years afterward. The next review is required to be conducted in or by 2023.

In the Proposing Release, the Commission proposed to add a category to the accredited investor definition that would enable “knowledgeable employees,” as defined in Rule 3c-5(a)(4) under the Investment Company Act, of a private fund to qualify as accredited investors for investments in the fund.¹¹¹ Rule 3c-5(a)(4) under the Investment Company Act defines a “knowledgeable employee” with respect to a private fund as: (i) an executive officer, director, trustee, general partner, advisory board member, or person serving in a similar capacity, of the private fund or an affiliated management person (as defined in Rule 3c-5(a)(1)) of the private fund; and (ii) an employee of the private fund or an affiliated management person of the private fund (other than an employee performing solely clerical, secretarial or administrative functions with regard to such company or its investments) who, in connection with his or her regular functions or duties, participates in the investment activities of such private fund, other private funds, or investment companies the investment activities of which are managed by such affiliated management person of the private fund, provided that such employee has been performing such functions and duties for or on behalf of the private fund or the affiliated management person of the private fund, or substantially similar functions or duties for or on behalf of another company for at least 12 months.

i. Comments

Commenters generally supported the proposal to add knowledgeable employees

¹¹¹ Private funds, such as hedge funds, venture capital funds, and private equity funds, are issuers that would be an investment company, as defined in Section 3 of the Investment Company Act, but for the exclusion from the definition of “investment company” in Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act. Private funds generally rely on Section 4(a)(2) and Rule 506 to offer and sell their interests without registration under the Securities Act.

of private funds to the definition of accredited investor,¹¹² with one commenter opposed to expanding the accredited investor definition to include these individuals.¹¹³

Several commenters recommended that we expand the definition of knowledgeable employee for purposes of determining accredited investors. For example, some commenters recommended that we include a broader pool of employees in the definition, such as analysts and contract administrators.¹¹⁴ Two commenters requested that we expand the definition of knowledgeable employee to include knowledgeable employees of managing entities.¹¹⁵ Another commenter stated that employees often invest in or through entities affiliated with their employer other than the fund itself, including, for example, the general partner or equivalent entity of the fund. This commenter requested that we permit knowledgeable employees to be accredited investors when acquiring securities of any affiliated management person of a private fund and any entity or vehicle that, directly or indirectly, primarily owns an interest in such private fund or affiliated management person.¹¹⁶ This commenter also recommended expanding

¹¹² See P. Rutledge Letter; J. LaBerge Letter; A. Naegele Letter; Geraci Letter; A. Hemmingsen Letter; letter from Stephen Clossick dated Dec. 31, 2019 (“S. Clossick Letter”); letter from Shaun Jolley dated Mar. 10, 2020 (“S. Jolley Letter”); IPA Letter; S. Moller Letter; ALTI Letter; CCMC Letter; SBIA Letter; Republic Letter; Better Markets Letter; AIC Letter; J. Na Letter; MFA and AIMA Letter; Cornell Sec. Clinic Letter; letter from Institutional Limited Partners Association dated Mar. 14, 2020 (“ILPA Letter”); Artivist Letter; ABA Fed. Reg. of Sec. Comm. Letter; and Geraci Letter and AAPL Letter.

¹¹³ See CA Attorney General et al. Letter (opposing the expansion of the accredited investor definition to include more individual investors).

¹¹⁴ See letter from S. Laughlin Letter dated Feb. 6, 2020 (“S. Laughlin Letter”) and S. Clossick Letter. In addition, one commenter suggested allowing knowledgeable employees of non-fund issuers to meet the definition of accredited investor (see P. Rutledge Letter), while others were opposed to including such employees (see D. Kui Letter and A. Naegele Letter).

¹¹⁵ See Geraci Letter and AAPL Letter. See also Republic Letter (supporting including knowledgeable employees of private funds in the definition and requesting clarification that principals and knowledgeable employees of investment advisers (whether registered or exempt) to private funds are included in the expanded definition).

¹¹⁶ See AIC Letter.

the definition of accredited investor to cover individuals investing in privately offered pooled investment vehicles that rely on an exemption other than Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act, where such individuals would be knowledgeable employees with respect to such vehicles (as defined in Rule 3c-5 under the Investment Company Act) if the vehicles were relying on Section 3(c)(1) or 3(c)(7). Several commenters also recommended expanding the definition of accredited investor to include all “qualified purchasers” as defined in Section 2(a)(51)(A) of the Investment Company Act.¹¹⁷

The Proposing Release requested comment on whether a knowledgeable employee’s accredited investor status should be attributed to his or her spouse and/or dependents when making joint investments in private funds for purposes of the accredited investor definition. Commenters that responded to this question generally supported this approach.¹¹⁸ For example, one commenter suggested attributing accredited investor status to joint investments with spouses or dependents, family corporates, or estate-planning vehicles.¹¹⁹ Another commenter suggested attributing accredited investor status to a knowledgeable employee’s spouse and/or dependents only when such investment decisions are jointly made with the agreement of all persons in the particular joint investment.¹²⁰

ii. Final Amendments

¹¹⁷ See AIC Letter; Calfee Letter; IAA Letter; ABA Fed. Reg. of Sec. Comm. Letter; and MFA and AIMA Letter.

¹¹⁸ See A. Hemmingsen Letter; AIC Letter; and J. Na Letter. One commenter opposed attributing a knowledgeable employee’s accredited investor status to his or her spouse and/or dependents when making joint investments in private funds. See A. Naegel Letter.

¹¹⁹ See AIC Letter.

¹²⁰ See J. Na Letter.

We are adopting, as proposed, the addition of a category to the accredited investor definition that will enable “knowledgeable employees” of a private fund to qualify as accredited investors for investments in the fund. The new category of accredited investor will be the same in scope as the definition of “knowledgeable employee” in Rule 3c-5(a)(4).¹²¹ It includes, among other persons, trustees and advisory board members, or persons serving in a similar capacity, of a Section 3(c)(1) or 3(c)(7) fund or an affiliated person of the fund that oversees the fund’s investments, as well as employees of the private fund or the affiliated person of the fund (other than employees performing solely clerical, secretarial, or administrative functions) who, in connection with the employees’ regular functions or duties, have participated in the investment activities of such private fund for at least 12 months.¹²² This category will be similar to the existing category for directors, executive officers, or general partners of the issuer (or directors, executive officers, or general partners of a general partner of the issuer).¹²³

As discussed in the Proposing Release, we believe that such employees, through their knowledge and active participation of the investment activities of the private fund, are likely to be financially sophisticated and capable of fending for themselves in

¹²¹ See Rule 501(a)(11).

¹²² The scope of the term “knowledgeable employee” in Rule 3c-5(a)(4) also includes executive officers, directors, and general partners, or persons serving in a similar capacity, of a Section 3(c)(1) or 3(c)(7) fund or an affiliated person of the fund that oversees the fund’s investments. For these persons, the new category for “knowledgeable employees” in the definition of “accredited investor” will overlap with the existing category in Rule 501(a)(4). A person is determined to be a knowledgeable employee at the time of investment. See Rule 3c-5(b)(1).

¹²³ Rule 501(a)(4). We are not modifying the definition to include knowledgeable employees of non-fund issuers, as suggested by one commenter, in light of this existing category set forth in Rule 501(a)(4), which is applicable to non-fund and fund issuers.

evaluating investments.¹²⁴ These employees, by virtue of their position with the fund, are presumed to have meaningful investing experience and sufficient access to the information necessary to make informed investment decisions about the fund's offerings. Allowing these employees to invest in the funds for which they work (and other funds managed by their employer) as accredited investors also may help to align their interests with those of other investors in the fund.

We are not modifying this definition to include additional types of employees as suggested by commenters. We continue to believe that the existing definition of knowledgeable employee accurately captures non-executive employees with sufficient knowledge and expertise to participate in investment opportunities that do not have the additional protections provided by registration under the Securities Act. We also believe issuers will benefit from the consistency with the current knowledgeable employee definition. The definition is intended to cover non-executive employees only if they actively participate in the investment activities of the fund, any other private fund or any investment company the investment activities of which are managed by the fund's affiliated management person. We believe that participating in the management of a fund's investments is what gives the employee sufficient knowledge and expertise to participate in investment opportunities that do not have the additional protections provided by registration under the Securities Act. Whether any particular employee is one who participates in the investment activities of a fund is a determination that must be made on a case-by-case basis.

¹²⁴ As is the case under Rule 3c-5(a)(4), the scope of "knowledgeable employees" under this proposed amendment will not include employees who simply obtain information but do not participate in the investment activities of the fund.

We generally believe that many employees of managing entities are likely included in the knowledgeable employee definition through the concept of “affiliated management persons” (as defined by Rule 3c-5 under the Investment Company Act) and existing language in the knowledgeable employee definition that includes persons who in connection with their regular functions or duties, participate in the investment activities of the fund, or other funds or investment companies the investment activities of which are managed by affiliated management persons of the fund.¹²⁵ Rule 501(a)(11) does not limit accredited investor status to only those knowledgeable employees making investments in the private fund of which they participate in the management. In addition, because the definition of knowledgeable employee is intended to capture individuals who do not need the protection of the Securities Act when investing in private funds, we do not see a need to expand the definition to accommodate arrangements where employees invest in entities other than private funds.

The inclusion of knowledgeable employees in the definition of “accredited investor” will also allow these employees to invest in the private fund without the fund itself losing accredited investor status when the fund has assets of \$5 million or less. Under Rule 501(a)(8), private funds with assets of \$5 million or less may qualify as accredited investors if all of the fund’s equity owners are accredited investors.¹²⁶ Unless they qualify as accredited investors, these small private funds could be excluded from

¹²⁵ See Rule 3c-5(a)(1) (defining “affiliated management person”). For purposes of Rule 3c-5(a)(1), an investment adviser to a private fund is an affiliated management person of the fund to the extent that the investment adviser, whether registered or not, manages the fund’s investment activities.

¹²⁶ A private fund may qualify as an accredited investor if it holds total assets in excess of \$5 million and is a corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered. A private fund may also be able to qualify as an accredited investor if it is a trust with total assets in excess of \$5 million that was not formed for the specific purpose of acquiring the securities offered, and the purchase is directed by a sophisticated person.

participating in some offerings under Rule 506 that are limited to accredited investors. Amending the accredited investor definition in this manner will allow knowledgeable employees to invest in these small private funds as accredited investors, while permitting the funds to remain eligible to qualify as accredited investors under Rule 501(a)(8) and potentially participate in certain offerings under Rule 506 in which they would not otherwise be eligible to participate.

We believe Congress's intent to apply the spousal joint interest position in Section 2(a)(51)(A)(i) of the Investment Company Act should also apply to a knowledgeable employee and his or her spouse in the context of accredited investor status under Rule 501(a)(11).¹²⁷ We therefore believe it is appropriate to attribute a knowledgeable employee's accredited investor status to his or her spouse with respect to joint investments made by the knowledgeable employee and his or her spouse in a private fund.¹²⁸

After considering comments, we are not modifying the definition of accredited investor to include "qualified purchasers" as defined in Section 2(a)(51)(A) of the Investment Company Act. Most qualified purchasers already meet the definition of

¹²⁷ This is consistent with the American Bar Association Section of Business Law, SEC Staff No-Action Letter (Apr. 22, 1999) ("ABA Letter"). In the ABA Letter, staff stated that it would not recommend enforcement action under Section 7 of the Investment Company Act if a knowledgeable employee and his or her spouse who is not a knowledgeable employee (or a qualified purchaser) invest jointly in a Section 3(c)(7) fund. The staff took this position because it believed Congress's intent to apply the spousal joint interest position should apply in the context of Rule 3c-5.

¹²⁸ We do not believe it is appropriate to attribute a knowledgeable employee's accredited investor status to joint investments other than those held with the knowledgeable employee's spouse. This is consistent with the Commission's position with respect to qualified purchasers. Under Section 2(a)(51)(A)(i) of the Investment Company Act, a spouse who is not a qualified purchaser can hold a joint interest in a Section 3(c)(7) fund with his or her qualified purchaser spouse. However, dependents of a qualified purchaser who are not themselves qualified purchasers may not hold a joint interest in a Section 3(c)(7) fund with the qualified purchaser. *See* ABA Letter. *See also* Privately Offered Investment Companies, Release No. IC-22597 (Apr. 3, 1997) [62 FR 17512 (Apr. 9, 1997).]

accredited investor by virtue of the higher financial thresholds required to qualify as a qualified purchaser.¹²⁹ While there may be limited circumstances where this is not the case, we do not believe it is appropriate at this time to further extend the accredited investor definition to include qualified purchasers, given that the “accredited investor” standard and “qualified purchaser” standard are distinct standards that each serves a different regulatory purpose.¹³⁰

We are not able to estimate the number of individuals that will qualify as accredited investors under the amendment to the definition. Using data on private fund statistics compiled by the Commission’s Division of Investment Management, we estimate that there were 32,620 private funds as of second quarter 2019.¹³¹ However, we lack data on the number of knowledgeable employees per fund. We also cannot estimate how many individuals that meet the definition of “knowledgeable employee” may already qualify as accredited investors under the current financial thresholds.

2. Entities

In the Proposing Release, the Commission proposed to amend the definition of accredited investor to add several categories of entities: SEC- and state-registered investment advisers, rural business investment companies, limited liability companies, family offices, family clients, and a catch all category.

a. Registered Investment Advisers

The Commission proposed to include in Rule 501(a)(1) investment advisers

¹²⁹ See Section 2(a)(51) of the Investment Company Act.

¹³⁰ See *supra* note 8.

¹³¹ See <https://www.sec.gov/divisions/investment/private-funds-statistics/private-funds-statistics-2019-q2.pdf>.

registered under Section 203 of the Advisers Act¹³² and investment advisers registered under the laws of the various states. The Proposing Release also requested comment on whether exempt reporting advisers should qualify as accredited investors.¹³³

i. Comments

Several commenters supported adding SEC- and state-registered investment advisers to the definition of accredited investor.¹³⁴ Commenters supporting their inclusion generally stated that registered investment advisers have the investment acumen to make allocations of capital and discern among investments, including in the private placement market.¹³⁵ While no commenters indicated they opposed this addition, one commenter recommended that the Commission narrow the definition to include only advisory firms, and not natural persons who are registered investment advisers.¹³⁶ This commenter expressed the view that natural persons should be evaluated under the wealth tests that apply to individuals. Other commenters, on the other hand, recommended that the Commission expand the definition to include exempt reporting advisers, noting that exempt reporting advisers are professionals managing either venture capital funds or

¹³² See Section 203 of the Advisers Act (15 U.S.C. 80b-3).

¹³³ An exempt reporting adviser is an investment adviser that qualifies for the exemption from registration under Section 203(l) of the Advisers Act because it is an adviser solely to one or more venture capital funds, or under Rule 203(m)-1 of the Advisers Act because it is an adviser solely to private funds and has assets under management in the United States of less than \$150 million. See Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than \$150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers Act Release No. 3222 (June 22, 2011) [76 FR 39646 (July 6, 2011)].

¹³⁴ See P. Rutledge Letter; A. Hemmingsen Letter; CFA Letter; Mercer Advisors Letter; CCMC Letter; SBIA Letter; NASAA Letter; letter from Financial Planning Coalition dated Mar. 16, 2020 (“FPC Letter”); IWI Letter; and D. Burton Letter.

¹³⁵ See, e.g., CCMC Letter and A. Hemmnigsen Letter.

¹³⁶ See NASAA Letter.

small investment funds as a business.¹³⁷

ii. Final Amendments

We are adopting the amendment with certain modifications from our proposal. We believe that registered investment advisers, including those that are sole proprietorships, have the requisite financial sophistication needed to conduct meaningful investment analysis. As discussed in the Proposing Release, registered investment advisers are generally considered to be institutional investors under state law, and we see no compelling reason to distinguish SEC- and state-registered investment advisers acting for their own account from other institutional investors already treated as accredited investors.¹³⁸

As a result, we believe it is appropriate to extend accredited investor status to all SEC- and state-registered investment advisers. We estimate that there are currently approximately 13,400 SEC-registered investment advisers and approximately 17,500 state-registered investment advisers.¹³⁹ We are not able to estimate, however, how many of those SEC- or state-registered investment advisers meet the \$5 million assets test under Rule 501(a)(3) and therefore currently qualify as accredited investors.

After considering comments, we also believe it is appropriate to include exempt reporting advisers in the definition of accredited investor. We believe exempt reporting

¹³⁷ See P. Rutledge Letter and A. Hemmingsen Letter.

¹³⁸ See Proposing Release at 2586 (describing the inclusion of certain institutional investors in the definition of accredited investor, including banks, insurance companies, certain employee benefit plans, investment companies, small business investment companies (“SBICs”), savings and loan associations, credit unions, and registered broker-dealers).

¹³⁹ Of these, 72 SEC-registered investment advisers are sole proprietorships and 1,712 advisers registered with one or more states are sole proprietorships. We do not believe sole proprietorships should be distinguished from other registered investment advisers for purposes of determining accredited investor status.

advisers, as advisers to private funds, have the requisite financial sophistication needed to conduct meaningful investment analysis. To qualify as an exempt reporting adviser under Section 203(m) or Section 203(l) of the Advisers Act, an adviser would otherwise be required to register as an investment adviser with the Commission and thereby meet the minimum asset thresholds triggering such requirement.¹⁴⁰ Additionally, private funds themselves are institutional investors and all investors therein are presumed to be financially sophisticated. We estimate that there are currently approximately 4,244 exempt reporting advisers.¹⁴¹ We are not able to estimate, however, how many of those exempt reporting advisers may meet the \$5 million assets test under Rule 501(a)(3) and therefore currently qualify as accredited investors.

b. Rural Business Investment Companies

The Commission proposed to include rural business investment companies (“RBIC”) in Rule 501(a)(1). A RBIC is defined in Section 384A of the Consolidated Farm and Rural Development Act¹⁴² as a company that is approved by the Secretary of Agriculture and that has entered into a participation agreement with the Secretary.¹⁴³ RBICs are intended to promote economic development and the creation of wealth and job

¹⁴⁰ Advisers must apply for registration with the SEC if their regulatory assets under management are at least \$110 million or if they have regulatory assets under management of at least \$25 million but less than \$100 million and meet one of the requirements to be classified as a “mid-sized adviser.” *See* Section 203A(a)(2) of the Advisers Act. *See also* Form ADV: Instructions for Part 1A, instr. 2.b.

¹⁴¹ Exempt reporting advisers are required to submit, and periodically update, reports on Form ADV. *See* Rule 204-4 under the Advisers Act.

¹⁴² 7 U.S.C. 2009cc.

¹⁴³ *See* Pub. L. 115-417 (2019). To be eligible to participate as an RBIC, the company must be a newly formed for-profit entity or a newly formed for-profit subsidiary of such an entity, have a management team with experience in community development financing or relevant venture capital financing, and invest in enterprises that will create wealth and job opportunities in rural areas, with an emphasis on smaller enterprises. *See* 7 U.S.C. 2009cc-3(a).

opportunities in rural areas and among individuals living in such areas.¹⁴⁴ Their purpose is similar to the purpose of small business investment companies (“SBICs”), which are intended to increase access to capital for growth stage businesses.¹⁴⁵ Because SBICs and RBICs share the common purpose of promoting capital formation in their respective sectors, advisers to SBICs and RBICs are treated similarly under the Advisers Act in that they have the opportunity to take advantage of expanded exemptions from investment adviser registration.¹⁴⁶ SBICs are already accredited investors under Rule 501(a)(1) and the Commission proposed to include RBICs as accredited investors under Rule 501(a)(1).

i. Comments

Several commenters supported adding RBICs to the definition of accredited investor,¹⁴⁷ while no commenters opposed the addition. Some commenters stated that including RBICs would serve as a critical source of capital for rural communities.¹⁴⁸ One commenter further stated that including RBICs would reduce a significant burden that has limited their ability to invest in private businesses.¹⁴⁹ Commenters also agreed that

¹⁴⁴ See <http://www.rd.usda.gov/programs-services/rural-business-investment-program>.

¹⁴⁵ A SBIC is a type of privately owned and managed investment fund that is licensed and regulated by the U.S. Small Business Administration (“SBA”). A SBIC uses its own capital, plus funds borrowed with an SBA guarantee, to make equity and debt investments in qualifying small businesses. See <https://www.sba.gov/partners/sbics>.

¹⁴⁶ Advisers to solely RBICs and advisers to solely SBICs are exempt from investment adviser registration. See Advisers Act Sections 203(b)(8) and 203(b)(7), respectively. The venture capital fund adviser exemption deems RBICs and SBICs to be venture capital funds for purposes of the exemption. See 15 U.S.C. 80b-3(l). The private fund adviser exemption excludes the assets of RBICs and SBICs from counting towards the \$150 million threshold. 15 U.S.C. 80b-3(m). See also Exemptions from Investment Adviser Regulation for Advisers to Certain Rural Business Investment Companies, Investment Advisers Act Release No. 5454 (Mar. 2, 2020) [85 FR 13734 (Mar. 10, 2020)].

¹⁴⁷ See P. Rutledge Letter; SBIA Letter; NASAA Letter; CCMC Letter; D. Burton Letter; and ABA Fed. Reg. of Sec. Comm. Letter.

¹⁴⁸ See CCMC Letter and SBIA Letter.

¹⁴⁹ See SBIA Letter.

RBICs and SBICs should be treated in the same manner and therefore agreed that RBICs also should be accredited investors.¹⁵⁰

ii. Final Amendments

We are adopting the amendment as proposed. Because of their common purpose and similar treatment under other federal securities laws, we believe that SBICs and RBICs should be treated similarly under the Securities Act. As SBICs are already accredited investors under Rule 501(a)(1), we continue to believe that RBICs should be included as accredited investors under Rule 501(a)(1).

c. Limited Liability Companies

Rule 501(a)(3) sets forth the following types of entities that qualify for accredited investor status if they have total assets in excess of \$5 million and were not formed for the specific purpose of acquiring the securities being offered: organizations described in Section 501(c)(3) of the Internal Revenue Code, corporations, Massachusetts or similar business trusts, and partnerships.¹⁵¹ Though this list does not include limited liability companies, which have become a widely adopted corporate form since the Commission last updated the accredited investor rules in 1989 to include additional entities,¹⁵² a longstanding staff position has been that limited liability companies satisfying the other requirements of the definition are eligible to qualify as accredited investors under Rule 501(a)(3).¹⁵³

¹⁵⁰ See SBIA Letter and D. Burton Letter.

¹⁵¹ See Rule 501(a)(3).

¹⁵² See Regulation D, Release No. 33-6825 (Mar. 15, 1989) [54 FR 11369 (Mar. 20, 1989)].

¹⁵³ See Division of Corporation Finance interpretive letter to Wolf, Block, Schorr and Solis-Cohen (Dec. 11, 1996); and question number 255.05 of Securities Act Rules Compliance and Disclosure Interpretations, available at <https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm>.

i. Comments

Several commenters supported adding LLCs,¹⁵⁴ while no commenters opposed the addition. One commenter also suggested that the Commission include “any similar business entity in order to encompass any new form of entity that might be created in the future and thus avoid the problem that has existed with respect to LLCs.”¹⁵⁵ The Proposing Release also requested comment on whether the Commission should amend its rules to specifically include all managers of limited liability companies as executive officers under Rule 501(f) or whether the rule should be limited to managing members, thereby precluding third-party managers from being considered executive officers under Rule 501(f). Several commenters supported allowing any manager of a limited liability company to qualify as an “executive officer” under Rule 501(f).¹⁵⁶ One commenter stated that it did not believe naming managers was necessary because “they are already covered, to the extent appropriate, by the term ‘executive officer’ as a ‘person who performs similar policy making functions.’”¹⁵⁷

ii. Final Amendments

We are adopting the amendment as proposed. We continue to believe that limited liability companies that meet the requirements of Rule 501(a)(3), including the assets test,

¹⁵⁴ See P. Rutledge Letter; letter from Farrell Fritz PC dated Jan. 13, 2020 (“Farrell Fritz Letter”); Md St. Bar Assn. Comm. on Sec. Laws Letter; CCMC Letter; SBIA Letter; NASAA Letter; MFA and AIMA Letter (stating that “[w]e believe these changes[, including adding LLCs and the catch-all provision,] are appropriate and will provide objective, bright-line standards for issuers to determine whether certain types of entities qualify as accredited investors”); D. Burton Letter; ABA Fed. Reg. of Sec. Comm. Letter.

¹⁵⁵ See ABA Fed. Reg. of Sec. Comm. Letter (positing that “the concern identified in the Proposing Release regarding other entities, like government bodies for which an asset would not be meaningful, would be addressed”).

¹⁵⁶ See Farrell Fritz Letter; CCMC Letter; D. Burton Letter; and ABA Fed. Reg. of Sec. Comm. Letter.

¹⁵⁷ See ABA Fed. Reg. of Sec. Comm. Letter.

should be considered to have the requisite financial sophistication to qualify as accredited investors. Based on data from the Internal Revenue Service, there were 2,696,149 limited liability companies at the end of 2017.¹⁵⁸ However, due to a lack of more detailed publicly available information about limited liability companies, such as the distribution of total assets across companies, we are unable to estimate the number of these limited liability companies that meet the requirements of Rule 501(a)(3). As this amendment is a codification of a long standing staff interpretation, we do not expect that the pool of accredited investors will change significantly as a result of this amendment.

As the Commission noted in the Proposing Release, Rule 501(a)(4) includes as an accredited investor any director, executive officer, or general partner of the issuer of the securities being offered or sold. The term “executive officer” is defined in Rule 501(f) as “the president, any vice president in charge of a principal business unit, division or function, as well as any other officer who performs a policy making function, or any other person who performs similar policy making functions for the issuer.” Regarding whether to list managers in 501(f) or which managers should be included, while we continue to believe that managers of limited liability companies, through their knowledge and management of the issuer, are likely to be financially sophisticated and capable of fending for themselves in evaluating investments in the limited liability company’s securities, we also continue to believe that such a manager performs a policy making function for the issuer equivalent to that of an executive officer of a corporation under Rule 501(f), and therefore we do not believe it is necessary to amend Rule 501(a)(4) or

¹⁵⁸ See IRS, Statistics of Income Division, Partnerships, May 2019, Table 8, *available at* <https://www.irs.gov/pub/irs-soi/17pa08.xlsx>. See also D. Burton Letter.

Rule 501(f) to specifically include managers of limited liability companies. Further, consistent with the views of commenters on this issue, we do not believe that it is necessary to distinguish between member managers and third-party managers, as either could be considered an executive officer under Rule 501(f).

We are not expanding Rule 501(a)(3) to include any similar business entity, as suggested by a commenter. As discussed below, we believe the new catch-all category for entities in Rule 501(a)(9), which includes an investments test, appropriately addresses new entity types that may be created in the future.

d. Other Entities Meeting an Investments-Owned Test

Certain types of entities, such as Indian tribes, labor unions, governmental bodies and funds, and entities organized under the laws of a foreign country, are not included in the accredited investor definition. The Commission proposed to add a new category in the accredited investor definition for any entity owning “investments,” as that term is defined in Rule 2a51-1(b) under the Investment Company Act, in excess of \$5 million that is not formed for the specific purpose of acquiring the securities being offered.¹⁵⁹ The Commission indicated in the Proposing Release that the intent of this new category was 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.

To assist both issuers and investors, the Commission proposed to incorporate the definition of investments from Rule 2a51-1(b) under the Investment Company Act, which includes, among other things: securities; real estate, commodity interests, physical

¹⁵⁹ Rule 501(a)(9).

commodities, and non-security financial contracts held for investment purposes; and cash and cash equivalents.¹⁶⁰ By using an existing definition, the Commission indicated that it hoped to alleviate confusion and facilitate compliance.

i. Comments

Many commenters supported adding a catch-all category for entities to the definition.¹⁶¹ No commenter specifically objected, although one commenter indicated that it opposed including governmental bodies and Indian tribes in the catch-all category because entities funded by taxpayers should not be given accredited investor status when “[t]axpayers themselves would not likely qualify under existing restrictions.”¹⁶² A few commenters suggested that the Commission clarify the types of entities to be included in the catch-all category,¹⁶³ with two commenters suggesting specific enumerated lists that include Indian tribes and their various instrumentalities.¹⁶⁴ To maintain flexibility and to

¹⁶⁰ See Rule 2a51–1(b), which was adopted by the Commission in Privately Offered Investment Companies, Release No. IC–22597 (Apr. 3, 1997) [62 FR 17512 (April 9, 1997)].

¹⁶¹ See letter from California Municipal Treasurers Association Legislative Committee dated Feb. 12, 2020 (“CMTA Letter”); letter from Arnold Porter Kaye Scholer LLP dated Feb. 14, 2020 (“Arnold & Porter Letter”); letter from National Association of State Treasurers et al. dated Feb. 27, 2020 (“NAST et al. Letter”); A. Hemmingsen Letter; letter from Southern Ute Indian Tribe dated Mar. 3, 2020 (“Southern Ute Letter”); NAFOA Letter; ICI Letter; TIAA Letter (stating that the Commission should “clarify in its final rule that the phrase “governmental bodies” should be construed broadly to include a comprehensive range of state, territorial, and local governmental entities, as well as U.S. government agencies and departments, sovereign governments recognized by the United States and sovereign investment funds, and funds, pools, and endowments established by U.S. federal, state, and local governments for a specified purpose and subject to control by a government officer, board, or similar body”); NASAA Letter; letter from PFM Asset Management LLC dated Mar. 16, 2020 (“PFM Letter”); MFA and AIMA Letter; Better Markets Letter; SIFMA Letter; CCMC Letter; SBIA Letter; letter from California Association of County Treasurers and Tax Collectors dated Feb. 14, 2020 (“CACTTC Letter”); Artivist Letter; and ABA Fed. Reg. of Sec. Comm. Letter.

¹⁶² See letter from Vulcan Consultants, LLC dated Feb. 17, 2020 (“Vulcan Letter”) (stating that “adding to the risk profile in hopes of increased returns only serves to encourage government entities to keep more taxpayer funds in city hall rather than returning them to their rightful owner—the taxpayer”).

¹⁶³ See Arnold & Porter Letter; ICI Letter; PFM Letter; Southern Ute Letter; and NAFOA Letter.

¹⁶⁴ See Southern Ute Letter and NAFOA Letter.

allow for new entity types to be included within the accredited investor definition, another commenter suggested that the Commission describe in the text of the release the types of entities to be included instead of enumerating entity types in the rule.¹⁶⁵ One commenter suggested that the Commission use the term “person,” as defined in Section 2(a)(2) of the Securities Act instead of “entity,” in order to clarify that governmental funds would be included in this new category.¹⁶⁶

The Proposing Release requested comment on whether any restrictions should be applied with respect to entities covered by proposed Rule 501(a)(9), such as restrictions on entities organized or incorporated under the laws of a foreign country. Two commenters responded that they did not support restrictions,¹⁶⁷ one of whom noted that international investment should not be discouraged.¹⁶⁸ In addition, two commenters noted that Indian tribes are not foreign governments or countries.¹⁶⁹

Regarding the use of an investments test for this category of institutional

¹⁶⁵ See Arnold & Porter Letter (suggesting the following list: “State, Commonwealth or Territory of the United States, the District of Columbia, Puerto Rico, Guam, the U.S. Virgin Islands, and any county or subdivision thereof; ‘Municipal government entity’ as that term is defined in Section 15B(8) of the Securities Exchange Act of 1934 and regulations thereunder, including, without limitation, a state government, county government or city government; United States government branch, agency, department or unit; Federal or state-recognized tribe within the United States; Foreign sovereign government recognized by the United States government; Multi-lateral agency such as those listed in 17 C.F.R. 230.902(k)(2)(vi); Subdivision, department, agency, bureau or other formally-constituted body of a municipal government entity, United States federal government entity, or foreign sovereign entity that is recognized by the United States; Sovereign investment fund; or Fund, pool or endowment, established by a federal, state, local, tribal or foreign government pursuant to a Constitution, statute, regulation, executive order, or treaty, for a specified use or purpose, subject to oversight and control by a government officer, board or similar governing body with the powers to contract and to litigate”).

¹⁶⁶ See letter from Oregon State Treasury dated Mar. 16, 2020 (“OST Letter”) (recommending the use of Section 2(a)(2)’s “person” because it “is not wholly clear whether all state and local governmental funds are completely separate ‘entities’ in a legal sense”). In the alternative, this commenter suggested that “unincorporated organization, or governmental or political subdivision thereof” be added after “entity.”

¹⁶⁷ See Arnold & Porter Letter and D. Burton Letter.

¹⁶⁸ See D. Burton Letter.

¹⁶⁹ See NAFOA Letter and Southern Ute Letter.

investors, the Proposing Release sought comment on several topics. The Commission requested comment on whether an investments test or an asset test was appropriate. A few commenters supported an asset test over an investments test,¹⁷⁰ noting that an asset test is already used in the accredited investor definition. One commenter supported an investment test, noting that an investment test “demonstrates that an entity has sufficient investment experience and financial sophistication,”¹⁷¹ and a few other commenters supported either test.¹⁷² The Commission also requested comment on whether \$5 million in investments is the appropriate threshold. A few commenters stated that \$5 million is an appropriate threshold,¹⁷³ while one commenter supported a \$10 million threshold.¹⁷⁴ One commenter took no position on a threshold but noted that it did not support a “substantial increase” in the amount proposed,¹⁷⁵ and no commenters indicated support for a lower threshold.

The Commission also requested comment on whether using the definition of investments from Rule 2a51-1(b) under the Investment Company Act was appropriate. A

¹⁷⁰ See Southern Ute Letter; MFA and AIMA Letter; and D. Burton Letter.

¹⁷¹ See Artinvest Letter (noting that “[w]e agree with the Commission’s view, with respect to the \$5 million catch-all for entities described above, that an investment test is appropriate as it demonstrates that an entity has sufficient investment experience and financial sophistication to automatically qualify as an accredited investor”).

¹⁷² See Arnold & Porter Letter (stating that “[i]n the case of governmental entities, the test (whether investments or assets) should include investment (or assets) of related governmental entities if either: (a) they are consolidated into the same financial reporting unit for governmental accounting standards; or (b) they are managed by the same office or officer of the broader government of which they are a part”) and NAFOA Letter.

¹⁷³ See Arnold & Porter Letter; NAFOA Letter; and Artinvest Letter.

¹⁷⁴ See NASAA Letter.

¹⁷⁵ See Southern Ute Letter (noting that the “Tribe does not take a position on whether \$5 million in investments or assets is the appropriate threshold, although it would not support a substantial increase in the threshold”).

few commenters stated that using the definition from Rule 2a51-1(b) was appropriate,¹⁷⁶ while a few commenters indicated it was not.¹⁷⁷ Two commenters noted that the use of the terms “Prospective Qualified Purchaser” and “qualified purchaser” in the definition of investments has the potential to confuse.¹⁷⁸ Given the presence of the qualified-purchaser-specific terminology in the definition of “investments,” these commenters sought clarification on the use of the term “investments” in the accredited investor context.

ii. Final Amendments

We are adopting the amendment as proposed. Consistent with the support of many commenters, we are adopting the amendment to add a new category to the accredited investor definition that includes any entity owning “investments,” as that term is defined in Rule 2a51-1(b) under the Investment Company Act, in excess of \$5 million that is not formed for the specific purpose of acquiring the securities being offered.¹⁷⁹ While we agree with some commenters that clarification of the types of entities included in the new category is warranted, we do not believe that enumerating a list of entities in the rule is necessary. Instead, we reiterate that the intent of this new category is to capture all entity types not already included in the definition of accredited investor as

¹⁷⁶ See P. Rutledge Letter (noting that the use of the term “gives certainty as to what assets held by the entity qualify for purposes of being deemed an accredited investor”) and A. Hemmingsen Letter (stating that “[a]n important feature of Rule 2a51-1(b) is its inclusion of binding capital commitments. This inclusion is an important facilitator for funds structured as draw down vehicles”).

¹⁷⁷ See Southern Ute Letter (noting that “the definition of ‘investments’ from Section 270.2a51-1 currently applies in the context of establishing status as a ‘qualified purchaser’ under the [Investment Company Act],” which “complicates the application of this definition to a determination of ‘accredited investor’ status . . .”) and D. Burton Letter (noting that “[u]sing assets [instead of investments] as defined by generally accepted accounting principles would eliminate most ambiguity”).

¹⁷⁸ See Southern Ute Letter and NAFOA Letter.

¹⁷⁹ Rule 501(a)(9).

well as those entity types that may be created in the future. We believe the term “entity” is sufficiently broad in this context to encompass Indian tribes and the divisions and instrumentalities thereof, federal, state, territorial, and local government bodies, funds of the types identified by commenters, and entities organized or under the laws of foreign countries.

We do not agree with commenters who suggested substituting an asset test for the investment test. We continue to believe that requiring more than \$5 million in investments instead of assets for this catch-all category of entities may better demonstrate that the investor has experience in investing and is therefore more likely to have a level of financial sophistication similar to that of other institutional accredited investors. Certain types of entities covered by the amendment, such as governmental entities, may have more than \$5 million in non-financial assets such as land, buildings, and vehicles, but not have any investment experience. We continue to believe that an investments test may be more likely than an assets-based test to serve as a reliable method for ascertaining whether an entity is likely to require the protections of Securities Act registration. We also believe that \$5 million in investments is an appropriate threshold that demonstrates the investor’s experience in investing. Although one commenter suggested a \$10 million threshold, we are not persuaded that setting the threshold at double the amount applicable under the assets test for other institutional accredited investors is warranted in order to illustrate a similar level of financial sophistication.

We are applying the definition of investments from Rule 2a51-1(b) under the Investment Company Act to Rule 501(a)(9), as proposed. We believe that the use of an existing definition will facilitate compliance and alleviate confusion. We do not believe

that additional guidance is necessary to enable market participants to apply this definition in the accredited investor context, notwithstanding the use of the terms “Prospective Qualified Purchaser” and “qualified purchaser” in the definition of “investments.”

e. Certain Family Offices and Family Clients

In the Proposing Release, the Commission proposed to add new categories to the accredited investor definition for certain “family offices” and “family clients of family offices.” “Family offices” are entities established by families to manage their assets, plan for their families’ financial future, and provide other services to family members. The Commission has previously observed that single family offices generally serve families with at least \$100 million or more of investable assets.¹⁸⁰ Family offices generally meet the definition of “investment adviser” under the Advisers Act, as the Commission has interpreted the term, because, among the variety of services provided, family offices are in the business of providing advice about securities for compensation. However, the Commission adopted the “family office rule”¹⁸¹ in 2011 to exclude single family offices from regulation under the Advisers Act under certain conditions.¹⁸² Under that rule, a family office generally is a company that has no clients other than “family clients.”¹⁸³

¹⁸⁰ See Family Offices, Release No. IA-3098 (Oct. 12, 2010) [75 FR 63753 (Oct. 18, 2010)] (“Family Office Proposing Release”). See also Proposing Release at note 158.

¹⁸¹ 17 CFR 275.202(a)(11)(G)-1.

¹⁸² See Family Offices, Release No. IA-3220 (June 22, 2011) [76 FR 37983 (June 29, 2011)] (“Family Office Adopting Release”). See also Family Office Proposing Release (“We viewed the typical single family office as not the sort of arrangement that Congress designed the Advisers Act to regulate. We also were concerned that application of the Advisers Act would intrude on the privacy of family members. . . . The Act was not designed to regulate the interactions of family members in the management of their own wealth”).

¹⁸³ A family office also (1) must be wholly owned by family clients and exclusively controlled (directly or indirectly) by one or more family members or family entities (each as defined in the rule), and (2) must not hold itself out to the public as an investment adviser. See Rule 202(a)(11)(G)-1(b) under the Advisers Act.

“Family clients” generally are family members, former family members, and certain key employees of the family office, as well as certain of their charitable organizations, trusts, and other types of entities.¹⁸⁴

In the Proposing Release, the Commission proposed that for a family office to qualify as an accredited investor, it would need to have more than \$5 million in assets under management and its investments would need to be directed by a person who has such knowledge and experience in financial and business matters that such family office would be capable of evaluating the merits and risks of the prospective investment.

i. Comments

Commenters generally supported the proposed amendments to the definition of accredited investor to include any “family office” with more than \$5 million in assets under management,¹⁸⁵ and no commenters opposed the amendments. One commenter noted that under the current regulatory scheme, depending on their organizational structure, many family offices are already able to meet the definition of an accredited investor, and establishing a clear standard would allow family offices to manage family assets more prudently and make issuers more comfortable working with family office

¹⁸⁴ For a full list of family clients, *see* 17 CFR 275.202(a)(11)(G)-1(d)(4). The family office rule defines a “family member” to include “all lineal descendants (including by adoption, stepchildren, foster children, and individuals that were a minor when another family member became a legal guardian of that individual) of a common ancestor (who may be living or deceased), and such lineal descendants’ spouses or spousal equivalents; provided that the common ancestor is no more than 10 generations removed from the youngest generation of family members.” 17 CFR 275.202(a)(11)(G)-1(d)(6).

¹⁸⁵ *See* J. LaBerge Letter; M. Trudeau Letter; SBIA Letter; ILPA Letter; CCMC Letter; Carta Letter; AIC Letter; PIC Letter; Artivest Letter. One commenter also recommended that the Commission provide an exemption from the definition of “investment company” under the Investment Company Act for family offices and their family clients. *See* PIC Letter. This rulemaking is intended to amend the definition of accredited investor under the Securities Act. Accordingly, the suggested exemption from the definition of investment company is beyond the scope of this rulemaking.

investors.¹⁸⁶

Several commenters supported the proposed requirement that qualifying family offices have more than \$5 million in assets under management.¹⁸⁷ While no commenters disagreed with the proposal to require that family offices have a minimum amount of assets under management, one commenter proposed increasing the minimum to \$10 million.¹⁸⁸ The commenter stated that this higher threshold would be more likely to capture investors who can reasonably be expected to have the sophistication and ability to withstand economic losses as to enable them to fend for themselves.

Commenters generally supported the requirement that the family office's prospective investments be directed by a person who has such knowledge and experience in financial and business matters that such family office is capable of evaluating the merits and risks of the prospective investment,¹⁸⁹ noting that the underlying premise of the amendments is that family offices and their professionals have the knowledge, experience and sophistication to apply to investment decisions, even though a family client may not.¹⁹⁰

On the other hand, one commenter opposed the inclusion of the knowledge and experience requirement under proposed Rule 501(a)(12)(iii).¹⁹¹ The commenter

¹⁸⁶ See M. Trudeau Letter. See also PIC Letter.

¹⁸⁷ See J. LaBerge Letter; M. Trudeau Letter; A. Hemmingsen Letter (noting it would be appropriate to impose a financial threshold for a family office to qualify as an accredited investor as proposed); Carta Letter; PIC Letter; Artivest Letter; and ILPA Letter.

¹⁸⁸ See NASAA Letter.

¹⁸⁹ See M. Trudeau Letter (adding a sophistication requirement for family office managers is integral to the rationale of the accredited investor definition); ILPA Letter; and PIC Letter.

¹⁹⁰ See PIC Letter. The commenter also noted structural similarities of this requirement with the trust category in accredited investor definition in Rule 501(a)(7) of the Securities Act that requires that the purchase of a trust be directed by a sophisticated person as described in Rule 506(b)(2)(ii).

¹⁹¹ See P. Rutledge Letter.

suggested that the Commission should instead require an issuer to obtain a written representation that the purchaser qualifies as a family office under Rule 202(a)(11)(G)-1 under the Advisers Act and, at the time of the purchase, meets all of the requirements of that rule.

Nearly all commenters that addressed the issue were supportive of including in the definition of accredited investor family clients of a family office that meets the proposed requirements of Rule 501(a)(12).¹⁹² One of these commenters expressed support for allowing a family client to “piggyback” on the sophistication of the family office for purposes of meeting the accredited investor requirement as long as the family office is involved in the investment decision-making process for the particular investment in question.¹⁹³ One commenter opposed including in the accredited investor definition family clients of a family office meeting the proposed requirements of Rule 501(a)(12).¹⁹⁴ The commenter raised investor protection concerns and stated that including family clients in the definition would reduce what it means to be a sophisticated investor to a test of familial relationships.

The Proposing Release also requested comment on whether a person who receives assets upon the death of a family member (or other involuntary transfer from a family member) (“a beneficiary”) should qualify as an accredited investor during the year

¹⁹² See ILPA Letter; J. LaBerge Letter; CCMC Letter; Carta Letter; P. Rutledge Letter; AIC Letter; PIC Letter; and Artinvest Letter.

¹⁹³ See PIC Letter (expressing the view that the family client should not meet the accredited investor definition unless the family client relies on the family office for investment support with respect to the investment in question).

¹⁹⁴ See M. Trudeau Letter.

following such involuntary transfer if the beneficiary would not otherwise qualify.¹⁹⁵

One commenter expressly supported this approach, noting that it would be consistent with the family office rule.¹⁹⁶ The commenter also stated that carving out such a “beneficiary” from the accredited investor definition could potentially prevent or complicate the orderly liquidation or transition of the beneficiary from its status as a family client.

ii. Final Amendments

We are adopting, substantially as proposed, amendments to the definition of accredited investor to include certain family offices and their family clients. The definition encompasses a “family office” as defined in the “family office rule”¹⁹⁷ that meets the following additional requirements: (i) it has more than \$5 million in assets under management,¹⁹⁸ (ii) it is not formed for the specific purpose of acquiring the securities offered,¹⁹⁹ and (iii) its prospective investment is directed by a person who has such knowledge and experience in financial and business matters that such family office is capable of evaluating the merits and risks of the prospective investment.²⁰⁰ The final

¹⁹⁵ The family office rule deems a person who receives assets upon the death of family member (or other involuntary transfer from a family member) to be a family client for one year following the involuntary transfer. *See* Rule 202(a)(11)(G)-1(b) under the Advisers Act.

¹⁹⁶ *See* PIC Letter.

¹⁹⁷ 17 CFR 275.202(a)(11)(G)-1. One commenter suggested that we emphasize that Rule 501(a)(12) does not apply to multi-family offices. *See* M. Trudeau Letter. Rule 501(a)(12) directly references the definition of “family office” under the family office rule, and as such, the amendments apply only to family offices that meet this definition and do not apply to multi-family offices. *See also* Family Office Adopting Release (noting that the family office exclusion does not extend to family offices serving multiple families).

¹⁹⁸ Rule 501(a)(12)(i).

¹⁹⁹ Rule 501(a)(12)(ii).

²⁰⁰ Rule 501(a)(12)(iii).

amendments to the definition of accredited investor also include “family clients” (as defined in the family office rule) of a family office that meets the requirements stated above, whose prospective investment in the issuer is directed by such family office.²⁰¹

We believe the policy rationale for adopting the family office rule also supports the adoption of these amendments to the definition of accredited investor for family offices and their family clients. We continue to believe that family offices and their family clients can sustain the risk of loss of investment, given their assets.²⁰² We also continue to believe that certain protections otherwise afforded to less financially sophisticated investors by federal securities laws are not necessary to protect family offices or their clients. Finally, while one commenter raised concerns that including family clients in the accredited investor definition reduces what it means to be a sophisticated investor to a test of familial relationships, we believe these concerns are mitigated by the requirements of the definition. In particular, to qualify as an accredited investor, a person must be a family client of a family office meeting the requirements of Rule 501(a)(12), including that the family office has more than \$5 million in assets under management and its investments are directed by a person who has such knowledge and experience in financial and business matters that such family office is capable of evaluating the merits and risks of the prospective investment.

After considering comments, the amendment will require a family office to have more than \$5 million in assets under management as proposed. We believe a \$5 million

²⁰¹ Rule 501(a)(13). A family client will not qualify as an accredited investor under Rule 501(a)(13) with respect to a prospective investment if the family client’s prospective investment is not directed by a family office meeting all the requirements of Rule 501(a)(12).

²⁰² See Proposing Release at 2589.

threshold, and not a \$10 million threshold as suggested by one commenter, is the appropriate level to ensure the family office has sufficient assets to sustain the risk of loss. We believe the \$5 million threshold sufficiently captures investors who can reasonably be expected to have financial sophistication and the ability to withstand economic losses and fend for themselves. This threshold also is consistent with the asset threshold required by other accredited investor categories.²⁰³

In addition, as proposed, the amendment will require that the family office's purchase be directed by a person who has such knowledge and experience in financial and business matters that such family office is capable of evaluating the merits and risks of the prospective investment. This requirement is designed to ensure that the person directing the investments of the family office is able to evaluate the risks and take steps to protect the interests of family clients, particularly with respect to family clients who do not on their own meet the definition of an accredited investor.²⁰⁴ This requirement is similar to the financial sophistication requirement for trusts to meet the definition of an accredited investor under Rule 501(a)(7) under the Securities Act, and we do not believe that determining that the family office or family client meets the relevant definition will create an undue burden for issuers.²⁰⁵

Finally, after considering comments, we are not excluding from the accredited investor definition a beneficiary that temporarily qualifies as a family client under the family office rule. That is, a person who receives assets upon the death of a family

²⁰³ Rule 501(a)(1), (a)(3), and (a)(7).

²⁰⁴ Additionally, the amendments require family clients to invest through a family office that meets the requirements of Rule 501(a)(12) to qualify as an accredited investor.

²⁰⁵ An issuer could, for example, obtain a representation that the family office meets the requirement of Rule 501(a)(12)(iii) as part of a traditional investor questionnaire.

member or key employee (or other involuntary transfer from a family member or key employee) will qualify as a family client for purposes of the accredited investor definition for one year. We do not believe it is appropriate to differentiate family clients within the definition and agree with commenters that excluding a beneficiary from the accredited investor definition could negatively impact the family office's management and transition of the beneficiary from its status as a family client.²⁰⁶

3. Permitting Spousal Equivalents to Pool Finances for the Purposes of Qualifying as Accredited Investors

In the Proposing Release, the Commission proposed to allow natural persons to include joint income from spousal equivalents when calculating joint income under Rule 501(a)(6), and to include spousal equivalents when determining net worth under Rule 501(a)(5). The proposed amendments would define spousal equivalent as a cohabitant occupying a relationship generally equivalent to that of a spouse. The Commission previously has used this formulation of spousal equivalent. As discussed above, a family office is exempted from regulation under the Advisers Act when the family office advises "family clients."²⁰⁷ The Commission defined "family clients" to include "family members," of which "spousal equivalents" are a part, with "spousal equivalent" defined as a cohabitant occupying a relationship generally equivalent to that

²⁰⁶ A person is determined to be an accredited investor at the time of investment, so a beneficiary would not be required to unwind any holdings acquired through an involuntary transfer from a family member (or made during the period that the beneficiary is a family client), but the beneficiary would not be able purchase additional holdings, unless the beneficiary qualifies as an accredited investor on another basis. *See* Rule 501(a).

²⁰⁷ *See* Family Office Adopting Release.

of a spouse.²⁰⁸ The crowdfunding rules adopted to implement the requirements of Title III of the Jumpstart Our Business Startups Act (“JOBS Act”) also use this definition of “spousal equivalent.”²⁰⁹ In Regulation Crowdfunding, the Commission included the term “spousal equivalent” in the definition of the term “member of the family of the purchaser or the equivalent,” with “spousal equivalent” having the same definition used in the Advisers Act and as the one we proposed to use in Rule 501(a).²¹⁰

a. Comments

Several commenters supported adding spousal equivalents,²¹¹ with one commenter noting that adding spousal equivalents may allow more investment opportunities for investors.²¹² A few commenters did not support adding spousal equivalents,²¹³ with one commenter opposed to the addition because of potential tax consequences,²¹⁴ and another suggesting a different definition limited solely to “legally-

²⁰⁸ Rule 202(a)(11)(G)-1(d)(9).

²⁰⁹ Public Law No. 112–106, 126 Stat. 306 (2012). The JOBS Act provides that securities issued in reliance on the crowdfunding exemption may not be transferred by the purchaser for one year after the date of purchase, except when transferred to, among other persons, “a member of the family of the purchaser *or the equivalent*” (emphasis added). See JOBS Act Section 302(e)(1)(D). In addition, though the Commission rule governing accountant independence also includes “spousal equivalents,” the term is not defined in that rule. See 17 CFR 210.2-01.

²¹⁰ 17 CFR 227.501(c).

²¹¹ See letter from Sean Mortensen dated Dec. 18, 2019 (“S. Mortensen Letter”); P. Rutledge Letter; letter from Daniel Hoeller dated Feb. 19, 2020 (“D. Hoeller Letter”); J. LaBerge Letter; A. Hemmingsen Letter; CCMC Letter; NASAA Letter; SBIA Letter; Mercer Advisors Letter; S. Moller Letter; Better Markets Letter; M. Trudeau Letter; and Artinvest Letter.

²¹² See D. Hoeller Letter (positing that the amendment “would help . . . thousands more to access potentially better investment opportunities”).

²¹³ See Md St. Bar Assn. Comm. on Sec. Laws Letter (recommending a different definition) and Cornell Sec. Clinic Letter.

²¹⁴ See Cornell Sec. Clinic Letter (positing that the addition “might encourage tax shifting because individuals who are taxed separately could be taxed less than a married couple due to different tax brackets between the two taxable units”).

recognized relationships besides marriage.”²¹⁵

b. Final Amendments

We are adopting the amendment as proposed for the reasons noted in the Proposing Release. We continue to believe that there is no need to deviate from the definition of “spousal equivalent” already used in Commission rules. Revising Rule 501(a)(5) and (6) to permit spousal equivalents to pool their financial resources will promote consistency with these existing rules. By contrast, using a different, more limited definition, as suggested by one commenter, would add complexity to our rules without an obvious benefit in terms of investor protection.

4. Notes to 501(a)

The Commission proposed to amend the accredited investor definition to incorporate three long-standing staff interpretations. The first is the inclusion of limited liability companies in Rule 501(a)(3), which is discussed in Section II.B.2.c above. The second relates to the term “joint” in Rule 501(a)(5), and the third relates to the identity of the owners of entities seeking accreditation under Rule 501(a)(8).

a. Note to Rule 501(a)(5)

The Commission proposed to add a note to Rule 501 to clarify that the calculation of “joint net worth” for purposes of Rule 501(a)(5) can be the aggregate net worth of an investor and his or her spouse (or spousal equivalent if “spousal equivalent” is included in Rule 501(a)(5)), and that the securities being purchased by an investor relying on the joint net worth test of Rule 501(a)(5) need not be purchased jointly.

²¹⁵ See Md St. Bar Assn. Comm. on Sec. Laws Letter (recommending that the definition be limited “solely to persons in other legally-recognized relationships besides marriage, including domestic partnerships and civil unions, that provide legal rights to the participants in such an arrangement that are similar to those accorded to legal spouses (at least with respect to financial matters)”).

The Commission noted that nothing in previous Regulation D releases indicates that the Commission intended the term “joint” in Rule 501(a)(5) to require (1) joint ownership of assets when calculating the net worth of the spouses, or (2) that an investor relying on the joint net worth test acquire the security jointly instead of separately. The Commission also noted that allowing spouses to own assets in various forms for the purposes of the net worth test is consistent with how the Commission treats spousal ownership of assets in other contexts.²¹⁶

i. Comments

Every commenter that addressed this amendment supported it,²¹⁷ with one commenter noting that the addition “may help some investors and practitioners to better understand the rules.”²¹⁸

ii. Final Amendments

We are adopting the amendment as proposed. We continue to believe that it does not appear necessary in the accredited investor context to limit how an investor takes title to securities or how spouses or spousal equivalents own assets.

b. Note to Rule 501(a)(8)

Under Rule 501(a)(8), an entity qualifies as an accredited investor if all of the equity owners of that entity are accredited investors. Because in some instances, an equity owner of an entity is another entity, not a natural person, the Commission proposed to add a note to Rule 501(a)(8) that would clarify that, in determining

²¹⁶ See Rule 2a51–1 under the Investment Company Act, which permits separate ownership, joint ownership, and community property ownership.

²¹⁷ See P. Rutledge Letter; Mercer Advisors Letter; CCMC Letter; D. Burton Letter; and ABA Fed. Reg. of Sec. Comm. Letter.

²¹⁸ See D. Burton Letter.

accredited investor status under Rule 501(a)(8), one may look through various forms of equity ownership to natural persons. Thus, if those natural persons are themselves accredited investors, and if all other equity owners of the entity are accredited investors, the entity would be an accredited investor under Rule 501(a)(8). The Commission noted its belief that this approach is appropriate because the intent of Rule 501(a)(8) is to qualify as accredited investors those entities that are 100% owned by accredited investors and, for this purpose, it should not matter whether the ownership is direct or indirect.

i. Comments

Several commenters supported adding the note as written,²¹⁹ while two commenters supported the note but with modifications, positing that the proposed note would have a disproportionate impact on Indian tribes and other entities because tribes may use limited liability companies and other entities to make investments, with the tribes, not individual natural persons, as the owner of the entity.²²⁰

ii. Final Amendments

We are adopting the amendment as proposed. We do not share the commenters' concerns that the note, as drafted, would disproportionately disadvantage Indian tribes and other entities. The purpose of the amendment is to clarify that it is appropriate to look through various forms of ownership under Rule 501(a)(8) to natural persons in those

²¹⁹ See P. Rutledge Letter; Arnold & Porter Letter (would also add a related note stating that “one may look through the various forms of ownership and control of a governmental entity to the overarching government of which a specific governmental entity is a part when determining accredited investor status under Rule 501(a)(9)”; NAFOA Letter; CCMC Letter; NASAA Letter; and D. Burton Letter.

²²⁰ See Southern Ute Letter (stating that “[t]he Tribe regularly invests and conducts business through state-organized limited liability companies and other entities, and the proposed rule that allows a look through only to natural persons would disadvantage the Tribe and other Indian tribes”) and NAFOA Letter (stating that “[s]ince Indian tribes would be included as an accredited investor[, the Commission] should add the generic “entities” to the “natural persons” to read “natural persons or entities” to avoid disadvantaging Indian tribes”).

cases where an equity owner of an entity is itself an entity, but that owner-entity does not qualify on its own merits as an accredited investor (*e.g.*, if the owner-entity is an LLC that does not meet the \$5 assets test). This clarification does not supersede the application of Rule 501(a)(8) to entities; therefore, for example, if an Indian tribe or state forms and is the sole equity owner of an LLC, such LLC could qualify as an accredited investor either if it meets the requirements of Rule 501(a)(3), or if the Indian tribe or state equity-owner meets the requirements of Rule 501(a)(9).

5. Amendment to Rule 215

The Commission proposed to amend the accredited investor definition in Rule 215 to conform to the amendments to the accredited investor definition in Rule 501(a). Rule 215 defines the term “accredited investor” under Section 2(a)(15) of the Securities Act²²¹ for purposes of Section 4(a)(5) of the Securities Act.²²² The accredited investor definition in Rule 215 has historically been substantially consistent but not identical to the accredited investor definition in Rule 501(a) of Regulation D. For example, in contrast to the definition in Rule 501(a), the scope of the accredited investor definition in Rule 215 does not include banks, insurance companies, registered investment companies, business development companies as defined in Section 2(a)(48) of the Investment

²²¹ 15 U.S.C. 77b(a)(15). Section 2(a)(15) of the Securities Act sets forth an enumerated list of entities that qualify as accredited investors as well as “any person who, on the basis of such factors as financial sophistication, net worth, knowledge, and experience in financial matters, or amount of assets under management qualifies as an accredited investor under rules and regulations which the Commission shall prescribe.”

²²² 15 U.S.C. 77d(a)(5). Section 4(a)(5) of the Securities Act provides an exemption for issuers for the offer and sale of securities to accredited investors if the aggregate offering amount does not exceed \$5 million; the issuer, or anyone acting on its behalf, does not engage in general solicitation or general advertising; and the issuer files a notice on Form D with the Commission. Based on DERA staff’s review of Form D filings from January 1, 2009 through December 31, 2019, no issuer reported relying on the Section 4(a)(5) exemption during that time period.

Company Act, or SBICs. In addition, the accredited investor definition in Rule 215 does not contain a reasonable belief standard as in Rule 501(a).²²³

To ensure uniformity in the accredited investor definition in both provisions, the Commission proposed to replace the existing definition in Rule 215 with a cross reference to the accredited investor definition in Rule 501(a). By including this cross reference, the definition of “accredited investor” in Rule 215 as amended would be expanded to include any amendments to the accredited investor definition in Rule 501(a), as well as those entities that are presently included in the definition in Rule 501(a) but not the definition in Rule 215. As amended, the definition would also contain the same reasonable belief standard as in Rule 501(a).

a. Comments

All of the commenters responding to this proposed amendment supported its adoption.²²⁴ The Proposing Release also requested comment on whether amending the scope of the accredited investor definition in Rule 215 as proposed would raise concerns regarding the application of the Section 4(a)(5) exemption. No commenters indicated that the amendment would raise concerns about Section 4(a)(5), while one commenter expressly stated that it did not believe that Section 4(a)(5) would be affected.²²⁵ The Commission also requested comment on whether adding a reasonable belief standard to the definition in Rule 215 would raise concerns. No commenters indicated that adding a

²²³ Under Rule 501(a), natural persons and entities that come within any of eight enumerated categories in the definition, or that the issuer reasonably believes comes within any of the categories, are accredited investors.

²²⁴ See P. Rutledge Letter; Arnold & Porter Letter; CCMC Letter; Republic Letter; D. Burton Letter; and ABA Fed. Reg. of Sec. Comm. Letter.

²²⁵ See Arnold & Porter Letter.

reasonable belief standard raised concerns, while two commenters expressly stated that no concerns would exist.²²⁶

b. Final Amendments

We are adopting the amendment as proposed. We continue to believe that the historical intended consistency between Rules 215 and 501(a) should be maintained, and we agree with the commenter that replacing the definition in Rule 215 with a cross-reference to Rule 501(a) would simplify compliance.²²⁷

6. Other Comments

The Proposing Release also requested comment on other topics related to the accredited investor definition but not the subject of specific proposals, including whether the Commission should adjust the financial thresholds for inflation, whether the Commission should include geographic-specific financial thresholds, and whether investors advised by a registered investment adviser or a registered broker-dealer should be included as accredited investors.

a. Adjustments to Financial Thresholds

With respect to inflation adjustment, comments were mixed. Several commenters expressed support for maintaining the thresholds as they are,²²⁸ with one commenter suggesting that raising the thresholds would adversely affect certain real estate

²²⁶ See Arnold & Porter Letter and D. Burton Letter.

²²⁷ See Arnold & Porter Letter.

²²⁸ See IPA Letter; Morningstar Letter; Md St. Bar Assn. Comm. on Sec. Laws Letter; CCMC Letter; NAM Letter; Republic Letter; AIC Letter; D. Burton Letter (this commenter also believes that the threshold could “possibly” be reduced); and Geraci Letter and AAPL Letter.

investors²²⁹ and another commenter suggesting that certain manufacturing investors would be adversely affected.²³⁰

A number of commenters supported raising the thresholds to reflect inflation either since adoption of the rule, on a going-forward basis, or both.²³¹ One commenter noted that unadjusted thresholds have lowered the level of sophistication required for accredited investor status over time;²³² while several other commenters posited that investor protections have been weakened over time.²³³ A few commenters supported lowering the financial thresholds,²³⁴ with one commenter positing that changes in the

²²⁹ See IPA Letter (noting that raising the thresholds could affect the ability of some to accomplish like-kind exchanges under Section 1031 of the Internal Revenue Code).

²³⁰ See NAM Letter (positing that “[i]ncreasing the income or net worth tests would reclassify many manufacturing investors as non-accredited, disrupting the businesses that already rely on their investment capital and reducing capital formation opportunities for manufacturers on a going forward basis”).

²³¹ See letter from George Humm dated Jan. 29, 2020 (“G. Humm Letter”); letter from Howard Lichtman dated Feb. 21, 2020 (“H. Lichtman Letter”); letter from Marc. I. Steinberg dated Jan. 23, 2020; B. Delaplaine Letter; M. L. Letter; ICI Letter; S. Moller Letter; St. John’s Sec. Arbitration Clinic Letter; NASAA Letter; Better Markets Letter; CA Attorney General et al. Letter; M. Trudeau Letter; MFA and AIMA Letter; Cornell Sec. Clinic Letter; R. Maud Letter; PIABA Letter (suggesting that the Commission “rais[e] the net worth threshold to \$2.5 million and income threshold to \$500,000/\$750,000 for individuals and couples”); letter from Tyler Yagman and Nicholas Bruno dated Mar. 15, 2020; and Artivest Letter. See also SBCFAC Recommendations (recommending that the Commission “[g]oing forward, index the financial thresholds for inflation on periodic basis”) and IAC Recommendations (recommending that the Commission consider “whether financial thresholds need to be adjusted for inflation”).

²³² See B. Delaplaine Letter.

²³³ See ICI Letter (stating that “changes in technology that have occurred since 1982 do not make up for the loss of investor protection as a result of the erosion of the financial thresholds”); S. Moller Letter (stating that “adjustment is not only definitively warranted but essential for the protection of investors”); St. John’s Sec. Arbitration Clinic Letter (stating that “the SEC’s purpose in setting those monetary requirements in 1982 is undermined as inflation increases and yet the thresholds remain the same”); M. Trudeau Letter (positing that the thresholds should be raised to “get back to the original intent of the category”); PIABA Letter (stating that raising the thresholds would “be a meaningful step forward in moving back to the original intention of limiting the pool of accredited investors”); and Better Markets Letter (stating that “there may indeed now [be] hundreds of thousands of investors who have become qualified as Accredited Investor solely on the virtue of inflation of their asset prices but who otherwise lack necessary financial sophistication to carefully weigh the risks associated in investing in exempt offerings”).

²³⁴ See letter from Stuart dated Dec. 19, 2019; letter from Max Harker dated Dec. 19, 2019 (“M. Harker Letter”); letter from Robert Hall dated Feb. 23, 2020 (“R. Hall Letter”); and B. Andrews et al. Letter (stating that “[t]he current income and wealth standards that determine who can participate in private

availability of information since the adoption of the accredited investor definition reduced the efficacy of the financial thresholds in identifying sophisticated investors.²³⁵

The Proposing Release also requested comment on whether certain assets or liabilities should be excluded from or included in the calculation of net worth under Rule 501(a)(5). A few commenters responded that home equity should be included as an asset;²³⁶ another commenter proposed to exclude “agricultural land and machinery held for production;”²³⁷ and a few commenters proposed to exclude the value of certain retirement accounts.²³⁸ One commenter suggested that the net worth calculation be based on “documented liquid net worth.”²³⁹ Another commenter did not believe changes were necessary.²⁴⁰

After considering these comments, we continue to believe that it is not necessary or appropriate to modify the definition’s financial thresholds at this time. As stated in the Proposing Release, we believe that in evaluating the effectiveness of the current thresholds, it is appropriate to consider changes beyond the impact of inflation, such as

capital markets shut out even many ‘wealthy’ Americans from investing in founders from their communities”).

²³⁵ See R. Hall Letter (noting that “[w]e are in an age of information where plenty of performance data is available for your average citizen to make intelligent investments in small companies”).

²³⁶ See J. Evans Letter and B. Andrews et al. Letter (stating that “[a]lthough there are over 600,000+ Black people that have a \$1M net worth in the US; with most of that net worth in personal residences, Dodd Frank excludes them from meeting the [accredited investor] rule”).

²³⁷ See NASAA Letter.

²³⁸ See NASAA Letter (recommending exclusion of “the value of any defined benefit or defined contribution tax-deferred retirement accounts”) and D. Kui Letter (recommending exclusion of a portion of the investor’s “retirement accounts” and suggesting that the Commission could “(i) [set] forth a maximum amount of money from a retirement account which can be included in the calculation of net worth, (ii) [use] a discount or likewise formula to proportionately include the money from a retirement account into the calculation of net worth, and (iii) set a maximum amount that an investor may invest by fund from his/her retirement account”).

²³⁹ See Mercer Advisors Letter.

²⁴⁰ See D. Burton Letter.

changes over the years in the availability of information and advances in technologies. Information about many issuers and other participants in the exempt markets is more readily available now to a wide range of market participants, which was not the case at the time the accredited investor definition was adopted. In addition, we continue to believe that (1) at an individual level, removing investors from the current pool, particularly those who have participated, or are currently participating, in the private placement market would be inappropriate on various grounds, including the imposition of costs and principles of fairness more generally and (2) at a more general level, a significant reduction in the accredited investor pool through an increase in the definition's financial thresholds could have disruptive effects on certain aspects of the Regulation D market.²⁴¹ For example, a sharp decrease in the accredited investor pool may result in a higher cost of capital for certain companies, particularly companies in regions of the country with lower venture capital activity who may rely on "angel" or other individual investors as a primary source of funding, as well as for regions of the country with relatively lower wages and net worth.²⁴²

We remain mindful of investor protection concerns raised by the wealth tests. Notwithstanding the assertions of some commenters, we are not persuaded that the

²⁴¹ See Proposing Release at 2594. Substantially increasing the thresholds to reflect, for example, the effect of inflation since they were adopted, would reduce significantly the number of individuals that currently qualify as accredited investors under those tests. Such an increase would reduce the percentage of qualifying households from approximately 13.0% today to approximately 4.2%.

²⁴² See, e.g., Laura Lindsey & Luke C.D. Stein, *Angels, Entrepreneurship, and Employment Dynamics: Evidence from Investor Accreditation Rules* (Working Paper, 2019) (examining the effects of changes in angel financing stemming from the 2011 amendment to the accredited investor definition required by the Dodd-Frank Act, which excluded an investor's primary residence in determining an accredited investor's net worth and finding as the pool of potential accredited investors was reduced, there was an increase in negative effects to firm entry, reduced employment levels at small entrants, and a decline in relative wages for the startup sector).

investor protections provided by the financial thresholds have been meaningfully weakened over time due to inflation. Although it may be argued that an investor with an income of \$200,000 or a net worth of \$1 million now is not as “wealthy” as such an investor would have been in 1982, we do not believe that this correlates to a lower level of financial sophistication. It is not clear what specific factors the Commission took into account in 1982 when it established the individual income and net worth thresholds. Further, we note that in 1982, the calculation of net worth included the value of the primary residence, but in 2011, the Commission amended the net worth standard to exclude the value of the investor’s primary residence.²⁴³

In the Proposing Release the Commission noted that it was 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.”²⁴⁴ The Commission requested comment in the Proposing Release on whether there is evidence that any fraud in the private markets is driven or affected by the levels at which the accredited investor definition is set, or that maintaining the current financial thresholds would place investors at a greater risk of fraud. We also asked whether there is any quantitative data available that shows an increased incidence of fraud in particular types of exempt offerings or in the market for exempt offerings as a whole. One commenter responded with references to various

²⁴³ Net Worth Standard for Accredited Investors, Release No. 33-9287 (Dec. 21, 2011) [76 FR .81793 (Dec. 29, 2011)].

²⁴⁴ See Proposing Release at 2594.

Commission enforcement actions involving private offerings,²⁴⁵ and another commenter responded that “evidence strongly suggests that private markets are highly risky and are fertile environments for fraud.”²⁴⁶ However, commenters did not provide information that would indicate that any such incidents of fraud in the private markets are driven or affected by the levels at which the accredited investor definition is set.

We do not believe the financial thresholds need to be adjusted at this time. The Commission will continue to monitor the size of the accredited investor pool, the characteristics of individual accredited investors who participate in the private markets, the appropriateness of the income and net worth thresholds, and, to the extent data is available, performance and incidence of fraud in exempt offerings, including in connection with the Commission’s quadrennial review of the accredited investor definition required by the Dodd-Frank Act.²⁴⁷

b. Geography-specific thresholds

A few commenters expressed support for geography-specific financial thresholds,²⁴⁸ noting that incomes vary throughout the country. The SBCFAC Recommendations proposed to “possibly adjust [the financial thresholds] downwards for certain regions of the country.”²⁴⁹ The SEC Small Business Forum Report proposed to

²⁴⁵ See NASAA Letter (also noting that “private offerings are often characterized by opaque disclosures, related party transactions, illiquidity, minimal financial information and, unfortunately, fraud”).

²⁴⁶ See CA Attorney General et al. Letter (also referencing NASAA’s Enforcement Reports for 2013-15 and referencing statements on the Commission’s Investor.gov website and Division of Enforcement’s Annual Report for 2018).

²⁴⁷ See *supra* note 110.

²⁴⁸ See D. Kui Letter (noting that “income levels largely vary among different regions in the United States”) and K. Pulavarthi Letter.

²⁴⁹ See *supra* note 18.

“[r]evise the dollar amounts to scale for geography, lowering the thresholds in states/regions with a lower cost of living.”²⁵⁰ A few commenters were opposed to geography-specific financial thresholds,²⁵¹ with one commenter highlighting that it would add complexity to the accredited investor definition²⁵² and another commenter noting that it would add administrative complexity for issuers²⁵³, which could ultimately result in a higher cost of capital. Although we acknowledge that geographical income and wealth disparities may lead to bunching of accredited investors in large coastal cities, we believe the complexities that geography-specific financial thresholds would create for issuers and investors do not weigh in favor of adding such geography-specific financial thresholds to the accredited investor definition at this time. Further, we believe the new accredited investor criteria we are adopting today may help mitigate the disparate geographic effects of the current wealth-based criteria by including non-wealth-based alternative criteria for natural persons to qualify under the definition. The Commission will have the opportunity to further consider this issue in connection with its quadrennial reviews of the accredited investor definition.

c. Advised by third parties

Regarding whether the Commission should permit an investor advised by a registered investment adviser or broker-dealer to be deemed an accredited investor, many

²⁵⁰ See *supra* note 19.

²⁵¹ See CFA Letter and D. Burton Letter.

²⁵² See D. Burton Letter.

²⁵³ See CFA Letter (noting that “[g]iven the challenge small issuers can face in verifying accredited investor status, the Commission should avoid over-complicating the calculation, particularly with so little evidence that a problem exists that merits this adjustment”).

commenters expressed support,²⁵⁴ with a number of these commenters positing that the client would be able to rely on the knowledge and the sophistication of the adviser to determine whether an investment is appropriate.²⁵⁵ One commenter stated that the idea could merit consideration in the future once the market gains some experience under Regulation Best Interest.²⁵⁶ Another commenter suggested the use of the purchaser representative concept of Regulation D as a possible means of permitting advised investors to participate in exempt offerings.²⁵⁷ Commenters that supported treating clients of financial intermediaries as accredited investors did not offer additional conditions or protections that should be considered as part of this expansion.²⁵⁸

Several commenters were opposed,²⁵⁹ with one stating that such an amendment would expand the definition of accredited investor without ensuring that adequate

²⁵⁴ See SAF Financial Letter; C. Lakumb Letter; letter from Brian Schreiner dated Feb. 20, 2020; letter from Robert R. Champion dated Jan. 15, 2020; letter from Seth Haymes dated Dec. 29, 2019; letter from Dolan McEniry Capital Management, LLC dated Mar. 9, 2020; IPA Letter; ALTI Letter; letter from GW&K Investment Management, LLC dated Mar. 16, 2020 (“GW&K Letter”); letter from iCapital Network dated Mar. 16, 2020; Fidelity Letter; Artivest Letter; letter from GTS Securities LLC dated May 5, 2020; and M. Harker Letter (suggesting that investors advised by funding portals be included).

²⁵⁵ See Fidelity Letter (indicating that “[a] retail investor who does not qualify as an accredited investor and yet would like to access private offering opportunities should be able to work with, and rely on, the knowledge and sophistication that registered investment advisers and broker-dealers have in determining whether such an investment is appropriate for the investor, as analyzed under the appropriate standard of conduct”) and IPA Letter (noting that the adviser acts as a fiduciary for the client).

²⁵⁶ See ABA Fed. Reg. of Sec. Comm. Letter (noting that “this idea may merit further consideration after there has been some experience with Regulation Best Interest and with the rule amendments (once adopted) proposed here”).

²⁵⁷ See D. Burton Letter (positing that “[f]leshing out the purchaser representative concept [of Regulation D] seems to me to be a more fruitful path forward than treating advised investors as accredited”).

²⁵⁸ See, e.g., Fidelity Letter (stating “we do not believe that additional limits would be necessary should the SEC permit this expansion”).

²⁵⁹ See J. LaBerge Letter; A. Hemmingsen Letter; CFA Letter; Mercer Advisors Letter; St. John’s Sec. Arbitration Clinic Letter; ICI Letter (noting that “even if a financial intermediary has the sophistication to make informed decisions about private market offerings, that alone would not satisfy the Commission’s longstanding policy of considering retail investors’ access to resources to bear loss from products that lack Securities Act protections”); NASAA Letter; CA Attorney General et al. Letter; and PIABA Letter.

protections exist that would make the protections of the securities laws unnecessary.²⁶⁰

Another commenter posited that such an expansion would negate the investor protections provided by the accredited investor definition and generally shift capital formation efforts from the public markets to the private markets.²⁶¹ One commenter predicted that only intermediaries with conflicts of interest would participate and argued that the supposed expertise of a financial intermediary is no substitute for the investor's own sophistication, experience, and wherewithal.²⁶² Finally, one commenter stated that expanding the definition of accredited investor to clients of financial intermediaries raises concerns about economies of scale and adverse selection.²⁶³

After considering the comments received, we are not expanding the accredited investor definition to include customers of a broker-dealer or clients of a registered investment adviser. We believe that neither a recommendation by a broker-dealer nor advice by a registered investment adviser should serve as a proxy for an individual investor's financial sophistication or his or her ability to sustain the risk of loss of investment or ability to fend for him or herself. Additionally, we are concerned that

²⁶⁰ See St. John's Sec. Arbitration Clinic Letter.

²⁶¹ See CA Attorney General et al. Letter (stating that "broker-dealers and investment advisors often have conflicts of interest in their relationships with individual investors . . . data suggests that broker-dealers who market securities in private offerings are more likely to be the subject of complaints to FINRA . . . [and] this expansion of accredited investor status is likely to swallow the general rule that private placements are limited to a select pool of accredited investors").

²⁶² See NASAA Letter (indicating that "[r]esponsible, reputable investment advisers will be unlikely to recommend private offerings to clients unless they are already sophisticated and wealthy enough to qualify as accredited. The only investment advisers who would do so are those whose business models are conflicted in favor of private issuers. Further, a review of suitability cases brought by NASAA members, [FINRA], and in private FINRA arbitrations reveals that conflicted investment advice is not uncommon").

²⁶³ See, e.g., ICI Letter (stating "[w]hile larger retail or institutional investors with research staffs and large pools of capital can access the more attractive investment opportunities and negotiate pricing and access to information, smaller retail investors and their financial intermediaries only may be able to access less-attractive opportunities. In addition, it is possible that at least some intermediaries will not have the expertise to properly evaluate those investments").

allowing investors receiving recommendations or investment advice to be considered accredited investors, regardless of their financial sophistication, experience, or ability to bear loss, could undermine the purpose of the accredited investor definition in identifying investors who possess a sufficient level of financial sophistication to participate in investment opportunities that do not have the additional protections provided by registration under the Securities Act and our framework for regulating the offering process.

Furthermore, as the Commission noted in the Proposing Release, being advised by a financial professional has historically not been a complete substitute for the protections of the Securities Act registration requirements and, if applicable, the Investment Company Act.²⁶⁴ The presence of a financial intermediary may not solve for certain of the investment protection concerns associated with private offerings, such as illiquidity, agency costs (including bargaining power in contracting when the investor has less money to invest), information asymmetry, as well as high transaction and search costs. For the reasons discussed above, we are not expanding the accredited investor definition to include investors advised by a registered investment adviser or broker-dealer.

d. Other comments received

Several commenters responded with ideas that were not responses to specific requests for comment. A few commenters proposed a multi-level accreditation system

²⁶⁴ See Proposing Release at 2595.

for natural persons²⁶⁵ allowing investors at a lower level of income or net worth²⁶⁶ to invest either a capped amount²⁶⁷ or invest through an investor group.²⁶⁸ Another commenter proposed an “investments assets” test for natural persons with \$1 million in investments.²⁶⁹ One commenter proposed to remove the requirement that any institutional investor not be formed for the purposes of investing in the offered securities.²⁷⁰ Other commenters suggested changes related to the financial thresholds, with one commenter suggesting that accredited-investor status be maintained for life,²⁷¹ and another suggesting that accredited-investor status should not need to be re-evaluated often.²⁷² One commenter suggested that “sophisticated investors” be allowed to invest in Rule 506(c) offerings.²⁷³ A few commenters suggested changes related to how defined contribution employee benefit plans count beneficial owners for the purposes of compliance with the Investment Company Act.²⁷⁴ Some commenters proposed to eliminate the accredited investor definition,²⁷⁵ with one of these commenters

²⁶⁵ See J. Kelner Letter; Cityvest Letter; and T. Parker Letter.

²⁶⁶ See J. Kelner Letter (did not specify thresholds); Cityvest Letter (\$100,000 in annual income or \$500,000 in net worth); and T. Parker Letter (\$100,000 in annual income or \$500,000 in net worth).

²⁶⁷ See J. Kelner Letter (\$25,000 or \$50,000) and Cityvest Letter (\$50,000).

²⁶⁸ See T. Parker Letter (proposing to allow investors to “invest in deals through an established Angel Group that provides education and possibly also a more experienced mentor”).

²⁶⁹ See G. Fryer Letter.

²⁷⁰ See CCMC Letter.

²⁷¹ See G. Hodge Letter.

²⁷² See K. Pulavarthi Letter.

²⁷³ See R. Courtney Letter.

²⁷⁴ See letters from Institute for Portfolio Alternatives dated July 10, 2020 and from Defined Contribution Alternatives Association dated July 20, 2020. These commenters also recommended changes to Rule 22e-4 under the Investment Company Act.

²⁷⁵ See *supra* note 16.

recommending that the definition be replaced with an online acknowledgement-of-risk form²⁷⁶ and another recommending elimination of the distinction between accredited and non-accredited investors in Regulation D offerings.²⁷⁷

After considering these comments, we do not believe additional amendments to the definition of accredited investor are warranted at this time. Nor are we eliminating the accredited investor definition. We believe that the amendments we are adopting in this release provide appropriate investor protections while facilitating capital formation. The Commission will have the opportunity to consider these and other matters in connection with its quadrennial review of the accredited investor definition required by the Dodd-Frank Act.²⁷⁸

III. Amendments to Securities Act Rule 163B and Exchange Act Rule 15g-1

A. Securities Act Rule 163B

In registered offerings under the Securities Act, issuers may engage in test-the-waters communications with qualified institutional buyers or institutional accredited investors to gauge their interest in a contemplated offering. Under Section 5(d) of the Securities Act, an emerging growth company, as defined in Securities Act Rule 405,²⁷⁹ is permitted to engage in oral or written communications with potential investors that are either qualified institutional buyers, as defined in Rule 144A(a)(1), or institutions that are

²⁷⁶ See K. Wilson Letter (stating that “[a]cknowledging risks could be as simple as having a person go through an online survey, providing a written verification or clicking an acceptance of terms that a person understands the risks, no matter what their level of net worth is”).

²⁷⁷ See J. Peter Letter (stating “please treat all equal and let everyone invest in accredited deals”).

²⁷⁸ See *supra* note 110.

²⁷⁹ An emerging growth company is defined in Rule 405 as an issuer that had total annual gross revenues of less than \$1,070,000,000 during its most recently completed fiscal year.

accredited investors as defined in Rule 501(a), to offer securities before or after the filing of a registration statement.

In September 2019, the Commission adopted Securities Act Rule 163B, which extends this testing-the-waters accommodation to all issuers.²⁸⁰ Pursuant to Rule 163B, an issuer may engage in test-the-waters communications with potential investors that are, or that the issuer or person authorized to act on its behalf reasonably believes are, qualified institutional buyers, as defined in Rule 144A, or institutions that are accredited investors, as defined in Rule 501(a)(1), (a)(2), (a)(3), (a)(7), or (a)(8).

In connection with the amendments to the accredited investor definition in Rule 501(a), the Commission also proposed to amend Rule 163B to include a reference to proposed Rules 501(a)(9) and (a)(12). The proposed amendment was intended to maintain consistency between Rule 163B and Section 5(d), in that institutional accredited investors under proposed Rules 501(a)(9) and (a)(12) would automatically fall within the scope of Section 5(d).

1. Comments

The Proposing Release requested comment on whether Rule 163B should be amended to include a reference to Rules 501(a)(9) and (a)(12). Three commenters responded, with two commenters supporting inclusion of a reference to Rule 501(a)(9) and (a)(12).²⁸¹ The other commenter supported including a reference only to Rule 501(a)(9), and indicated that he had no view on whether to include 501(a)(12).²⁸² The

²⁸⁰ See Solicitations of Interest Prior to a Registered Public Offering, Release No. 33-10699 (Sept. 25, 2019) [84 FR 53011 (Oct. 4, 2019)].

²⁸¹ See CCMC Letter and ABA Fed. Reg. of Sec. Comm. Letter.

²⁸² See D. Burton Letter.

Commission also requested comment on whether the proposed amendments to the accredited investor definition and the qualified institutional buyer definition raise concerns in connection with the test-the-waters communications that issuers may engage in pursuant to Rule 163B or Section 5(d) of the Securities Act. One commenter responded that the proposed amendments would raise no concerns.²⁸³

2. Final Amendments

We are adopting the amendment as proposed with one addition. We continue to believe that expanding the types of entities with whom an issuer may engage in test-the-waters communications, by amending the accredited investor definition and the qualified institutional buyer definition,²⁸⁴ may increase the use of Rule 163B, as well as Section 5(d), and may result in issuers more effectively gauging market interest in contemplated registered offerings. We also continue to believe that the expanded scope of entities that would receive test-the-waters communications under the proposed amendment to Rule 163B have the financial sophistication to process this information and to review the registration statement that is filed with the Commission against the test-the-waters materials before making an investment decision.

Accordingly, we are amending Rule 163B to include references to Rules 501(a)(9) and (a)(12). We are also including a reference to Rule 501(a)(13) to cover family clients that are institutions and qualify as accredited investors under such rule. As noted above, the definition of “family client” includes both natural persons and institutions. Section 5(d) of the Securities Act refers to “institutions that are accredited

²⁸³ *Id.*

²⁸⁴ The amendments to the qualified institutional buyer definition in Rule 144A are discussed below in Section IV.

investors,” and, unlike Rule 163B, does not specify particular paragraphs of Rule 501(a) that refer to such institutions. As the intent in proposing to amend Rule 163B was to maintain consistency between Rule 163B and Section 5(d) of the Securities Act and capture institutions that are able to newly qualify as accredited investors, we believe including family clients that are institutions in the list of institutional accredited investors is appropriate.

B. Exchange Act Rule 15g-1

The Proposing Release also proposed to amend Rule 15g-1(b) to include a reference to proposed Rules 501(a)(9) and (a)(12).²⁸⁵ Pursuant to Exchange Act Rule 15g-2 through Rule 15g-6, broker-dealers are required to disclose certain specified information to their customers prior to effecting a transaction in a “penny stock,” as defined in 17 CFR 240.3a51-1 under the Exchange Act.²⁸⁶ Rule 15g-1 under the Exchange Act exempts certain transactions from these disclosure requirements. In particular, paragraph (b) of Rule 15g-1 exempts transactions in which the customer is an institutional accredited investor, as defined in Rule 501(a)(1), (2), (3), (7), or (8) of Regulation D.²⁸⁷

1. Comments

²⁸⁵ We are also adopting a technical amendment to Rule 15g-1(c) to update the reference to Section 4(2) of the Securities Act to reflect the current numbering scheme in Section 4.

²⁸⁶ Rules 15g-1 through 15g-9 under the Exchange Act [17 CFR 240.15g-2 through 15g-9] are collectively known as the “penny stock rules.” *See also* Schedule 15G under the Exchange Act.

²⁸⁷ In addition, Rule 15g-1(a), (d), (e), and (f) exempt certain other transactions from the disclosure requirements in Rules 15g-2 through 15g-6. Rule 15g-1(c) exempts transactions that meet the requirements of Regulation D or that are exempt from the registration requirements of the Securities Act pursuant to Section 4(a)(2). Rule 15g-1 also includes a provision the Commission can use to exempt by order any other transactions or persons from the penny stock rules as consistent with the public interest and the protection of investors.

The Proposing Release requested comment on whether Rule 15g-1(b) should be amended to include a reference to Rules 501(a)(9) and (a)(12). A few commenters supported adding Rule 501(a)(9).²⁸⁸ No commenters responded on whether 501(a)(12) should be added, and no commenters indicated that neither should be added. The Commission also requested comment on whether limited liability companies should continue to be included in the exemption set forth in Rule 15g-1(b). One commenter responded that limited liability companies should continue to be included.²⁸⁹

2. Final Amendments

We are adopting the amendment as proposed with one addition. We continue to believe that, like the institutional accredited investors currently within the scope of Rule 15g-1(b), those institutions that we are adding to the accredited investor definition in Rule 501(a)(1), entities owning investments in excess of \$5 million that are not formed for the specific purpose of acquiring the securities being offered, and family offices do not need the additional protections provided by Rules 15g-2 through 15g-6.²⁹⁰ We also continue to believe that, consistent with the categories of institutional accredited investors presently listed in Rule 15g-1(b), entities within the scope of Rule 501(a)(9), family offices, and the other types of entities we are adding to the accredited investor definition generally invest in speculative equity securities as part of an overall investment plan, have a good understanding of the risks of investing in penny stocks, and have the ability

²⁸⁸ See P. Rutledge Letter and CCMC Letter.

²⁸⁹ See D. Burton Letter.

²⁹⁰ As discussed above, we are also amending a number of the existing categories in the accredited investor definition relating to institutional investors that fall within the scope of the exemption in Rule 15g-1(b).

to obtain and evaluate independent information regarding these stocks.²⁹¹

As discussed above in connection with the addition of institutional “family clients” to Rule 163B, we are also including institutional family clients in the list of institutional accredited investors in Rule 15g-1(b). We believe this addition is appropriate to capture institutions that are newly able to qualify as accredited investors and to prevent confusion that could arise if we do not maintain consistency in the references to institutional accredited investors across our rules.

IV. Discussion of the Final Amendments to the Qualified Institutional Buyer Definition

A. Proposed Amendments

Rule 144A(a)(1)(i) specifies the types of institutions that are eligible for qualified institutional buyer status if they meet the \$100 million in securities owned and invested threshold.²⁹² The Commission proposed to expand the qualified institutional buyer definition by adding RBICs to Rule 144A(a)(1)(i)(C) and limited liability companies to Rule 144A(a)(1)(i)(H) to correspond to the proposed amendments to Rule 501(a)(1) and Rule 501(a)(3). In addition, to ensure that entities that qualify for accredited investor status also qualify for qualified institutional buyer status when they meet the \$100 million in securities owned and invested threshold in Rule 144A(a)(1)(i), the Commission proposed to add new paragraph (J) to Rule 144A(a)(1)(i). The proposed new paragraph would permit institutional accredited investors under Rule 501(a), of an entity type not already included in paragraphs 144A(a)(1)(i)(A) through (I) or 144A(a)(1)(ii) through

²⁹¹ See Penny Stock Disclosure Rules, Release No. 34-29093 (Apr. 17, 1991) [56 FR 19165 (Apr. 25, 1991)] and Penny Stock Disclosure Rules, Release No. 34-30608 (Apr. 20, 1992) [57 FR 18004 (Apr. 28, 1992)].

²⁹² Rule 144A(a)(1)(i)(A) – (G) and (I).

(vi), to qualify as qualified institutional buyers when they satisfy the \$100 million threshold.²⁹³ This new category in the qualified institutional buyer definition would encompass the new category in the accredited investor definition for entities owning investments in excess of \$5 million that are not formed for the specific purpose of acquiring the securities being offered under Regulation D,²⁹⁴ as well as any other entities that may be added to the accredited investor definition in the future, although such entities would also have to meet the \$100 million threshold in order to be qualified institutional buyers under Rule 144A.

B. Final Amendments

1. Comments

Commenters generally supported expanding the definition of qualified institutional buyer in Rule 144A,²⁹⁵ with several specifically supporting the amendments to Rule 144A(a)(1)(i)(C),²⁹⁶ Rule 144A(a)(1)(i)(H),²⁹⁷ and Rule 144A(a)(1)(i)(J).²⁹⁸ No commenter opposed the proposed amendments to Rule 144A.

²⁹³ Because Rule 144A(a)(1)(i)(J) covers entities not included in paragraphs (A) through (I), a bank or other financial institution specified in those paragraphs would continue to be required to satisfy the net worth test in Rule 144A(a)(vi).

²⁹⁴ Rule 501(a)(9).

²⁹⁵ See Better Markets Letter; ICI Letter; Fidelity Letter; and letter from Corbyn Investment Management, Inc. dated Jul. 15, 2020 (“Corbyn Letter”).

²⁹⁶ See CCMC Letter and ABA Fed. Reg. of Sec. Comm. Letter.

²⁹⁷ See Arnold & Porter Letter; CCMC Letter; and ABA Fed. Reg. of Sec. Comm. Letter.

²⁹⁸ See letter from Matthew L. Clark, State Investment Officer South Dakota Investment Council dated Feb. 7, 2020 (“SD Investment Council Letter”); letter from Income Research + Management dated Feb. 13, 2020 (“IR+M Letter”) (positing that “permitting institutional accredited investors that meet the asset threshold of \$100 million to be considered qualified institutional buyers under Rule 144A will allow for greater investment opportunities within the fixed income markets that are already afforded to other institutional investors of a similar nature”); CMTA Letter; Arnold & Porter Letter; J. LaBerge Letter; PIC Letter; ICI Letter; Am. Bankers Assn. Letter; OST Letter; TIAA Letter; CCMC Letter; Fidelity Letter; PFM Letter; letter from Coalition of Collective Investment Trusts dated Mar. 16, 2020 (“CCIT Letter”); Better Markets Letter; CACTTC Letter; and ABA Fed. Reg. of Sec. Comm. Letter.

We also received comments from several commenters with specific support for including in the definition of qualified institutional buyer all state and local governments.²⁹⁹ A few commenters discussed the changing nature of the commercial paper markets in which they invest, with one commenter stating that “[w]ith the growth of the [Securities Act Section] 4(a)(2) and [Rule] 144A commercial paper markets and the recent trend of public corporations replacing exempt and registered securities programs with private placement programs, local governments face growing challenges to invest public funds for the benefit of our constituents.”³⁰⁰ Another commenter noted that, as a state government investor, it “can only purchase commercial paper issued under [Securities Act] Section 3(a)(3), which is relatively rare, compared to commercial paper issued under [Securities Act] Section 4(a)(2).”³⁰¹ Another commenter noted that changes have occurred in the Rule 144A market for bond offerings in the last 20 years, with more fixed income issuers opting to rely on the Rule 144A process for bond issuances, rather than going through the more expensive and burdensome public offering process.³⁰²

In the Proposing Release, the Commission noted that proposed Rule 144A(a)(1)(i)(J) would encompass bank-maintained collective investment trusts that

²⁹⁹ See SD Investment Council Letter (indicating that “[s]tate governmental entities have the expertise to evaluate the 144A securities and make prudent investments in these securities”); letter from Amundi Pioneer Institutional Asset Management, Inc. dated Feb. 12, 2020 (“Amundi Pioneer Letter”); NAST et al. Letter; letter from David C. Damschen, Utah State Treasurer dated Feb. 26, 2020 (“Utah State Treasurer Letter”) (stating that “[o]ur investments would be greatly advantaged through increased diversification and marginally enhanced yield by expanding the pool of available securities to include corporate bonds and commercial paper available only to QIBs”); TIAA Letter; and Arnold & Porter Letter (positing that “[a]llowing governmental entities that meet the investment size threshold to qualify as QIBs would increase such entities’ flexibility in their investments without posing an increased risk to the markets or investors”).

³⁰⁰ See CACTTC Letter.

³⁰¹ See Utah State Treasurer Letter.

³⁰² See IAA Letter.

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.³⁰³ A few commenters supported the addition of Rule 144A(a)(1)(i)(J) specifically because it would capture certain collective investment trusts.³⁰⁴ One of these commenters supported the addition of Rule 144A(a)(1)(i)(J) because it would allow “bank-maintained [collective investment trusts and common trust funds] to qualify as qualified institutional buyer[s] if they satisfy the other requirements of Rule 144A.”³⁰⁵

The Proposing Release also requested comment on whether certain types of entities are less likely to have experience in the private resale market for restricted securities and may have more need for the protections afforded by the Securities Act registration provisions. The only commenter responding to this request for comment stated that it was not aware of any such entities.³⁰⁶ The Proposing Release also requested comment on whether the proposed amendments to the qualified institutional buyer definition would result in a greater likelihood of restricted securities sold under Rule 144A flowing into the public market. All of the commenters responding to this request indicated that they did not foresee such a likelihood.³⁰⁷

We received comments proposing additional expansions to Rule 144A. One commenter requested that the Commission include family clients in addition to family

³⁰³ See Proposing Release at note 241.

³⁰⁴ See CCIT Letter and Am. Bankers Assn. Letter.

³⁰⁵ See Am. Bankers Assn. Letter.

³⁰⁶ See Utah State Treasurer Letter.

³⁰⁷ See SD Investment Council Letter; Arnold & Porter Letter; and Utah State Treasurer Letter.

offices, which could be included under proposed Rule 144A(a)(1)(i)(J).³⁰⁸ One commenter proposed adding private funds with \$100 million in gross asset value and investment advisers managing the investments of such a private fund.³⁰⁹ A few commenters proposed to include clients of any SEC-registered adviser that manages more than \$100 million in securities.³¹⁰ Another commenter proposed to allow SEC-registered investment advisers to purchase 144A securities for clients that are not qualified institutional buyers.³¹¹

2. Final Amendments

We are adopting the amendments as proposed and are adding a note in response to comments. We continue to believe that the \$100 million threshold for these entities to qualify for qualified institutional buyer status should ensure that these entities have sufficient financial sophistication and access to resources to participate in investment opportunities that do not have the additional protections provided by registration under the Securities Act. The scope of Rule 144A(a)(1)(i)(J) encompasses all entity types that are not already listed in paragraphs (a)(1)(i)(A) through (I) or paragraphs (a)(1)(ii) through (vi) of Rule 144A, including Indian tribes, governmental bodies, and bank-maintained collective investment trusts. We also believe that the inclusion of Indian tribes and governmental bodies will provide these entities with expanded access to the commercial paper markets, which, according to the commenters discussed above, have changed in recent years.

³⁰⁸ See PIC Letter.

³⁰⁹ See AIC Letter.

³¹⁰ See IAA Letter; GW&K Letter; and Corbyn Letter.

³¹¹ See GW&K Letter.

Regarding the requests from commenters to expand Rule 144A to include various persons, including “family clients,” private funds with \$100 million in gross asset value and their investment advisers, clients of SEC-registered advisers that manage more than \$100 million in securities, and clients of any SEC-registered investment advisers, at this time, we are not expanding the scope of Rule 144A further than what the Commission proposed in the Proposing Release.

We are not expanding the definition to include private funds with \$100 million in gross asset value as one commenter suggested. Although we acknowledge that such funds likely have a high level of financial sophistication, we do not believe it is appropriate to add a new financial threshold to the definition exclusively for private funds. We are concerned about the application of different thresholds to similarly situated investors. We are also concerned about the confusion this would create. Furthermore, we believe that most private funds with \$100 million in gross asset value will already meet the definition of a qualified institutional buyer under Rule 144A (a)(1)(i)(H) or Rule 144A(a)(1)(i)(J).

We also are not expanding the definition to include clients of SEC-registered advisers. As discussed above with respect to the accredited investor definition, being advised by a financial professional has historically not been a complete substitute for the protections of the Securities Act registration requirements and, if applicable, the Investment Company Act.³¹² We do not believe it is appropriate to effectively transfer the status of an adviser to its individual clients, or to expand the aggregation of investments managed by an adviser in order to permit such persons to qualify as qualified

³¹² See *supra* note 264.

institutional buyers. We do note, however, that, if such a person is an institutional accredited investor, then it could also qualify as a qualified institutional buyer under Rule 144A(a)(1)(i)(J) if it meets the requirements of Rule 144A(a)(1)(i).³¹³

One commenter noted that the addition of Rule 144A(a)(1)(i)(J) would import the “not formed for the specific purpose of acquiring the securities offered” modifier of Rule 501(a) to several categories of institutional accredited investors that would qualify as qualified institutional buyers, a condition that does not appear at all in the current definition.³¹⁴ The provision in Rule 501(a) that the entity not be formed for the purpose of acquiring securities does not apply in the Rule 144A context. Consistent with the Proposing Release, we intend that eligible purchasers under Rule 144A(a)(1)(i) will 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.³¹⁵ To address the potential for confusion,³¹⁵ we are adding a note to Rule 144A(a)(1)(i)(J) to clarify that the entity seeking qualified institutional buyer status under Rule 144A(a)(1)(i)(J) may be formed for the purpose of acquiring the 144A securities being offered.

V. Other Matters

If any of the provisions of these rules, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or

³¹³ For example, a family client that is an institution and qualifies as an accredited investor under Rule 501(a) and meets the \$100 million in securities owned and invested threshold of Rule 144A(a)(1)(i), will qualify as a qualified institutional buyer.

³¹⁴ See CCMC Letter.

³¹⁵ See Proposing Release at 2598. This is in contrast to the amendment to the accredited investor definition in Rule 501(a)(3), which will continue to require that the entity not be formed for the specific purpose of acquiring the securities offered.

application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

Pursuant to the Congressional Review Act, the Office of Information and Regulatory Affairs has designated these rules as a “major rule,” as defined by 5 U.S.C. 804(2).

VI. Economic Analysis

We are attentive to the costs imposed by and the benefits obtained from the final amendments.³¹⁶ The discussion below addresses the potential economic effects of the final amendments, including the likely benefits and costs, as well as the likely effects on efficiency, competition, and capital formation. We also analyze the potential costs and benefits of reasonable alternatives to the amendments.

A. Introduction and Broad Economic Considerations

As discussed above, we are adopting amendments, generally as proposed, to the “accredited investor” definition in Rule 501(a) of Regulation D to, among other things: (1) add new categories of natural persons that qualify as accredited investors based on certain professional certifications or designations or other credentials, or with respect to investments in a private fund, as a “knowledgeable employee” of the private fund; (2) add certain entity types to the current list of entities that qualify as accredited investors and a new category for any entity with “investments,” as defined in Rule 2a51-1(b) under

³¹⁶ Section 2(b) [15 U.S.C. 77b(b)] and Section 3(f) [15 U.S.C. 78c(f)] of the Exchange Act directs the Commission, when engaging in rulemaking where it is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. Further, Section 23(a)(2) [15 U.S.C. 78w(a)(2)] of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact that the rules would have on competition, and prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

the Investment Company Act, in excess of \$5 million and that was not formed for the specific purpose of investing in the securities offered; (3) add family offices with more than \$5 million in assets under management and their family clients to the definition; (4) add the term “spousal equivalent” to the definition, so that spousal equivalents may pool their finances for the purpose of qualifying as accredited investors; and (5) codify certain staff interpretive positions that relate to the accredited investor definition. We also are adopting an amendment to the definition of “qualified institutional buyer” in Rule 144A to expand the list of entities that are eligible to qualify as qualified institutional buyers. The final amendments are designed to better align access to unregistered offerings with the financial sophistication required to assess an investment opportunity without the added investor protections that come with registration under the Securities Act.

Registration under the Securities Act is intended to provide certain investor protections, for example, by imposing procedural and substantive disclosure requirements that go significantly beyond general antifraud rules. These requirements are designed to mitigate certain information asymmetry and principal-agent problems that can arise when companies make public offerings of securities to investors, and also provide other investor protections, including, for example, a right of rescission under Section 12 of the Securities Act, if certain procedural requirements are not followed, and rights of action under Sections 11 and 12(a)(2) of the Securities Act, in the event of material misstatements or omissions that in certain cases do not require proof of intent or reliance. Registration also imposes various costs, such as compliance costs and the risk of issuers disclosing sensitive proprietary information to competitors. Although registration is the

default under our rules, Congress and the Commission have long recognized that the investor protection benefits of registration may not be necessary or appropriate in various circumstances, including in light of the significant attendant fixed and variable costs of registration, and have provided exemptions for certain offerings based on various factors, including when the offerings are generally limited to individuals and entities that do not require the protection of registration. We note that issuers conducting larger offerings with broad investor participation continue to rely on our public markets to avail themselves of the various attendant benefits of being a public company. The final amendments adjust the categories of individuals and entities eligible for participation in certain exempt offerings in several areas by expanding the definitions of accredited investor and qualified institutional buyer to include additional individuals and institutions that the Commission believes have sufficient knowledge and expertise to participate in investment opportunities that do not come with the additional protections provided by registration under the Securities Act.

In 2019, the estimated amount of capital reported as being raised in offerings under Regulation D was over \$1.5 trillion,³¹⁷ which was larger than the \$1.2 trillion

³¹⁷ See *infra* Table 4 in Section VI.B. Offerings under Regulation D include offerings under Rules 504, 506(b), and 506(c). DERA staff analysis is based on Form D filings from 2019. These estimates are based on the reported “total amount sold” at the time of the original filing—required within 15 days of the first sale—as well as any additional capital raised and reported in amended filings. The data likely underreport the actual amount sold due to two factors. First, underreporting could occur in all years because Regulation D filings can be made prior to the completion of the offering, and amendments to reflect additional amounts sold generally are not required if the offering is completed within one year and the amount sold does not exceed the original offering size by more than 10%. Second, Rule 503 requires the filing of a notice on Form D, but filing a Form D is not a condition to the availability of a Regulation D exemption. Hence, it is possible that some issuers do not file a Form D for offerings relying on Regulation D. Finally, in their annual amendments, some funds appear to report net asset values for total amount sold under the offering. Net asset values could reflect fund performance as well as new investment into, and redemptions from, the fund. For these reasons, based on Form D data, it is not possible to distinguish between the two impacts.

raised in registered offerings.³¹⁸ As private capital markets have grown, the vast majority of the capital that has been raised in unregistered offerings under Regulation D has been through investment by accredited investors. For example, though securities sold in offerings conducted pursuant to Rule 506(b) are permitted to be purchased by up to 35 non-accredited investors who are sophisticated, we estimate that, from 2009 to 2019, only between 3.4% and 6.9% of the aggregate number of offerings conducted under Rule 506(b) included non-accredited investor purchasers.³¹⁹ Further, these non-accredited investors in the aggregate likely accounted for a negligible amount of the capital raised in those offerings, and any impact was likely heavily weighted towards smaller offerings.³²⁰ These facts emphasize the prominent role our private markets play, and, as a result, accredited investors (particularly institutional accredited investors) play, in capital formation.³²¹

³¹⁸ We obtain data for issuers conducting registered offerings from SDC Platinum's New Issues database. We select all public offerings conducted in the U.S. market during 2019, excluding IPOs and government/federal agency offerings. For this comparison, we consider follow-on equity offerings and debt offerings as more appropriate benchmarks for Regulation D offerings because the motivations for conducting an IPO extend beyond raising capital to meet company's financial needs, such as considerations of pre-IPO owners' diversification and liquidity needs, among others.

³¹⁹ This estimated range is based on DERA staff analysis of Form D data on initial Form D filing among all Rule 506(b) offerings from 2009 to 2019. In particular, the 3.4% estimate is based on offerings that report that at least one non-accredited investor already have invested in the offering as of the Form D filing and may represent a lower bound because it relies on available Form D filings, and because a final Form D upon the conclusion of an offering is not required to be filed. If we also include Rule 506(b) offerings on Form D that accept non-accredited investors but reported having zero non-accredited investors in the initial filing, the estimated percentage of offerings involving accredited investors during the 2009-2019 period is approximately 6.9%, which may be viewed as an upper bound estimate.

³²⁰ For example, based on Form D filings during the period 2009-2019, the aggregate amount raised in offerings reporting participation by at least one non-accredited investor in their initial Form D filings was approximately 2.5% of the total aggregate amount raised in 506(b) offerings. Based on offerings reporting a non-zero amount of capital raised in their initial Form D filings, the median amount raised in offerings that included non-accredited investors was \$463,000, whereas the median amount raised in offerings with only accredited investors was approximately \$1,552,000.

³²¹ Individual accredited investors play an important role in certain aspects of the market, particularly for smaller, early stage issuers. However, they likely represent a much smaller portion of the overall investment in our private markets as a whole, including Regulation D, Rule 144A offerings, etc.

We anticipate that the final amendments may, in certain circumstances, reduce the costs of finding investors (*i.e.*, search costs) for issuers in private offerings, as well as reduce their transactions costs (*e.g.*, through a potentially lower cost of determining and verifying accredited investor status and a potentially lower level of intermediation) and cost of capital, thereby facilitating capital formation in those circumstances. In general, we expect these effects will be more meaningful for smaller private offerings than for larger private offerings.

The final amendments will also affect investors. Investors with specified attributes of financial sophistication who do not otherwise qualify as accredited investors will be able to participate in investment opportunities that historically generally have not been available to them, such as investments in issuers that are not Exchange Act reporting companies and offerings by certain private equity funds, venture capital (VC) funds, and hedge funds, which are frequently offered under Rule 506.³²² Additionally, accredited investors are not subject to investment limits in offerings made under Tier 2 of Regulation A. Thus, expanding the definition of accredited investor will permit additional investors to participate in Regulation A offerings at higher amounts. In addition, expanding the definition of qualified institutional buyer in the final rule will give certain institutional investors the opportunity to participate in the Rule 144A market, thereby giving those investors access to an expanded set of investment opportunities.

As discussed in more detail below, the main anticipated benefit to investors from the final amendments is access to a broader investment opportunity set that can potentially improve the risk-return characteristics of their portfolios. However, we

³²² See, *e.g.*, *infra* Table 2 in Section VI.B.

recognize that any potential gains in the efficiency of investors' portfolios from access to exempt offerings may be moderated by the lower levels of investor protection provided by these offerings as compared to registered offerings, and factors such as information asymmetry, illiquidity, and prevailing market practices (such as specific investor solicitation practices across different types of issuers) that nevertheless limit investors' opportunity set for private markets.

We generally expect the individuals and institutions that will become newly eligible accredited investors or qualified institutional buyers to have a level of financial sophistication that will enable them to assess both the opportunities and risks offered by private offerings. For example, for reasons discussed in more detail above,³²³ we think it is reasonable to believe that individuals that pass one or more of the Series 7, 65, and 82 exams, and meet the requirements to represent or advise others in connection with securities market transactions (including private securities offerings), have demonstrated a sufficient level of financial sophistication to be able to evaluate and participate in investment opportunities that do not have the additional protections provided by registration under the Securities Act.

The final amendments could increase the size and alter the composition of the pool of accredited investors by providing additional measures of financial sophistication (*e.g.*, professional certifications for individuals and an investments-owned threshold for entities) to qualify for accredited investor status. If many of the individuals who qualify as accredited investors under the final amendments already meet the income and wealth thresholds in the current accredited investor definition, then the impact of the change on

³²³ See *supra* Section II.B.1.a.

the pool of individuals that qualify as accredited investors could be limited. For entities, we anticipate that the impact of the amendments could be more significant, as we are amending the accredited investor definition to include a broad range of entities not previously covered under the definition. Because we believe family offices have generally qualified as accredited investors under the existing definition, we expect that the effect of the amendments on them will be much smaller than on other entities.

Expanding the pool of accredited investors may have a positive impact on capital formation in certain circumstances, such as in offerings by issuers that are small, in development stages, or in geographic areas that currently have lower concentrations of accredited investors. Similarly, the final amendments to the qualified institutional buyer definition in Rule 144A will increase the number of entities that qualify for this status, thus improving the ability of issuers to raise capital in the institutional investor market, including by enhancing competition among investors in this market.³²⁴ Further, the final amendments will permit issuers to engage in test-the-waters communications in registered offerings with a larger set of investors as a result of changes to the scope of entities that qualify as institutional accredited investors and qualified institutional buyers, further facilitating capital formation.

Where possible, we have attempted to quantify the benefits, costs, and effects on efficiency, competition, and capital formation expected to result from the amendments. In many cases, however, we are unable to quantify the economic effects because we lack the information necessary to derive a reasonable estimate. We have incorporated

³²⁴ Although Rule 144A is a non-exclusive safe harbor for resale transactions, market participants have used Rule 144A since its adoption in 1990 to facilitate capital raising by issuers. *See, e.g.*, Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Release No. 33-9415 (July 10, 2013) [78 FR 44771 (July 24, 2013)].

feedback provided by commenters in our analysis of the economic effects of the final amendments. However, as explained in more detail below, because we do not have, have not received, and, in certain cases, do not believe we can obtain data that may inform on certain economic effects, we are unable to quantify those effects. For example, we are unable to quantify the costs to issuers and investors of verifying an investor's accredited investor status and the potential capital raising and compliance cost savings that may arise from the amendments to the accredited investor definition. We further note that, even in cases where we have some data or have received some data regarding certain economic effects, the quantification of these effects is particularly challenging due to the number of assumptions that we would need to make to forecast how issuers and newly eligible (and potentially eligible) accredited investors and qualifying institutional buyers will respond to the final amendments, and how those responses will, in turn, affect the broader private and public securities markets.

Although many commenters supported expanding the accredited investor definition,³²⁵ some commenters raised a number of concerns with the proposed amendments and the analysis of their anticipated economic effects in the Proposing Release.³²⁶ We have considered those concerns and, in appropriate circumstances, have expanded our economic analysis to address those concerns.

The remainder of this economic analysis presents the baseline; anticipated benefits and costs from the final amendments; potential effects on efficiency, competition, and capital formation; and alternatives to the final amendments.

³²⁵ See *supra* note 14.

³²⁶ See *supra* note 15 for comment letters generally objecting to expanding the definition of accredited investor.

B. Baseline and Affected Parties

The main affected parties of the final amendments to the accredited investor definition will be investors and issuers. For example, certain entities that are currently not designated accredited investors will become accredited investors under the final amendments and will be eligible to participate in an expanded array of private offerings. Correspondingly, current accredited investors may face greater competition from newly qualified accredited investors to participate in investment opportunities in this market. Similarly, we anticipate that certain issuers, such as issuers that are smaller or in early stages of development, will need to compete less intensively and may incur fewer costs to access accredited investors under the final amendments.

We do not have precise data on the number of individuals and entities that currently qualify as accredited investors. Rule 501(a) of Regulation D uses net worth and income as bright-line criteria to identify natural persons as accredited investors.³²⁷ Using data on household wealth from the Federal Reserve's Survey of Consumer Finances (SCF) database,³²⁸ we estimate that under the current income and wealth thresholds noted above, approximately 16.0 million U.S. households representing 13% of the total population of U.S. households, qualify as accredited investors. This estimate does not, however, identify the precise number of accredited investors that do or could invest in the

³²⁷ Under the current definition, individuals may qualify as accredited investors if (i) their net worth exceeds \$1 million (excluding the value of the investor's primary residence), (ii) their income exceeds \$200,000 in each of the two most recent years, or (iii) their joint income with a spouse exceeds \$300,000 in each of those years and the individual has a reasonable expectation of reaching the same income level in the current year.

³²⁸ See <https://www.federalreserve.gov/econresdata/scf/scfindex.htm>.

Regulation D market or in other exempt offerings.³²⁹

Based on Form D filings during the period 2009-2019, we estimate that there were on average approximately 295,069 accredited investors participating annually in Regulation D offerings at the time of the initial filing.³³⁰ However, because an investor can participate in more than one Regulation D offering, this number likely includes duplicate investors and therefore represents an upper bound estimate. We lack data to estimate the actual number of unique accredited investors who participate annually in Regulation D offerings. Additionally, from the information reported on Form D, we cannot distinguish accredited investors that are natural persons from accredited investors that are institutions.³³¹ The average number of accredited investors per offering during the period 2009-2019 was 14, and the median number was four.

Table 2 presents evidence on investor participation in Regulation D offerings by industry type during the period 2009-2019. The participation of accredited investors in Regulation D offerings during that period varied by type of issuer as well, with offerings by real estate investment trusts (REITs) having the largest average number of accredited investors per offering, and those by operating companies having the smallest average

³²⁹ Form D data and other data available to us on private placements do not allow us to estimate the number of unique accredited investors that participate in exempt offerings.

³³⁰ We estimate the number of accredited investors as the number of total investors minus the number of non-accredited investors reported on initial Form D filings.

³³¹ Other limitations of the data gathered from Form D may reduce the accuracy of the estimated number of accredited investors. For example, an issuer is required to file a Form D generally no later than 15 calendar days after the first sale of securities in a Regulation D offering, regardless of whether the offering will be ongoing after the filing of the Form D. Further, issuers are required to file amendments to Form D only in limited circumstances: (i) to correct a material mistake of fact or error in a previously filed Form D, (ii) to reflect a change in certain information provided in a previously filed Form D, and (iii) on an annual basis if the offering is continuing at that time. Also, because the Form D filing requirement is not a condition to claiming an exemption under Rule 506(b) or 506(c) but rather is a requirement of Regulation D, it is possible that some issuers do not file Form D when conducting Regulation D offerings.

number.

Table 2. Investors participating in Regulation D offerings: 2009-2019

	Total Number of Investors*	Mean Investors per Offering	Median Investors per Offering	Fraction of Offerings with One or More Non-Accredited Investors ³³²	Fraction of Offerings Accepting Non-Accredited Investors ³³³
Hedge Fund	28,875	16	2	3%	7%
Private Equity Fund	28,062	17	2	2%	3%
Venture Capital Fund	11,809	15	4	0%	1%
Other Investment Fund	38,445	22	5	2%	4%
Financial Services	18,450	15	4	7%	12%
Real Estate	73,082	26	8	6%	14%
Non-financial Issuers	107,192	10	4	5%	9%
All offerings	305,915	14	4	4%	8%

**2009-2019 data is annualized*

We are not able to directly estimate the number of individuals who may newly qualify as accredited investors as a result of the initial set of professional certifications or designations, as precise data on the number of current holders of each professional certification or designation are not available to us. Based on data from FINRA, we estimate that there were 691,041 FINRA-registered individuals as of December 2018.³³⁴ We estimate that 334,860 individuals were registered only as broker-dealer

³³² The estimated percentages are based on offerings that report that at least one non-accredited investor already invested in the offering as of the Form D filing and may represent a lower bound because it relies on available Form D filings, and because a final Form D upon the conclusion of an offering is not required to be filed.

³³³ The estimated percentages are based on offerings that indicate on their initial Form D filing that they accept non-accredited investors, whether or not they reported having non-accredited investors at the time of the initial filing.

³³⁴ See 2019 FINRA Industry Snapshot, *available at* <https://www.finra.org/sites/default/files/2019%20Industry%20Snapshot.pdf>.

representatives; 294,684 were dually registered as broker-dealer and investment adviser representatives; and 61,497 were registered only as investment adviser representatives. Assuming that all of these individuals represent separate households, and none are currently accredited investors, this would represent an approximately 4.3% increase in the number of households that qualify as accredited investors. However, many of these individuals may already qualify as accredited investors under the current financial thresholds. In addition, because many FINRA-registered representatives hold multiple professional certifications, this aggregation likely overstates the actual number of individuals that hold a Series 7 or Series 82, and we have no method of estimating the extent of overlap. Therefore, the number of FINRA-registered representatives provides an estimate of the upper bound of individuals that hold the relevant certifications and designations and will become newly eligible accredited investors under the final amendments. We do not have access to data to estimate how many of these registered representatives already qualify as accredited investors, and therefore we are unable to more precisely estimate how many individuals will be newly eligible under the final rules.

We are not able to directly estimate the number of knowledgeable employees at private funds that will be immediately affected by the final amendments, as we do not have precise data on the number of such employees. Using data on private fund statistics compiled by the Commission's Division of Investment Management, we estimate that there were 32,622 private funds as of third quarter 2019.³³⁵

³³⁵ See U.S. Securities and Exchange Commission, Division of Investment Management Third Quarter 2019 Private Fund Statistics, *available at* <https://www.sec.gov/divisions/investment/private-funds-statistics/private-funds-statistics-2019-q3-accessible.pdf>.

Although we are unable to provide more precise estimates of how many individuals will become newly eligible accredited investors, and while the upper bound estimate is modest compared to the current pool of individuals that currently qualify as accredited investors (4%) and the population more generally (0.2%), we are confident that the final amendments will cause some modest increase in the number of individual accredited investors. However, largely due to the fact that newly eligible individual accredited investors would not have relatively significant income or wealth (otherwise, they would have qualified as accredited investors under the existing thresholds), it is unlikely that these newly eligible investors will provide an additional, meaningful source of capital in most private offerings.

Estimates for the number of family offices in the United States vary. In 2015, an industry participant estimated that there were 3,000 family offices in the United States.³³⁶ In 2017, academic researchers estimated the number of family offices in the United States to have been between 2,500 and 5,000.³³⁷ In 2019, an industry group estimated that there are 10,489 family offices in the United States.³³⁸

When identifying entities as accredited investors, the current definition enumerates specific types of entities that will qualify. Certain enumerated entities are subject to a \$5 million asset threshold to qualify as accredited investors (*e.g.*, tax-exempt

³³⁶ See Robert Elliot, *Single family offices facing a transition*, Market Street Trust Company, (Dec. 2015), available at https://www.marketstreettrust.com/usr/PDF_Files/News/SFO_Transition_Final.pdf. A single family office generally provides services only to members of a single family.

³³⁷ See Elena Rivo-Lopez, Monica Villanueva-Villar, Alberto Vaquero-Garcia & Santiago Lago-Penas, *Family offices: What, why and what for*, *Organizational Dynamics* 46, 262-270, (2017), citing Family Office Exchange estimates.

³³⁸ See How Many Family Offices are there in the United States, available at <https://www.familyoffice.com/insights/how-many-family-offices-are-there-united-states>.

charitable organizations, trusts, and employee benefit plans), while others are not (e.g., banks, insurance companies, registered broker-dealers, entities in which all equity owners are accredited investors, private business development companies, and SBICs). Many of the entities that are not subject to asset tests are regulated entities. An entity that is not covered specifically by one of the enumerated categories, such as an Indian tribe or sovereign wealth fund, is generally not an accredited investor under the current rule.

Publicly reported information provides an indication of the number of entities, by type, that may currently qualify as accredited investors. There were 3,670 broker-dealers that filed Financial and Operational Combined Uniform Single (“FOCUS”) reports with the Commission for 2019. As of 2019, there were 4,518 FDIC-insured banks, 659 savings and loan institutions,³³⁹ and 299 SBICs.³⁴⁰ There were 101 business development companies (BDCs) as of December 31, 2019. There were 5,965 insurance companies as of 2018.³⁴¹ With respect to the final amendments to the accredited investor definition to add other types of institutional accredited investors, as of December 2019 there were approximately 13,479 registered investment advisers,³⁴² 4,244 exempt reporting advisers,³⁴³ and 17,533 state-registered investment advisers.³⁴⁴ However, we do not have access to data that would allow us to identify how many of these registered

³³⁹ See FDIC Statistics at a Glance as of December 31, 2019, *available at* <https://www.fdic.gov/bank/statistical/stats/2019dec/industry.pdf>.

³⁴⁰ See Small Business Administration (SBA) SBIC Program Overview as of December 31, 2019, *available at* https://www.sba.gov/sites/default/files/2020-02/SBIC%20Quarterly%20Report%20as%20of%20December_31_2019.pdf.

³⁴¹ See Insurance Information Institute Industry Overview, *available at* <https://www.iii.org/fact-statistic/facts-statistics-industry-overview#Insurance>.

³⁴² Identified from Forms ADV filed with the Commission as of December 31, 2019.

³⁴³ *Id.*

³⁴⁴ See 2020 NASAA Investment Adviser Section Annual Report, *available at* <https://www.nasaa.org/wp-content/uploads/2020/04/2020-IA-Section-Report-FINAL.pdf>.

investment advisers and exempt reporting advisers currently qualify as accredited investors. We also lack data to generate precise estimates of the overall number of other institutional accredited investors that may be newly eligible for accredited investor status because disclosure of accredited investor status across all institutional investors is not required and because, while we have information to estimate the number of some categories of institutional accredited investors, we lack comprehensive data that will allow us to estimate the unique number of investors across all categories of institutional accredited investors under Rule 501(a).

The final amendments will include limited liability companies in Rule 501(a)(3). Based on data from the Internal Revenue Service, there were 2,696,149 limited liability companies at the end of 2017.³⁴⁵ Due to a lack of more detailed publicly available information about limited liability companies, such as the distribution of total assets across companies, we are unable to estimate the number of these limited liability companies that currently meet the accredited investor requirements of Rule 501(a)(3). As this amendment is a codification of a long standing staff interpretation, we do not expect that the pool of accredited investors will change significantly as a result of this amendment.

Based on analysis of Form D filings, we have identified approximately 173,697 unique issuers (of which the majority were non-fund issuers) that have raised capital through Regulation D offerings from 2009 until 2019. This gives some indication of the scope of issuers that could be affected by the expansion of the accredited investor pool

³⁴⁵ See IRS, Statistics of Income Division, Partnerships, May 2019, Table 8, *available at* <https://www.irs.gov/pub/irs-soi/17pa08.xlsx>. See also D. Burton Letter.

under the final amendments.

Table 3. Frequency of Regulation D offerings by unique issuers: 2009-2019

Number of Offerings	<u>Non-Fund Issuers</u>		<u>Fund Issuers</u>		<u>All Regulation D Issuers</u>
	Number of Issuers	Proportion	Number of Issuers	Proportion	
1	80,245	75.9%	58,134	95.6%	138,379
2	12,574	11.9%	1,968	3.2%	14,542
3	5,361	5.1%	362	0.6%	5,723
4	2,874	2.7%	126	0.2%	3,000
5	1,738	1.6%	68	0.1%	1,806
6 or more Offerings	2,875	2.8%	132	0.4%	3,007
Total: Unique Issuers	105,667		60,790		166,457

Lastly, the final amendments to the accredited investor definition likely will impact the market for private offerings in terms of capital raising in certain circumstances. As noted above, currently eligible accredited investors, particularly institutional accredited investors, play a prominent role in Regulation D offerings and have substantial capital. As Table 4 shows, in 2019, issuers in the Regulation D market raised more than \$1.5 trillion. The vast majority of capital raised in this market was raised under Rule 506(b), which has no limit on the number of purchasers who are accredited investors but limits the number of non-accredited investors to 35 per offering. Offerings under Rule 506(c), under which purchasers are exclusively accredited investors, raised approximately \$66 billion. Table 4 also shows that the amount of capital raised in other exempt offerings was approximately \$1.2 trillion. Most of the capital raised in these other exempt offerings came from Rule 144A offerings, where qualified

institutional buyers constitute the ultimate purchasers of the offerings.³⁴⁶ Finally, Table 4 shows that the total amount of capital raised under Regulation A was approximately \$1 billion in 2019 (less than 1% of the amount raised in Rule 144A offerings). The overwhelming majority of capital raised in these Regulation A offerings was through Tier 2 offerings, for which accredited investors are not subject to investment limits.

Table 4: Overview of amounts raised in the exempt market in 2019³⁴⁷

Exemption	Amounts Reported or Estimated as Raised in 2019
Rule 506(b) of Regulation D	\$1,492 billion
Rule 506(c) of Regulation D	\$66 billion
Regulation A: Tier 1	\$0.044 billion
Regulation A: Tier 2	\$0.998 billion
Rule 504 of Regulation D	\$0.228 billion
Regulation Crowdfunding³⁴⁸	\$0.062 billion
Other exempt offerings³⁴⁹	\$1,167 billion

³⁴⁶ The term “Rule 144A offering” refers to a primary offering of securities by an issuer to one or more financial intermediaries (commonly known as the “initial purchasers”) in a transaction exempt from registration under the Securities Act, followed by the immediate resale of the securities by the initial purchasers to qualified institutional buyers in reliance on Rule 144A.

³⁴⁷ Data on Regulation D capital raising is taken from Form D and Form D/A filings. Information on Regulation A capital raising is taken from Form 1-A and Form 1-A/A filings.

³⁴⁸ Data on offerings under Regulation Crowdfunding were collected from Form C filings on EDGAR. For offerings that have been amended, the data reflects information reported in the latest amendment as of the end of the considered period. Regulation Crowdfunding requires an issuer to file a progress update on Form C-U within 5 business days after reaching 100% of its target offering amount. The data on Regulation Crowdfunding excludes withdrawn offerings. Some withdrawn offerings may be failed offerings. Amounts raised may be lower than the target or maximum amounts sought.

³⁴⁹ “Other exempt offerings” are identified from Regulation S and Rule 144A offerings. The data used to estimate the amounts raised in 2019 for other exempt offerings includes data on: Offerings under Section 4(a)(2) of the Securities Act that were collected from Thomson Financial’s SDC Platinum, which uses information from underwriters, issuer websites, and issuer SEC filings to compile its Private Issues database; offerings under Regulation S that were collected from Thomson Financial’s SDC Platinum service; and resale offerings under Rule 144A that were collected from Thomson Financial SDC New Issues database, Dealogic, the Mergent database, and the Asset-Backed Alert and Commercial Mortgage Alert publications to further estimate the number of exempt offerings under Section 4(a)(2) and Regulation S. We included amounts sold in Rule 144A resale offerings because those securities are typically issued initially in a transaction under Section 4(a)(2) or Regulation S but generally are not included in the Section 4(a)(2) or Regulation S data identified above. These amounts are accurate only to the extent that these databases are able to collect such information and may understate the actual amount of capital raised under these offerings if issuers and underwriters do not make this data available.

C. Anticipated Economic Effects

In this section, we discuss the anticipated economic benefits and costs of the final amendments to the accredited investor and qualified institutional buyer definitions. We first analyze the potential costs and benefits of the final amendments for each of the affected parties and then discuss how those effects may vary based on the characteristics of issuers and investors. We also discuss the anticipated effects on efficiency, capital formation and competition. Finally, we discuss the costs and benefits of reasonable alternatives to the final amendments.

Several commenters expressed general concerns that the analysis in the Proposing Release did not include sufficient data and evidence on the performance of private offerings and therefore that the Commission had not adequately assessed the benefits and costs to potentially newly eligible individual investors from investing in exempt offerings.³⁵⁰ In the Proposing Release, the Commission acknowledged that it is difficult to reach rigorous conclusions about the typical magnitude of investor gains and losses in exempt offerings. Understanding the effect of the amendments on individual investors requires more than a consideration of exempt offerings on their own. In particular, an equally if not more relevant consideration is how sophisticated investors that are currently not eligible to participate in (or significantly restricted from participating in) exempt offerings would benefit from having access to exempt offering investment opportunities as one part of their overall investment strategy. It is difficult to quantify with any reasonable degree of confidence the potential benefits to and cost that may be

³⁵⁰ See, e.g., CFA Letter; Healthy Markets Letter; Better Market Letter; NASAA Letter; and CA Attorney General et al. Letter.

incurred by newly eligible accredited investors at an individual level or on an aggregate basis. It is, however, clear that many existing accredited investors see benefits in participating in exempt offerings as part of their investment strategy.

Commission staff recently completed a report to Congress on the performance of Regulation D and Regulation A offerings. We have noted some supplementary information contained in this report in our more detailed discussion of the benefits and costs of the final amendments below. This information (including, for example, data on SEC litigation against Regulation D issuers), together with information provided by commenters, helps to further inform our analysis of the costs and benefits of the final amendments.

1. Potential Benefits to Issuers

We expect that issuers interested in raising capital through unregistered offerings will benefit from the final amendments in several ways.

a. More Efficient Capital Raising Process in Exempt Offerings

The final amendments will benefit issuers by potentially increasing the efficiency of the process of raising capital in unregistered offerings. Specifically, issuers interested in raising capital from accredited investors under Regulation D must have a reasonable belief that those investors are accredited investors. In addition, issuers conducting offerings under Rule 506(c) are required to take reasonable steps to verify the accredited investor status of all purchasers in the offering. The final amendments may make it easier for issuers to assess and verify an investor's status as an accredited investor. As discussed in the Proposing Release, compliance with this verification requirement has been cited as a potential impediment to the use of Rule 506(c) to raise capital despite the

ability to use general solicitation when conducting these types of offerings.³⁵¹ To the extent that issuers may face challenges complying with this requirement, the final amendments could facilitate the use of Rule 506(c) as a capital raising option by providing issuers with additional avenues (*e.g.*, professional certifications and investment tests) to meet this requirement.

There could be other efficiency gains to issuers from the final amendments. For example, by expanding the number of accredited investors and qualified institutional buyers, certain issuers that are highly uncertain of the degree of interest in their offerings may be able to find and attract investors more easily, thereby lowering search costs. In addition, certain issuers that rely on intermediaries when raising capital may be able to reduce intermediation costs if there is an increase in the number of sophisticated investors who are able to invest directly rather than through an intermediary. Given that the average intermediary fee in Regulation D offerings ranges from approximately 2% (for fund issuers) to 5.5% (for non-fund issuers) of the amount raised, the ability to raise capital without relying on an intermediary may be a significant cost saving for some issuers.³⁵²

There also may be certain efficiency gains for Rule 504 offerings that could increase issuers' reliance on this currently rarely used exemption. Under Rule 504 of Regulation D, issuers are permitted to use general solicitation or general advertising to offer and sell securities to accredited investors when offers and sales are made pursuant

³⁵¹ See, *e.g.*, Proposing Release at note 281.

³⁵² See Scott Bauguess, Rachita Gullapalli, & Vladimir Ivanov, *Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2017* (Aug. 2018), available at https://www.sec.gov/files/DERA%20white%20paper_Regulation%20D_082018.pdf.

to state law exemptions from registration that permit general solicitation and general advertising. Because the pool of accredited investors will increase under the final amendments, the cost effectiveness of general solicitation and general advertising under Rule 504 may improve (*e.g.*, due to fixed costs of advertising and solicitation). As a result, certain issuers may increase their reliance on Rule 504 to meet their capital needs. Some of these additional Rule 504 offerings may represent issuers switching from other offering exemptions, such as Rule 506(b). To the extent that will be the case, we expect issuers will only switch to Rule 504 offerings if such offerings are better suited to their particular facts and circumstances.

b. Facilitate Capital Formation by Expanding the Pool of Investors in Exempt Offerings

The final amendments will expand the pool of individual accredited investors and institutional accredited investors compared to the current baseline. The amendments add several new categories of entities to the definition of accredited investor. For example, the final amendments include all SEC- and state-registered investment advisers and all exempt reporting advisers in the definition of accredited investor. This constitutes a pool of approximately 45,000 entities, some of which may not already qualify as accredited investors under the current rules. In addition, a broad range of entities that do not currently qualify as accredited investors will qualify if they meet the \$5 million investments threshold under the final amendments, including, for example, Indian tribes and state and local governmental bodies. With respect to individual investors, as discussed above, we estimate that the upper bound percentage increase of the individual accredited investor pool due to the addition of these individuals will be approximately 4%. However, because many of the individuals that will qualify as accredited investors

under the amendments may already qualify as accredited investors based on the current financial thresholds, this percentage likely overestimates the actual increase. In addition, because the newly eligible individuals have income and net worth below the currently required thresholds for individual accredited investors, we expect the increase in the capital supply provided by the pool of individual accredited investors will be proportionately considerably lower than the increase in the number of individual accredited investors. For example, even in the unlikely event that (1) all 691,041 FINRA-registered securities representatives and 17,543 state-registered investment adviser representatives were newly eligible accredited investors (*i.e.*, no overlap in registration and no overlap with current eligible accredited investors) , and (2) all of them elected to invest \$30,000 (which is likely over 15% of many of these investors' income)³⁵³ in unregistered offerings, the aggregate additional capital available would be approximately \$21.3 billion, or an increase of less than 1.4% of the Regulation D market in 2019. Because this analysis assumes no overlap between these sets of individuals and between these individuals and current accredited investors, we expect the actual additional capital will be a small fraction of that number. Each of the entities that will be newly eligible accredited investors under the final amendments will have assets or investments in excess of \$5 million. Thus, we believe that the addition of new categories of entities to the definition of accredited investor is likely to contribute more meaningfully to the increase in potential capital supply than the addition of new categories of individuals.

³⁵³ To qualify based on the income threshold, an accredited investor would require income greater than \$200,000 (or joint income greater than \$300,000 with their spouse) in each of the two most recent years and a reasonable expectation of the same income in the current year, so the investor's income in any one year could be greater than either threshold.

Generally, accredited investors, and in particular, institutional accredited investors, supply the vast majority of capital raised under Regulation D and are vital to the capital raising needs of issuers conducting Regulation D offerings.³⁵⁴ Therefore, we anticipate that expanding the pool of accredited investors under the final amendments will lead to an increase in the aggregate potential supply of capital available for exempt offerings under Regulation D. Because we lack data on the total number of newly eligible accredited investors and the size of their asset portfolios, we are not able to estimate the magnitude of the aggregate increase in the potential capital supply, and therefore the overall impact on the market for Regulation D offerings is uncertain. However, as illustrated in the example above, we expect the impact of newly eligible individual accredited investors on capital supply to be limited. Increased capital supply from newly eligible institutional investors may be relatively more meaningful in certain offerings and could potentially increase competition among accredited investors in those offerings, thereby lowering the cost of capital and promoting capital formation.³⁵⁵ As discussed in more detail below, we expect these benefits will, in particular, be realized by issuers that have greater uncertainty about the interest in their prospective offerings,

³⁵⁴ See, e.g., NAM Letter (stating that “[m]anufacturers in every part of the country need capital for the operational challenges they face, and strong access to capital for growing manufacturers means job creation and economic expansion in all 50 states. As they grow, these small businesses utilize the SEC’s exemptions from registration to conduct private offerings—often raising capital from members of the communities in which they operate. Participation in offerings conducted under a registration exemption is usually restricted to accredited investors, meaning that the qualifications set by the SEC have a real-world impact on manufacturing businesses’ ability to raise capital”).

³⁵⁵ See, e.g., Nexus Private Capital Letter (stating that “[b]y changing the Definition of Accredited Investor as proposed, our company should realize two significant benefits: (a) greater access to capital to reinvest (which benefits a wide range of stakeholders); and (b) greater confidence that we are staying within our regulatory lanes (which is important to us)”; and J. Angel Letter (stating that “[t]he Commission should be generous in awarding accredited investor status. This will both promote capital formation by increasing the pool of capital available for private placements, and also make it possible for more investors to reap the rewards of investing in private deals”).

particularly ones that are small, in early development stages, or in geographic areas that currently have lower concentrations of accredited investors.

Similarly, the final amendments could enhance capital formation in the Regulation A market. As accredited investors are not subject to investment limits under Tier 2 of Regulation A, expanding the pool of accredited investors could enable issuers that are conducting offerings under Tier 2 of Regulation A to raise more capital and/or raise capital at a lower cost (*e.g.*, due to lower search and transaction costs).

Expanding the definition of qualified institutional buyer under Rule 144A will increase the number of potential buyers of Rule 144A securities, thereby increasing the aggregate potential supply of capital and increasing competition among investors for Rule 144A offerings. We expect as a result of any such increase that current and prospective issuers of Rule 144A offerings will experience lower costs of raising capital (*e.g.*, due to lower search and transaction costs), which will facilitate capital formation in this market.

Some commenters disagreed with the assessment in the Proposing Release of the potential positive effects on capital formation from the final amendments. In particular, some commenters asserted that there is currently no evidence of scarcity of capital in the market for exempt offerings, which suggests that positive net present value projects can already get funded and that issuers with economically viable projects will have low incentives to seek capital (outside their currently established funding channels) from the individuals that become newly eligible accredited investors.³⁵⁶ Therefore, according to these commenters, expanding the accredited investor definition to individuals beyond the

³⁵⁶ See, *e.g.*, NASAA Letter and Better Markets Letter.

current income and wealth thresholds could have little impact on capital formation. In addition, these commenters suggested there may even be a negative incremental impact on capital formation to the extent adverse selection occurs, wherein the newly eligible individual accredited investors may only be offered highly speculative investment opportunities.³⁵⁷

We disagree with these commenters' assessment of the potential effects on capital formation. Even if commenters are correct that there will be little increased demand from issuers with positive net present value projects for capital from the (comparatively low-capitalized) individuals that will become newly eligible accredited investors, there is no reason to believe this necessarily means that such issuers will not benefit from access to capital from (more well-capitalized) entities that will become newly eligible accredited investors or qualified institutional buyers under the final amendments (who we expect will be responsible for any meaningful increase in capital supply, as we noted above). Therefore, we still anticipate that the increased potential supply of institutional capital in the market for exempt offerings is likely to incrementally decrease the cost of capital (*e.g.*, due to lower search and transaction costs) for certain issuers that rely on capital from institutional accredited investors or qualified institutional buyers, thereby promoting capital formation. In addition, because we believe that the individuals that become newly eligible accredited investors will have the financial sophistication needed to assess the

³⁵⁷ See, *e.g.*, NASAA Letter (stating that “[e]vidence that promising and successful private companies have significant access to institutional private capital strongly suggests that the only companies eager to sell to accredited retail investors are speculative and suspect enterprises”); and Better Markets Letter (stating that “given the glut of funding available to viable companies (including, historically low levels of interest rates which cause lenders and investors to compete to find viable borrowers/issuers), companies that have challenges finding investors, and therefore need to resort to soliciting non-Accredited Investors, would need to have been denied by sophisticated investors and those who know the business or company’s executives well”).

various risks of unregistered offerings, including the risk of adverse selection, the likelihood of these individuals investing in highly speculative and potentially negative net present value projects may be attenuated.

c. Increase Liquidity of Securities Issued in Unregistered Offerings

We expect the final rule to have an effect on the liquidity of securities issued in unregistered offerings. For example, the amendments to the qualified institutional buyer definition could facilitate resales of Rule 144A securities by holders of these securities by expanding the pool of potential purchasers in resale transactions. This could increase demand for Rule 144A securities and have an impact on the price and liquidity of these securities when offered and sold by the issuer in Rule 144A offerings and in subsequent resale transactions. Because we do not have access to data that would enable us to estimate the magnitude of the potential increase in demand due to the newly eligible qualified institutional buyers, we are unable to quantify any such potential changes in the liquidity of Rule 144A securities as a result of the final amendments.

Moreover, investors that are seeking to resell restricted securities and that rely on the Rule 144 safe harbor for purposes of determining whether the sale is eligible for the Section 4(a)(1) exemption are required to meet certain conditions under Rule 144, which include holding the restricted securities for six months or one year, depending on the circumstances. An expanded accredited investor pool could make it easier to conduct a private resale of restricted securities in a time period shorter than six months or one year. For example, an investor may seek to rely on the Section 4(a)(7) exemption for the resale, which requires a number of conditions to be met, including that the purchaser is an accredited investor. If the final amendments make it easier to conduct private resales of

restricted securities, this could possibly reduce the liquidity discount for restricted securities when sold under Rule 506 (or another exemption), making Rule 506 more attractive to issuers as well as investors.

Additionally, the expanded accredited investor definition could impact resales under Rule 501 of Regulation Crowdfunding during the one-year resale restriction period, thus potentially affecting the liquidity discount for such securities. Securities purchased in a Regulation Crowdfunding transaction generally cannot be resold for a period of one year, unless they are transferred to, among others, an accredited investor.³⁵⁸ An expanded pool of accredited investors as a result of the final amendments could make it easier for holders of such securities to find a potential buyer, thus potentially leading to a lower liquidity discount at the time of issuance.

d. Other Benefits

The final amendments to the accredited investor definition will allow knowledgeable employees of private funds to qualify as accredited investors for purposes of investing in offerings by these funds without the funds themselves losing accredited investor status when the funds have assets of \$5 million or less.³⁵⁹ This amendment will enable private funds to offer knowledgeable employees additional types of performance incentives, such as investing in the fund. Permitting employees who participate in the investment activities of a private fund to co-invest in the private fund may align

³⁵⁸ See Rule 501 under Regulation Crowdfunding [17 CFR 227.501]. Such securities could also be transferred (i) to the issuer of the securities; (ii) as part of an offering registered with the Commission; or (iii) to a member of the family of the purchaser or the equivalent, to a trust controlled by the purchaser, to a trust created for the benefit of a member of the family of the purchaser or the equivalent, or in connection with the death or divorce of the purchaser or other similar circumstance.

³⁵⁹ Under Rule 501(a)(8), a private fund with assets of \$5 million or less may qualify as an accredited investor if all of the fund's equity owners are accredited investors.

incentives between such employees and fund investors. Although we expect that the increase in the capital that is supplied to private funds by knowledgeable employees of these private funds will be relatively small, the potential gains to the funds in incentive alignment and employee retention could affect fund performance positively.

In addition, the final amendments also will increase the number of potential investors with whom issuers undertaking a registered offering may be able to communicate under Section 5(d) of the Securities Act and Securities Act Rule 163B (the test-the-waters provisions). By expanding the pool of potential institutional accredited investors and qualified institutional buyers, the amendments will increase certain issuers' ability to gather valuable information about investor interest before a potential registered offering. This could result in a more efficient and potentially lower-cost and lower-risk capital raising process for such issuers.

2. Potential Benefits to Investors

We believe that the individuals and institutions that will be newly eligible accredited investors under the final amendments have the requisite financial sophistication for meaningful investment analysis, and could therefore benefit from gaining broader access to investment opportunities in private capital markets and greater freedom to make investment decisions based on their own analysis and circumstances.

There is recent empirical evidence that, for a number of reasons, issuers tend to stay private for longer than in the past and have been able to grow to a size historically available only to their public peers.³⁶⁰ This suggests that the high-growth stage of the

³⁶⁰ See Michael Ewens & Joan Farre-Mensa, *The Deregulation of the Private Equity Markets and the Decline in IPOs* (Nat'l Bureau of Econ. Research, Working Paper No. 26317, Sept. 2019) ("Ewens & Farre-Mensa (2019)").

lifecycle of many issuers occurs while they remain private. Thus, investors that do not qualify for accredited investor status may not be able to participate in the high-growth stage of these issuers because it often occurs before they engage in registered offerings.³⁶¹ Allowing additional financially sophisticated investors to invest in unregistered offerings of private firms will potentially enable them to participate in the high-growth stages of these firms.

All else equal, expanding the set of investment opportunities can increase diversification and improve the risk-return tradeoff of an investor's portfolio. More specifically, adding private investments to the set of investable assets could allow an investor to expand the efficient risk-return frontier and construct an optimal portfolio with risk-return properties that are better than, or similar to, the risk-return properties of a portfolio that is constrained from investing in certain asset classes, leading to a more efficient portfolio allocation.³⁶² For example, recent research has shown that investments in funds of private equity funds can outperform public markets.³⁶³ Thus, to the extent access to private offerings expands the efficient risk-return frontier for newly eligible accredited investors and qualified institutional buyers, we expect these investors will potentially benefit from an improvement in portfolio efficiency.

While private investments may offer the opportunity to invest in certain early-

³⁶¹ For example, according to one study, the median age of a firm that went public in 1999 was five years, and in 2018 the median age was 10 years. See Jay R. Ritter, *Initial Public Offerings: Median Age of IPOs Through 2019*, Jan. 2020, available at <https://site.warrington.ufl.edu/ritter/files/2020/02/IPOs2019Age.pdf>.

³⁶² See, e.g., John L. Maginn et al., *Managing Investment Portfolios: a Dynamic Process* (3rd ed. 2007) (“Maginn et al. (2007)”); and Zvi Bodie, Alex Kane, & Alan J. Marcus, *Investments* (10th ed. 2013).

³⁶³ See, e.g., Robert S. Harris et al., *Financial Intermediation in Private Equity: How Well Do Funds of Funds Perform?*, 129 J. Fin. Econ. 287 (2018).

stage or high-growth firms that are not as readily available in the registered market, private investments, particularly in small and startup companies, generally also pose a high level of risk, as noted by several commenters.³⁶⁴ For example, based on Bureau of Labor Statistics (BLS) data on establishment survival rates, the five-year survival rates for private sector establishments formed in March in each of the years 2010 - 2014 ranged between 50% and 51%.³⁶⁵ The higher risks of private investments may be mitigated by the financial sophistication of newly eligible accredited investors or if these investors invest in professionally managed private funds rather than selecting private company investments directly.³⁶⁶

Estimating the aggregate potential gains in portfolio efficiency from investments in private offerings is difficult, because comprehensive, market-wide data on the returns of private investments is not available due to a lack of required disclosure about these investment returns, the voluntary nature of disclosure of performance information by private funds, and the very limited nature of secondary market trading in these securities. Academic studies of the returns to private investments acknowledge limitations and biases in the available data.³⁶⁷ For instance, it has been shown that the data on returns of

³⁶⁴ See, e.g., CA Attorney General et al. Letter; NASAA Letter; Better Markets Letter; and CFA Letter.

³⁶⁵ See U.S. Bureau of Labor Statistics, *Survival of Private Sector Establishments by Opening Year*, available at https://www.bls.gov/bdm/us_age_naics_00_table7.txt.

³⁶⁶ See, e.g., the recommendation from an independent research organization to expand retail investor access to closed-end registered investment funds with significant exposures to alternatives, available at <https://www.capmktreg.org/wp-content/uploads/2018/10/Private-Equity-Report-FINAL-1.pdf>.

³⁶⁷ Research has examined (i) private equity returns (see, e.g., Steven N. Kaplan & Antoinette Schoar, *Private Equity Performance: Returns, Persistence, and Capital Flows*, 60 J. Fin. 1791 (2005); Andrew Metrick & Ayako Yasuda, *Venture Capital and Other Private Equity: A Survey*, 17 Eur. Fin. Mgmt. 619 (2011); Christian Diller & Christoph Kaserer, *What Drives Private Equity Returns? Fund Inflows, Skilled GPs, and/or Risk?*, 15 Eur. Fin. Mgmt. 643 (2009); Robert S. Harris et al., *Financial Intermediation in Private Equity: How Well Do Funds of Funds Perform?*, 129 J. Fin. Econ. 287 (2018); Robert S. Harris, Tim Jenkinson, & Steven N. Kaplan, *Private Equity Performance: What Do We Know?*, 69 J. Fin. 1851

private investments typically exhibit a survival bias due to the lack of reporting of underperforming investments and that the use of appraised valuations to construct returns on assets that are nontraded can make private investments seem less risky. There is also a lack of comprehensive data on angel investment returns³⁶⁸ and entrepreneur returns on investment of their own funds and savings in starting a private business.³⁶⁹

(2014); and Kasper Nielsen, *The Return to Direct Investment in Private Firms: New Evidence on the Private Equity Premium Puzzle*, 17 *Eur. Fin. Mgmt.* 436 (2011)); (ii) VC performance (see, e.g., John H. Cochrane, *The Risk and Return of Venture Capital*, 75 *J. Fin. Econ.* 3 (2005); Arthur Korteweg & Stefan Nagel, *Risk-Adjusting the Returns to Venture Capital*, 71 *J. Fin.* 1437 (2016); and Axel Buchner, Abdulkadir Mohamed, & Armin Schwiendbacher, *Does Risk Explain Persistence in Private Equity Performance?*, 39 *J. Corp. Fin.* 18 (2016)); and (iii) hedge fund returns (see, e.g., William Fung & David A. Hsieh, *Hedge Fund Benchmarks: A Risk-Based Approach*, *Fin. Analysts J.*, Sept./Oct. 2004, at 65; William Fung & David A. Hsieh, *Measurement Biases in Hedge Fund Performance Data: An Update*, *Fin. Analysts J.*, May/June 2009, at 36; Manuel Ammann, Otto R. Huber, & Markus Schmid, *Benchmarking Hedge Funds: The Choice of the Factor Model* (Working Paper, 2011); Zheng Sun, Ashley W. Wang, & Lu Zheng, *Only Winners in Tough Times Repeat: Hedge Fund Performance Persistence over Different Market Conditions*, 53 *J. Fin. & Quantitative Analysis* 2199 (2018); Charles Cao et al., *What Is the Nature of Hedge Fund Manager Skills? Evidence from the Risk-Arbitrage Strategy*, 51 *J. Fin. & Quantitative Analysis* 929 (2016); Vikas Agarwal, T. Clifton Green, & Honglin Ren, *Alpha or Beta in the Eye of the Beholder: What Drives Hedge Fund Flows?*, 127 *J. Fin. Econ.* 417 (2018); Turan G. Bali, Stephen J. Brown, & Mustafa O. Caglayan, *Systematic Risk and the Cross Section of Hedge Fund Returns*, 106 *J. Fin. Econ.* 114 (2012); Turan G. Bali, Stephen J. Brown, & Mustafa O. Caglayan, *Macroeconomic Risk and Hedge Fund Returns*, 114 *J. Fin. Econ.* 1 (2014); Andrea Buraschi, Robert Kosowski, & Fabio Trojani, *When There Is No Place to Hide: Correlation Risk and the Cross-Section of Hedge Fund Returns*, 27 *Rev. Fin. Stud.* 581 (2014); Ravi Jagannathan, Alexey Malakhov, & Dmitry Novikov, *Do Hot Hands Exist Among Hedge Fund Managers? An Empirical Evaluation*, 65 *J. Fin.* 217 (2010); Andrea Buraschi, Robert Kosowski, & Worrawat Sritrakul, *Incentives and Endogenous Risk Taking: A Structural View on Hedge Fund Alphas*, 69 *J. Fin.* 2819 (2014); Ronnie Sadka, *Liquidity Risk and the Cross-Section of Hedge-Fund Returns*, 98 *J. Fin. Econ.* 54 (2010); and Ilija D. Dichev & Gwen Yu, *Higher Risk, Lower Returns: What Hedge Fund Investors Really Earn*, 100 *J. Fin. Econ.* 248 (2011)).

³⁶⁸ Studies we have identified have used small, selected samples—sometimes from foreign markets—that do not generalize to the entire U.S. market. See, e.g., Vincenzo Capizzi, *The Returns of Business Angel Investments and Their Major Determinants*, 17 *Venture Cap.* 271 (2015) (using a small sample of Italian data); and Colin M. Mason & Richard T. Harrison, *Is It Worth It? The Rates of Return from Informal Venture Capital Investments*, 17 *J. Bus. Venturing* 211 (2002) (using a small UK sample). Investments through AngelList and similar platforms allow accredited investors to make VC-like investments in startups. For some evidence on the performance of such investments, see, e.g., Olga Itenberg & Erin E. Smith, *Syndicated Equity Crowdfunding: The Trade-Off Between Deal Access and Conflicts of Interest* (Simon Bus. Sch., Working Paper No. FR 17-06, Mar. 2017).

³⁶⁹ See, e.g., Elisabeth Mueller, *Returns to Private Equity – Idiosyncratic Risk Does Matter!*, 15 *Rev. Fin.* 545 (2011) (“Mueller (2011)”); Thomas Astebro, *The Returns to Entrepreneurship*, in *Oxford Handbook of Entrepreneurial Finance* (Douglas Cumming ed. 2012) (“Astebro (2012)”); and Thomas J. Moskowitz & Annette Vissing-Jørgensen, *The Returns to Entrepreneurial Investment: A Private Equity Premium Puzzle?*, 92 *Am. Econ. Rev.* 745 (2002) (“Moskowitz & Vissing-Jørgensen (2002)”). For instance, Moskowitz and Vissing-Jørgensen (2002) examine the returns to investing in U.S. non-publicly traded

The final amendments also include exempt reporting advisers in the definition of accredited investor, in addition to SEC- and state-registered investment advisers.³⁷⁰

Because exempt reporting advisers are professionals managing either venture capital funds or small investment funds as a business, we believe they also have the requisite financial sophistication needed to conduct meaningful investment analysis. Expanding the definition of accredited investor to encompass this additional category of advisers will allow these professionals to benefit from expanded access to investments in unregistered offerings.

Other aspects of the final amendments could provide additional benefits for investors. For example, persons that are “knowledgeable employees” of a private fund may benefit from increased access to investment opportunities with the fund as well as the availability of additional performance incentives. If investment by knowledgeable employees leads to better incentive alignment between the fund and investment personnel, other investors in the private fund could potentially benefit from enhanced fund performance.

In addition, the final amendments allowing natural persons to include spousal equivalents when determining joint income or net worth under Rule 501 of Regulation D will allow such investors to potentially benefit from increased investment opportunities in private offerings similar to the other newly eligible accredited investors, as discussed above.

equity and find that, although entrepreneurial investment is extremely concentrated, the returns to private equity are no higher than the returns to public equity. They attribute the willingness of households to invest substantial amounts in a single privately held firm with a seemingly far worse risk-return trade-off to large nonpecuniary benefits, a preference for skewness, or overestimated probability of survival.

³⁷⁰ See *supra* Section II.B.2.a.

With respect to entities, including additional entity types within the definitions of accredited investor and qualified institutional buyer will provide equal access to investment opportunities for entities with similar attributes of financial sophistication. The final amendments thus could help level the playing field among institutional investors and avoid certain inefficiencies associated with specific corporate forms. Likewise, the proposed amendment to include a catch-all category of accredited investor for entities with investments in excess of \$5 million would remove impediments to utilizing alternative legal forms and permit sophisticated investors to take advantage of different forms of business organization that may develop in the future, without having to worry about losing their accredited investor status.

Because the inclusion of limited liability companies in the definition of accredited investors is a codification of a long standing staff interpretation, we do not expect limited liability companies to receive incremental benefits as a result of the final amendments. Similarly, because most family offices likely already are considered accredited investors, we do not expect them to realize significant benefits as a result of the final amendments. However, family clients that are part of a family office will also qualify as accredited investors under the final amendments. To the extent such family clients do not currently qualify as accredited investors based on the financial thresholds for natural persons, we expect them to benefit from increased access to investment opportunities in unregistered offerings.

3. Potential Costs to Issuers

The final amendments could have a potential impact on the market for registered offerings, but in light of the relatively small amount of incremental capital that would

become potentially available in the private markets for issuers of sufficient size and sophistication to conduct a registered offering, we would expect the impact, if any, to be modest. However, certain commenters suggested that newly eligible accredited investors and qualifying institutional buyers may shift capital away from registered offerings and towards unregistered offerings as a result of the amendments.³⁷¹ To the extent such a switch in investment focus occurs, it could in theory decrease the amount of capital flowing into registered offerings and hence negatively affect issuers in this market through a potential increase in capital raising costs. However, as discussed above, the amount of incremental capital that would become potentially available for investment in exempt offerings is expected to be relatively small, particularly when compared to the aggregate amount of institutional capital that currently is eligible to participate in registered and exempt offerings. Moreover, the amendments seek to identify financially sophisticated individual and institutional accredited investors and qualified institutional buyers with the knowledge and investment experience to assess the differences in the risk-return profiles of public and private market investments and other asset classes and appropriately allocate their investments to diversify those risks. Accordingly, these newly eligible accredited investors and qualified institutional buyers will not necessarily shift their investment allocations from the registered offerings market but instead may increase investments in unregistered offerings by diverting capital from other investment opportunities (*e.g.*, savings, real estate). They also may shift their investments from indirect investments in exempt securities (for example, through financial products) to

³⁷¹ See, *e.g.*, NASAA Letter (stating that “[a] clear effect of the Proposal would be to further diminish the public markets by drawing investors away into riskier, illiquid private alternatives”).

direct investments. We are unable to quantify the potential impact on the market for registered offerings because we do not have access to data on these investors' investment portfolios or their preferences for different asset classes that would allow us to estimate how investors may choose to reallocate their investments as a result of the final amendments. However, because of the specific risk characteristics and relative illiquidity of private offerings, we believe the new investment opportunities in private offerings are more likely to be viewed as complements to current investments in registered offerings than substitutes. In addition, the investors that will become newly eligible accredited investors and qualified institutional buyers under the final amendments represent only a small fraction of currently invested capital in registered offerings. For these reasons, we do not expect any meaningful effect on the market for registered offerings.

4. Potential Costs to Investors

Newly eligible accredited investors will have access to more investment options under the final amendments. However, these investment options come without the additional investor protections of registration under the Securities Act and could entail greater costs related to illiquidity, agency costs, adverse selection, and higher business risk as compared to investments in the public capital markets. Thus, to the extent newly eligible accredited investors allocate more capital to private offerings, they could face greater overall investment risk.

We anticipate that some natural-person investors who do not meet the income and wealth thresholds under the current definition, but who will qualify as accredited investors under the final amendments, may not be able to sustain a loss of an investment in an unregistered offering. For example, an individual who has obtained a Series 7

license may possess experience in investing but may be less able to withstand investment losses of the same nominal size than an accredited investor qualifying on the basis of personal wealth.³⁷² However, we believe the relatively high level of financial sophistication demonstrated by professional certifications and designations or other credentials increases the likelihood that such individuals will be able to assess the risk of loss and avoid losses they cannot sustain through various actions, including, for example, calibrating investment size.

Several commenters expressed concerns that the Commission had not appropriately considered the various risks individual investors face in private offerings, such as risks related to low levels of disclosure, poor oversight, illiquidity, increased adverse selection, and outright fraud, which can make private offerings less valuable and more risky to individual investors.³⁷³ We agree with commenters that certain private offerings have distinct and in some case more substantial risks than public offerings. These risks and potential costs were recognized in the economic analysis in the Proposing Release,³⁷⁴ and we have expanded our discussion of these potential costs below. In addition, we recognize that in some cases private offerings may not be appropriate investments for individual investors who lack the knowledge and financial sophistication to recognize or evaluate the risks of the offerings, including the risk of over-allocating capital to such investments in light of their income or net worth. However, as discussed previously, we believe that certain professional certifications and designations or other

³⁷² See, e.g., CA Attorney General et al. Letter and NASAA Letter.

³⁷³ See, e.g., CA Attorney General et al. Letter ; Better Markets Letter ; CFA Letter; Healthy Markets Letter; NASAA Letter; and PIABA Letter.

³⁷⁴ See Section VI.D.4 of the Proposing Release.

credentials can provide an appropriate indication of the level of financial sophistication that renders individual investors capable of evaluating the merits and risks of a prospective investment in an exempt offering.³⁷⁵ We also believe that, to the extent accredited investors are financially sophisticated, they will generally not participate in an exempt offering unless they think it has a favorable risk-return profile, and that they will also consider their ability to sustain a loss before investing.

We also note that an assessment of the economic effects of the final amendments on newly eligible accredited investors should consider the source of the funds for investment in private offerings. Any increase in overall portfolio risk from investments in private offerings by newly eligible accredited investors and qualified institutional buyers may be mitigated to the extent some of the new capital invested in exempt offerings would have otherwise been allocated to other high-risk assets that also may require additional due diligence and other analysis,³⁷⁶ or to the extent the investors will reallocate some other portfolio capital to less risky assets. However, due to data limitations, we are unable to quantify the extent of potential portfolio reallocation and the resulting effect on overall portfolio risk.

Investing in securities that are acquired in exempt offerings could reduce investors' liquidity while increasing their transaction costs, compared to alternative

³⁷⁵ See *supra* Section II.B1.a.

³⁷⁶ These could be investments both in other parts of the securities market (*e.g.*, leveraged investments in individual listed securities; short positions; holdings of registered securities of foreign, small-cap, and over-the-counter (OTC) issuers; and holdings of registered nontraded securities, including REITs and structured notes) and outside of the securities market (*e.g.*, holdings of futures, foreign exchange, real estate, individual small businesses, and peer-to-peer lending).

investments in registered securities.³⁷⁷ This illiquidity is generally related to legal restrictions on the transferability of securities issued in many exempt offerings; a lack of—or limited—trading market for the securities;³⁷⁸ long-term horizon for exits for private issuers; and, in cases of private funds investing in private issuers, standard contractual terms designed to enable a long-term horizon for the portfolio.³⁷⁹ However, we believe that the cost of accredited investors not being able to manage their liquidity risk will be mitigated to the extent these investors are financially sophisticated, and therefore able to identify and avoid risks they cannot sustain. We also note that such liquidity considerations may be reflected in the priority of the securities and to the extent these investors are financially sophisticated, we believe they will be able to take these factors into account in making investment decisions.

All else being equal, the more limited disclosure requirements for unregistered offerings may make them more risky investments compared to registered offerings.³⁸⁰ For example, more limited disclosure makes it harder for prospective investors to evaluate business prospects or the financial health of the issuer and may result in investors spending more resources on due diligence or other analysis. In addition, as

³⁷⁷ See, e.g., Better Markets Letter (stating that “the [private] securities themselves—to the extent they can even be traded—are very illiquid”); CFA Institute letter (stating that “Current conditions heighten the illiquidity risks that are inherent in private markets”); Healthy Markets Letter (stating that “[l]iquidity risks and trading costs for public securities are often significantly lower than for similarly-situated private securities”); and Nasdaq Letter (stating that “private investments that are inherently risky and illiquid”).

³⁷⁸ See, e.g., David F. Larcker, Brian Tayan, & Edward Watts, *Cashing It In: Private-Company Exchanges and Employee Stock Sales Prior to IPO*, Stanford Closer Look Series (Sept. 12, 2018).

³⁷⁹ See, e.g., Private Equity: Fund Types, Risks and Returns, and Regulation (Douglas Cumming ed., 2011).

³⁸⁰ For example, issuers of securities in unregistered offerings generally are not required to provide information comparable to that included in a registration statement, and Commission staff does not review any information that may be provided to investors in these offerings. See 2015 Staff Report. See also, e.g., NASAA Letter and Healthy Markets Letter.

suggested by some commenters,³⁸¹ individual accredited investors and institutional accredited investors with low amounts of assets under management who lack the ability to perform more extensive due diligence on their own, or lack the bargaining power to extract more disclosure from the private issuers,³⁸² may be subject to adverse selection, in the sense that they may be offered highly speculative investment opportunities that are rejected by more sophisticated investors with the ability to perform extensive due diligence or have the bargaining power to demand more disclosure.³⁸³ However, we believe that financially sophisticated investors, such as the newly eligible accredited investors under the final amendments, can take these factors into account in making investment decisions.

Further, investing in securities of private companies for which less information is publicly available, also could increase the agency costs for investors. Because investors will potentially have less information about these private companies on an ongoing basis compared to similar public companies, they may be less able to effectively monitor the management of these companies. As a result, investors in securities of private companies may bear a heightened risk that management may take actions that reduce the value of

³⁸¹ See, e.g., Better Markets Letter and NASAA Letter.

³⁸² See, e.g., NASAA Letter (stating that “[r]etail investors generally will not have the leverage or bargaining power to obtain the information needed to make informed decisions about private offerings”) and Healthy Markets Letter (stating that “in the private markets, investor rights—much as access to key information about the companies themselves—are left to the bargaining power of the parties. This will naturally favor those with greater economic clout and access over those with less, such as smaller institutions or retail investors”).

³⁸³ Because we do not have access to detailed data that allows us to identify the risk characteristics of exempt offerings that are available to different types of accredited investors, we are not able to quantify the extent to which different types of accredited investors are subject to adverse selection problems in exempt offerings.

their stakes in such companies.³⁸⁴ Further, the combined presence of small individual investors without control rights and insiders or large private investors with concentrated control rights is likely to exacerbate agency conflicts. Such agency conflicts, as well as potentially an inability to negotiate preferential terms (such as downside protection options, liquidation preferences, and rights of first refusal) might place individual accredited investors, dollar-for-dollar, at a disadvantage to insiders and large investors.³⁸⁵ The impact of agency conflicts on minority investors in private companies might be relatively more significant than at exchange-listed companies because private companies generally are not subject to the governance requirements of exchanges or various proxy statement disclosures.

The risks related to limited disclosure in private offerings are mitigated for accredited investors that participate in Regulation A offerings because they have access to information comparable to that accompanying registered offerings—*e.g.*, publicly available offering circulars on Form 1-A (for both Tier 1 and Tier 2 offerings), ongoing reports on an annual and semiannual basis (Tier 2 offerings), and additional requirements for interim current event updates (Tier 2 offerings).

Regarding some commenters' specific concerns that individuals that become newly eligible accredited investors will be deliberately targeted by the lowest quality private issuers or be targets for outright fraud,³⁸⁶ we note that these investors largely will be registered representatives of investment advisers and broker-dealers or knowledgeable

³⁸⁴ *See, e.g.*, Healthy Markets Letter.

³⁸⁵ *Id.*

³⁸⁶ *See e.g.*, NASAA Letter; CA Attorney General et al. Letter; and PIABA Letter.

employees of private funds, and therefore they are likely on average to have a greater awareness of the risk of fraud and greater ability to identify fraudulent private offerings compared to individual investors who are not such financial professionals.³⁸⁷ We also note that investors will continue to be protected by the general antifraud provisions of the federal and state securities laws.

One commenter also asserted that the analysis in the Proposing Release failed to consider evidence on fraud in private offerings and referenced reports providing survey results on state securities enforcement activities.³⁸⁸ The reports show that Regulation D offerings were among the most common types of offerings that led to or were the focus of enforcement investigations by the surveyed state securities regulators.³⁸⁹ We agree that there is misconduct in some exempt offerings, and we believe accredited investors need to be aware of and consider the risk of misconduct in private offerings when making investment decisions. However, we do not think that the currently available evidence on misconduct necessarily suggests that misconduct in exempt offerings is widespread, given that the number of detected misconduct cases is low relative to the number of exempt offerings. For example, a recently completed analysis by Commission staff of publicly available information on SEC litigation against Regulation D issuers found that

³⁸⁷ In addition, based on staff experience, many fraudulent private offerings are performed outside the exempt offering framework altogether, making the issue of investor accreditation unlikely to be a deciding factor in the choice to commit fraud.

³⁸⁸ See CA Attorney General et al. Letter.

³⁸⁹ See NASAA Enforcement Section, *NASAA Enforcement Report: 2015 Report on 2014 Data 7* (2015), available at https://www.nasaa.org/wp-content/uploads/2011/08/2015-Enforcement-Report-on-2014-Data_FINAL.pdf; NASAA Enforcement Section, *NASAA Enforcement Report: 2014 Report on 2013 Data 7* (2014), available at https://www.nasaa.org/wp-content/uploads/2011/08/2014-Enforcement-Report-on-2013-Data_110414.pdf; and NASAA Enforcement Section, *NASAA Enforcement Report: 2013 Report on 2012 Data 7-8* (2013), available at <https://www.nasaa.org/wp-content/uploads/2013/10/2013-Enforcement-Report-on-2012-data.pdf>.

there were relatively few SEC civil court cases involving Form D filers over the 2009-2019 period compared to the total number of filers.³⁹⁰ Not all misconduct is detected, and the number of undetected cases is inherently unobservable. It is therefore not possible to ascertain whether undetected misconduct in exempt offerings is more widespread than undetected misconduct in registered offerings or other investment options.

One commenter stated that brokers selling private offerings to retail investors appear to be more likely to be associated with customer complaints and potential misconduct.³⁹¹ We believe that the individuals who will qualify as newly accredited investors based on certain professional certifications or designations or other credentials are more likely to be able to protect themselves from potential broker misconduct. These individuals largely will be registered representatives of investment advisers or broker-dealers that can give investment advice or recommendations to other investors, and therefore should have the professional knowledge and financial sophistication to be able to identify and evaluate the conditions and conflicts of interest that may incentivize brokers to sell excessively risky or lower quality private offerings. We also note that, as

³⁹⁰ Based on Ives Group's Audit Analytics data on litigation and private placements from 2009 through 2019, Commission staff identified 227 SEC-related civil complaints involving Form D filers (221 for non-fund filers and six for fund filers), some of which did not involve securities offerings, and excluding cases that were dismissed or ruled in favor of the defendant. By comparison, Commission staff estimated from Audit Analytics data that there were 108,158 (69,642) unique non-fund (fund) Form D filers during this period. As a caveat, these estimates are affected by the coverage of individual CIKs in the Audit Analytics litigation database and do not distinguish offering fraud from financial reporting and other violations that resulted in SEC litigation. In particular, the data reveal misconduct, whether related to offerings or to disclosure violations, that is detected and results in litigation against the issuer, which underestimates the rate of misconduct to the extent that detection is difficult. See DERA's *Report to Congress on Regulation A / Regulation D Performance* ("DERA Report") available at <https://www.sec.gov/files/Report%20to%20Congress%20on%20Regulation%20A.pdf>.

³⁹¹ See CA Attorney General et al. Letter.

a result of Regulation Best Interest, a broker-dealer’s recommendation of a private offering to a retail customer is required to be in the retail customer’s best interest, without putting the financial or other interest of the broker ahead of the interest of the retail customer, which we expect will lead to a reduction of unmitigated conflicts of interests.³⁹²

While investing in securities acquired in exempt offerings may increase an investor’s diversification (as discussed above), there are practical frictions that can make it difficult for an investor to diversify risk using these investments. For example, investment minimums demanded by certain issuers may decrease or eliminate the diversification benefits of incorporating private investments in an individual investor’s portfolio, which is likely to be a concern especially for those individuals who will be newly eligible accredited investors under the amendments as they have comparatively lower levels of income or net worth. Further, it has been shown that the data on returns of private investments typically exhibits smoothing due to the infrequent nature of observation of returns and/or the use of appraised valuations and other methods to construct returns on assets that are nontraded.³⁹³ This can result in an investor significantly overestimating the diversification benefits of private investments and underestimating the risk of private investments.³⁹⁴ Additionally, when compared to

³⁹² See Regulation Best Interest: The Broker-Dealer Standard of Conduct, Release No. 34–86031 (Jun. 5, 2019) [84 FR 33318 (Jul. 12, 2019)].

³⁹³ See, e.g., Gregory W. Brown, Oleg R. Gredil, & Steven N. Kaplan, *Do Private Equity Funds Manipulate Reported Returns?*, 132 J. Fin. Econ. 267 (2019); Arthur Korteweg, *Risk Adjustment in Private Equity Returns* (Working Paper, 2018) (“Arthur Korteweg (2018)”).

³⁹⁴ See, e.g., Maginn et al. (2007), *supra* note 362. See also Kenneth Emery, *Private Equity Risk and Reward: Assessing the Stale Pricing Problem*, J. Private Equity, Spring 2003, at 43; Arthur Korteweg & Morten Sorensen, *Risk and Return Characteristics of Venture Capital-Backed Entrepreneurial Companies*, 23 Rev. Fin. Stud. 3738 (2010); Gregory W. Brown, Oleg R. Gredil, & Steven N. Kaplan, *Do Private*

traded securities of public companies, private investments may be characterized by considerable downside and tail risk due to the frequently non-normally distributed returns.³⁹⁵ Overall, given their financial sophistication, we think that the likelihood that the newly accredited investors under the final amendments will misunderstand the risk profile and associated portfolio constraints of securities acquired in exempt offerings is relatively low.

Additionally, the increased competition amongst investors under an expanded accredited investor definition could lower investors' expected returns for private assets. That is, as more capital is available in the unregistered markets, investors could receive lower returns due to the entry of newly-accredited investors with a lower required rate of return or reduced search frictions associated with finding accredited investors.

5. Variation in Economic Effects

The magnitudes of the benefits and costs discussed above are expected to vary depending on the particular attributes of the affected issuers and investors.

With respect to issuers, we expect the final amendments to facilitate capital formation particularly for certain businesses that have greater uncertainty about the interest in their prospective offerings. The issuers most likely to benefit are small, in development stages, in geographic areas that currently have lower concentrations of accredited investors, or without a wealthy friends and family network.

Small businesses typically do not have access to registered capital markets and

Equity Funds Manipulate Reported Returns?, 132 J. Fin. Econ. 267 (2019); and Arthur Korteweg, *Risk Adjustment in Private Equity Returns* (Working Paper, 2018).

³⁹⁵ See, e.g., *supra* note 369.

commonly rely on personal savings, business profits, home equity loans, and friends and family as initial sources of capital.³⁹⁶ Data on unregistered offerings suggest that they can be an important source of capital for smaller issuers. For example, while the aggregate amount of capital raised through Rule 506 offerings in 2019 (\$1.5 trillion) is large, Commission staff analysis show that the median offering size was only \$1.7 million, indicating that offerings in the Regulation D market typically involve relatively small issues. In addition, recent Commission staff analysis of Regulation D offerings for the 2009-2019 time period find that 63% of non-fund issuers were incorporated for less than three years when they initiated their offering, and among issuers that report size, a majority reported revenues of \$1 million or less,³⁹⁷ which is consistent with these offerings being undertaken by smaller and growth-stage firms. Because a significant share of businesses that establish new funding relationships continue to experience unmet credit need,³⁹⁸ we expect that small issuers that face more challenges in raising external financing may benefit more from expanding the pool of accredited investors.

In particular, small businesses owned by underrepresented minorities may benefit from a larger pool of accredited investors. For example, based on the 2014 Annual Survey of Entrepreneurs, 28.4% of Black entrepreneurs and 17.5% of Hispanic entrepreneurs cited limited access to financial capital as having a negative impact on their

³⁹⁶ See A Financial System That Creates Economic Opportunities Capital Markets, U.S. Dept. of the Treasury (Oct. 2017), available at <https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf>.

³⁹⁷ See DERA Report.

³⁹⁸ See 2015 Staff Report.

firms' profitability.³⁹⁹ Additionally, despite being more likely to seek new sources of funding, businesses owned by underrepresented minorities were more likely to demonstrate unmet credit needs relative to other groups,⁴⁰⁰ which suggests that these businesses may benefit from amendments intended to facilitate private market capital raising.

Additionally, issuers located in geographic areas with lower concentrations of accredited investors may benefit relatively more from the amendments. For example, household income and net worth tend to be higher in the Northeast and West regions of the United States, which leads to higher concentrations of individual investors that qualify as accredited investors by meeting the financial threshold requirements. Thus, issuers that are outside those regions may currently find it relatively more difficult to identify and solicit accredited investors. Recent research has examined the importance of the pool of accredited investors for the entry of new businesses and employment and finds that geographic areas experiencing a larger reduction in the number of potential accredited investors experienced negative effects on new firm entry and employment levels at small entrants.⁴⁰¹ Thus, because we expect the final amendments to expand the pool of accredited investors, the incremental benefits of this expansion to issuers may be comparatively greater for issuers in geographic areas with currently lower concentrations

³⁹⁹ Alicia Robb, "Financing Patterns and Credit Market Experiences: A Comparison by Race and Ethnicity for U.S. Employer Firms," a study for the Office of Advocacy, U.S. Small Bus. Admin. (Feb. 2018), *available at* https://www.sba.gov/sites/default/files/Financing_Patterns_and_Credit_Market_Experiences_report.pdf.

⁴⁰⁰ *Id.*

⁴⁰¹ *See* Lindsey & Stein (2019). This study examines the effects on angel finance stemming from the Dodd-Frank Act's elimination of the value of the primary residence in the determination of net worth for purposes of accredited investor status.

of accredited investors.⁴⁰²

We expect that issuers that predominately offer and sell securities in registered offerings or that market their offerings to non-accredited investors would be less likely to be affected by the final amendments. We expect the incremental benefits of the proposed amendments also to be smaller for large and well-established issuers with low information asymmetry and a history of public disclosures, as these issuers likely have ready access to accredited investors, especially institutional accredited investors. Similarly, issuers with low costs of proprietary disclosure (*e.g.*, low research and development intensity and limited reliance on proprietary technology) may be less likely to benefit from the final amendments as they may be less reliant on exempt offerings.

With respect to investors, we expect the benefits and costs of the final amendments to be most immediately realized by new entrants to the pool of accredited investors, particularly entities that are not included in the current accredited investor definition and individuals that have professional certifications that do not meet the current income and net worth thresholds. We also expect that providing additional measures of financial sophistication, other than personal wealth, could expand investment opportunities for individual investors in geographic regions with lower levels of income and net worth.

6. Efficiency, Competition, and Capital Formation

The anticipated impacts of the final amendments on efficiency, competition, and capital formation are discussed throughout this section and elsewhere in this release. The

⁴⁰² We do not have access to detailed data on entities and individuals that would allow us to estimate the distribution of newly qualified accredited investors by region.

following discussion highlights several such impacts.

As discussed above, we expect there will be efficiency gains from the final amendments in the process for raising capital, such as increased ease for issuers of verifying accredited investor status, improved ability of issuers to gather valuable information about investor interest before a potential registered offering, and potentially decreased investor demands for liquidity discounts in some unregistered offerings.⁴⁰³ Such efficiency gains will improve the overall allocative efficiency of the securities markets. In addition, if the newly eligible accredited investors and qualified institutional buyers under the final amendments bring new and uncorrelated information signals to the market (*e.g.*, because of their specialized knowledge and skills), it could improve the price discovery process and make the market for private offerings more efficient. The increased pool of accredited investors and qualified institutional buyers could also enhance competition among investors in the market for private offerings, thus reducing the cost of capital for issuers in that market and improving allocative efficiency.

Additionally, as discussed above, expanding the accredited investor definition to include knowledgeable employees of a private fund could lead to better alignment between private funds and investors. The improved alignment could enable private funds to perform investment services more efficiently and effectively, thus potentially improving investor protection and market efficiency over the long term

Several commenters expressed concerns that expanding the definition of accredited investor would serve to promote the market for private offerings at the

⁴⁰³ See *supra* Sections VI.C.1.a and VI.C.1.c.

expense of the market for public offerings, which they expect to cause harm to investors by exposing them to riskier and more illiquid investments.⁴⁰⁴ Some commenters further stated that a shift of capital raising from public to private markets could potentially lead to a reduction in the allocative efficiency of capital in the economy, for example, by worsening the overall information and governance environment for investment and impairing price discovery.⁴⁰⁵ We acknowledge that expanding the pool of accredited investors may increase the availability of capital to private firms, which could allow them to stay private longer, thus reducing the number of companies going public. Less reliance on public markets to raise capital could have further implications for informational efficiency—to the extent that an efficient market incorporates firm-specific information quickly and correctly into asset prices, such an expansion could reduce the efficiency of public markets if there are fewer companies making disclosures into those markets. There could also be an increase in agency costs from less reliance in public markets, as minority shareholders may have less protection in private offerings, as discussed above.⁴⁰⁶

However, the extent of substitution between private and public securities is not well established. For example, although some academic studies suggest that the expanding role of private markets has contributed to the decline in the number of public

⁴⁰⁴ See, e.g., CFA Letter (stating that “[a]s their already expansive ability to raise capital in private markets is further expanded, companies will have even less reason than they do today to go public, further eroding our already shrinking public markets”); Healthy Markets Letter; NASAA Letter; and letter from Center for American Progress dated May 27, 2020 (“CAP Letter”).

⁴⁰⁵ See, e.g., Healthy Markets Letter; NASAA Letter; and CAP Letter.

⁴⁰⁶ See discussion *supra* in Section VI.C.4.

companies in the U.S.,⁴⁰⁷ other studies have focused on the increased flexibility to deregister provided by recent U.S. regulatory reforms.⁴⁰⁸ Yet other studies note the cyclical nature of offering activity more generally.⁴⁰⁹ We do not expect the final amendments' effect on the private-public choice to be significant, as there are a number of other, more relevant factors (*e.g.*, liquidity, cost of capital, ownership structure, compliance costs, valuations) that an issuer would consider when determining to go public or stay private.

The final amendments will expand the pool of accredited investors and qualified institutional buyers beyond the current baseline. As discussed above, we expect that the increased pool of accredited investors and qualified institutional buyers could result in increased amounts of capital available to private issuers and a lower cost of capital, thus potentially increasing capital formation, primarily for issuers with limited access to capital, such as ones that are small, in early development stages, or in geographic areas or communities that currently have lower concentrations of accredited investors.⁴¹⁰

7. Alternatives

In this section, we evaluate reasonable alternatives to the final amendments.

a. Inflation Adjustment of Financial Thresholds

⁴⁰⁷ See Ewens & Farre-Mensa (2019), *supra* note 360, and Craig Doidge et al., *Eclipse of the Public Corporation or Eclipse of the Public Markets?*, J. Applied Corp. Fin., Winter 2018, at 8.

⁴⁰⁸ See Nuno Fernandes, Ugur Lel, & Darius P. Miller, *Escape from New York: The market impact of loosening disclosure requirements*, 95 J. Fin. Econ. 2 (2010) (focusing on “Rule 12h-6, which has made it easier for foreign firms to deregister with the SEC and thereby terminate their U.S. disclosure obligations”) and Craig Doidge et al., *Why Do Foreign Firms Leave U.S. Equity Markets?*, 65 J. Fin. 4, 1507-1553.

⁴⁰⁹ See, *e.g.*, Michelle Lowry, *Why does IPO Volume fluctuate so much?*, 67 J. Fin. Econ. 1 (2003), 3-40; Aydoğan Altı, *IPO Market Timing*, 18 Rev. Fin. Stud. 3 (2005), 1105–1138; and Chris Yung et al., *Cycles in the IPO Market*, 89 J. Fin. Econ. 1 (2008), 192-208.

⁴¹⁰ See *supra* section VI.C.1.b.

The current accredited investor definition uses bright line income and net worth thresholds to identify natural persons as accredited investors. The Commission established the \$200,000 individual income and \$1 million net worth threshold in 1982 and the \$300,000 joint income threshold in 1988 and has not updated them since, with the exception of amending the net worth standard to exclude the value of the investor's primary residence in 2011. In the Proposing Release, the Commission used data from the SCF to estimate that the number of U.S. households that qualify as accredited investors has grown from approximately 2% of the population of U.S. households in 1983 to 13% in 2019 as a result of inflation.⁴¹¹ Several commenters expressed a concern that because there has been a substantial growth in the number of accredited investors through inflation alone, many households currently qualifying as accredited investors in the commenters' view are neither financially sophisticated enough nor wealthy enough to be exposed to the risk of exempt offerings.⁴¹² Because of this concern, some commenters suggested that we should adjust the bright-line income and wealth thresholds upwards and/or index them to inflation going forward.⁴¹³ However, other commenters were in favor of leaving the thresholds at current levels,⁴¹⁴ or supported lowering the thresholds.⁴¹⁵

We considered increasing the individual income thresholds from \$200,000 to \$538,000 and the net worth threshold from \$1 million to \$2.7 million to reflect the impact

⁴¹¹ See Proposing Release at 2593.

⁴¹² See e.g., B. Delaplane Letter; CA Attorney General et al. Letter; Better Markets Letter, CFA Letter; and NASAA Letter.

⁴¹³ See e.g., CA Attorney General et al. Letter; CFA Letter; NASAA Letter; and PIABA Letter.

⁴¹⁴ See *supra* notes 228–230 and accompanying text.

⁴¹⁵ See *supra* notes 234 and 235 and accompanying text.

of inflation since 1982. Because keeping the financial thresholds at their initial (1982) levels has over time effectively reduced the level of income or net worth needed to qualify as accredited investors, this alternative could provide further assurance that individuals eligible for accredited investor status are those investors who are able to sustain the risk of loss of investment or fend for themselves without the additional protections provided by registration under the Securities Act.

Using the SCF, we estimate that an immediate catch-up inflation adjustment would shrink the accredited investor pool to 5.3 million households (representing 4.2% of the population of U.S. households) from the current pool of approximately 16 million households (representing 13% of the population of U.S. households). Thus, increasing the individual income and net worth thresholds to reflect the cumulative effects of inflation would greatly reduce the number of natural persons who would qualify as accredited investors. Moreover, an immediate catch-up inflation adjustment would likely reduce the number of accredited investors to a proportionately greater extent in geographic areas with lower levels of income and net worth.

Although such a reduction in the number of individuals that would qualify as accredited investors would potentially increase the likelihood that the remaining individuals can sustain the risk of loss of similarly sized investments, there would also be potentially significant costs. In particular, adjusting the income and wealth thresholds may reduce private issuers' access to capital and would reduce investors' access to private investment opportunities. As discussed above in Section VI.B, from 2009 to 2019, only between 3.4% and 6.9% of the offerings conducted under Rule 506(b) included non-accredited investors. Significantly reducing the pool of accredited investors

through an immediate catch-up inflation adjustment could thus have disruptive effects on capital raising activity in the Regulation D market not justified by the incremental investor protection benefits. Moreover, as discussed in Section II.B., we acknowledge investor protection concerns raised by the wealth test and recognize that in the case of individuals, higher income or net worth does not necessarily correlate to a higher level of financial sophistication. Therefore, it also is unclear that a catch-up inflation adjustment would result in a pool of qualified accredited investors that would on average be more sophisticated than the current pool, and would likely eliminate some currently eligible investors who are sophisticated. However, we also believe that the investor protections provided by the financial thresholds have not been meaningfully weakened over time due to inflation. Specifically, we note that under the 1982 definition, the calculation of net worth included the value of the primary residence, but since 2011, the net worth standard excludes the value of the investor's primary residence.⁴¹⁶

We also considered indexing the financial thresholds in the definition for inflation on a going-forward basis, rounded to the nearest \$10,000 every four years following the effective date of the final rule amendment. This alternative likely would reduce the change in the number of accredited investors relative to the baseline of leaving the thresholds fixed, holding all else constant. Using the 2016 SCF, we estimate that in 2019, had the current wealth and income thresholds been adjusted for inflation since 2015 and 2010, the proportion of U.S. households that would qualify as accredited investors would have been 11.4% and 10.4%, respectively, which is consistent with an inflation

⁴¹⁶ For example, based on analysis of data from the SCF, if the value of the primary residence was still included in the calculation of an investor's net worth, we estimate that approximately 2.5 million (2%) additional households would have qualified as accredited investors in 2019.

adjustment reducing the pool of accredited investors relative to the baseline. Although indexing on a going-forward basis would be less disruptive to the market for exempt offerings compared to adjusting the thresholds based on inflation since 1982, it would still reduce the potential aggregate capital supply available for exempt offerings going forward compared to the baseline. The potential benefit of this alternative would be that by reducing the future growth of the number of individuals that qualify as accredited investors on the basis on income or net worth, it may reduce the risk of loss for some individuals that may not be able to bear such a risk. However this benefit would be attenuated to the extent individuals that would no longer qualify in the future as accredited investors are financially sophisticated and can bear the risk of loss, and would therefore lose any potential gains from expanded access to private offerings.

In considering whether to modify the accredited investor definition as described above, we also considered allowing issuers' current investors who meet and continue to meet the current accredited investor standards to continue to qualify as accredited investors with respect to future offerings of the securities of issuers in which they are invested at the time of the inflation adjustment. This type of provision could provide protection from investment dilution for current investors who no longer would be accredited investors because of any changes to the definition, assuming the issuer was willing to incur the time and expense to accommodate such an exception. Such a provision could apply to future investments in the same issuer only, and not to future investments in affiliates of the issuer. In either event, there would be administrative and other burdens. Allowing current investors to continue to qualify for certain existing investments would help to mitigate—although it likely would not completely eliminate—

the potential disruptive effect on those investors of an immediate catch-up inflation adjustment. Similarly, it could help to mitigate a potential reduction in the capital supply for existing issuers in the Regulation D market in certain cases, such as small businesses.

b. Investment Limits

We considered imposing investment limits for individuals who will become newly eligible accredited investors under the final amendments but who do not meet the current income or net worth thresholds.⁴¹⁷ Limiting investment amounts for individuals who do not meet the current income or net worth thresholds could provide protections for those individuals who are less able to bear financial losses. For example, we could have limited investments for such individuals to a percentage of their income or net worth (*e.g.*, 10% of prior year income or 10% of net worth, as applicable, per issuer, in any 12-month period). This alternative, however, would reduce the amount of capital available from these newly eligible accredited investors, make capital formation more difficult, and likely increase the implementation costs associated with verifying an investor's status as an accredited investor and her eligibility to participate in an offering. We also believe the individuals who will become newly eligible to qualify as accredited investors under the final amendments have the financial sophistication to assess investment opportunities and avoid allocating an inappropriately large fraction of their income or wealth in exempt offerings.

c. Geography-Specific Thresholds

Income and net worth levels vary throughout the country, and lower levels of

⁴¹⁷ While some commenters supported investment limits (*see supra* note 76), others did not (*see supra* note 77).

income and net worth do not preclude a relatively high degree of financial sophistication. Therefore, the current financial thresholds likely result in geographic areas with lower average levels of income and net worth having a relatively lower proportion of individuals that qualify as accredited investors even if the same proportion of individuals are financially sophisticated. In turn, this may lead to comparatively reduced access to accredited investors for issuers in such areas, which may negatively affect capital formation. To mitigate a geographically disparate impact of the current uniform financial thresholds, we, as an alternative, could have adopted geography-specific financial thresholds for those areas with lower average levels of income and net worth. Some commenters expressed support for including geography-specific financial thresholds in the definition of accredited investors.⁴¹⁸ However, other commenters were opposed to such an alternative, raising concerns that it would add costly complexities to the accredited investor definition.⁴¹⁹ In particular, for issuers with prospective accredited investors throughout the country, such an approach could increase the costs of verifying the accredited investor status of those individuals. Given these complexities, we have determined not to adopt this approach at this time.

d. Including Additional Categories of Natural Persons and Entities

We considered as an alternative that the Commission could permit an investor advised by a registered investment adviser or broker-dealer to be deemed an accredited investor. As discussed above, several commenters supported this alternative, suggesting that clients and customers of registered investment advisers and broker dealers would be

⁴¹⁸ See *supra* note 248.

⁴¹⁹ See *supra* notes 251-253 and accompanying text.

able to rely on the knowledge and the sophistication of their financial professional to determine whether an investment is appropriate.⁴²⁰ However, several commenters opposed this alternative, based on concerns related to, for example, investor protection, conflict of interests of financial professionals, erosion of public markets, and adverse selection risks.⁴²¹

Including investors advised by registered financial professionals in the definition of accredited investor would significantly expand the number of investors that would have the opportunity to participate in unregistered offerings, as there are many investors advised by a registered investment adviser or broker dealer that do not currently, and would not under the amendments, qualify as accredited investors, leading to a potentially meaningful increase in aggregate capital supply in the market for unregistered offerings. In turn, this could lower capital costs for issuers and promote capital formation. However, there could be significant costs to the newly eligible accredited investors under this alternative. Neither a recommendation by a broker-dealer nor advice by a registered investment adviser is a complete substitute for an investor's own financial sophistication, nor does it ensure that investors have the ability to sustain the risk of loss of investment or fend for themselves. Therefore, the newly eligible accredited investors that would invest in private offerings under this alternative would be more exposed to the risks of not having the investor protections of registration under the Securities Act, and thus more likely to bear the potential costs of private offerings, such as costs related to illiquidity, information asymmetry and agency costs (including bargaining power when the investor

⁴²⁰ See *supra* notes 254-258 and accompanying text.

⁴²¹ See *supra* notes 259-263 and accompanying text.

has less money to invest).

As another alternative to the final amendments, we considered permitting individuals with experience investing in exempt offerings to qualify as accredited investors. For example, we could have added a new category to the accredited investor definition that includes individuals who have invested in at least ten private securities offerings, each conducted by a different issuer, under Securities Act Section 4(a)(2), Rule 506(b), or Rule 506(c). Expanding the accredited investor definition to include individuals with relevant investment experience would recognize an objective indication of financial sophistication. These individuals presumably have developed knowledge about the private capital markets, including their inherent risks. This experience may include performing due diligence, negotiating investment terms, and making valuation determinations. This alternative would increase the pool of accredited investors, although by less than the final amendments. At the same time, this alternative could significantly increase the costs of conducting offerings under Regulation D or other exemptions that rely on the accredited investor definition, as verifying an individual's relevant investment experience likely would be difficult.

We also considered permitting certain knowledgeable employees of a non-fund issuer to qualify as accredited investors in securities offerings of that issuer. This would be an expansion of the current definition, which permits directors, executive officers, or general partners of the issuer (or of a general partner of issuer) to qualify as an accredited investor. For example, certain employees that are not executive officers of a company may still have access to the necessary information about that company to make an informed investment in that company's securities. Expanding the accredited investor

definition to include certain knowledgeable employees of a non-fund issuer would increase the pool of accredited investors relative to the baseline, and could make it easier for non-fund issuers to raise capital and potentially increase incentive alignments between employees and shareholders. On the other hand, this alternative could reduce investor protections, to the extent that a knowledgeable employee may have information about a company's business operations, but not possess the relevant financial sophistication to assess the company's offerings that a more senior officer or director or another type of accredited investor would have.

We also considered limiting the additional entity types to the enumerated entity types in Rule 501(a), instead of including all entities that meet an investments-owned test. For example, we could have expanded the enumerated entity types in Rule 501(a) to include additional entity types such as Indian tribes and sovereign wealth funds. Including additional specific entity types to the enumerated entity types in Rule 501(a) would expand the pool of accredited investors relative to the baseline. On the other hand, depending on what type of specific entities this alternative would include, it may result in a smaller number of new institutional accredited investors compared to the final amendments. Also, without an investments-owned test, some of these entities may be more exposed to lower investor protection compared to the final amendments.

Another alternative would be to apply an asset test for the new entities instead of an investments-owned test. An asset test would help to level the playing field among institutional investors and would reduce inefficiencies associated with specific corporate forms that could develop in the future relative to the current baseline. Moreover, an asset test would likely increase the number of new institutional investors that would qualify as

accredited investors relative to an investments-owned test, because, all else being equal, we expect more entities to have in excess of \$5 million in assets than would have in excess of \$5 million in investments. At the same time, to the extent that an investments-owned test is a better indicator than an asset test of those investors who have sufficient financial sophistication to participate in investment opportunities that do not have the additional protections provided by registration under the Securities Act, this alternative could result in lower levels of market efficiency and investor protection compared to the final amendments.

VII. Paperwork Reduction Act

The amendments do not impose any new “collection of information” requirement, as defined by the Paperwork Reduction Act of 1995,⁴²² nor do they amend any existing filing, reporting, recordkeeping, or disclosure requirements. As discussed above, by expanding the pool of accredited investors, the amendments could facilitate exempt offerings conducted pursuant to Regulation D or Regulation A and/or enable some companies to defer becoming a public reporting company, which may impact the number of annual responses under associated collections of information.⁴²³ It is difficult to estimate the magnitude of these effects as they would depend on a number of factors. Overall, however, for the reasons discussed in Section VI, we expect any impact on the annual number responses for associated collections of information to be relatively minor, and therefore we are not adjusting the burden estimates for these collections of

⁴²² 44 U.S.C. 3501 *et seq.*

⁴²³ These collections of information include: Form D (3235-0076), Form 1-A (3235-0286), Form 1-K (3235-0720), Form 1-SA (3235-0721), and Form 1-U (3235-0722).

information at this time. We note, however, that the Commission will reassess the number of responses for these associated collections of information every three years in accordance with the Paperwork Reduction Act⁴²⁴ and will make adjustments, as needed, to reflect any impact from the final amendments.

We requested comment on our assessment that the proposed amendments would not create any new, or revise any existing, collection of information requirement pursuant to the Paperwork Reduction Act. We also requested comment on whether the proposed amendments would impact the number of annual responses for any associated collections of information and, if so, how we should adjust our Paperwork Reduction Act burden estimates to reflect this impact. We did not receive any comments specifically addressing our assessment that the proposed amendments would not create any new, or revise any existing, collection of information pursuant to the Paperwork Reduction Act.

VIII. Final Regulatory Flexibility Analysis

The Regulatory Flexibility Act (“RFA”)⁴²⁵ requires us, in promulgating rules under Section 553 of the Administrative Procedure Act,⁴²⁶ to consider the impact of those rules on small entities. We have prepared this Final Regulatory Flexibility Analysis (“FRFA”) in accordance with Section 604 of the RFA.⁴²⁷ This FRFA relates to amendment to Rules 215 and 501(a) under the Securities Act.⁴²⁸ An Initial Regulatory

⁴²⁴ 44 U.S.C. 3507(h).

⁴²⁵ 5 U.S.C. 601 *et seq.*

⁴²⁶ 5 U.S.C. 553.

⁴²⁷ 5 U.S.C. 604.

⁴²⁸ Because the changes to Rule 144A of the Securities Act relate to entities that in the aggregate own and invest on a discretionary basis at least \$100 million in securities of issuers that are not affiliated with the entity, we do not believe the changes to Rule 144A would have an impact on small entities.

Flexibility Analysis (“IRFA”) was prepared in accordance with the RFA and was included in the Proposing Release.

A. Need for, and Objectives of, the Final Rules

The primary objective of the amendments to which this FRFA relates is to update and improve the definition of “accredited investor.” The reasons for, and objectives of, the amendments are discussed in more detail in Section II above.

B. Significant Issues Raised by Public Comments

In the Proposing Release, we requested comment on all aspects of the IRFA, including the number of small entities that would be affected by the proposed amendments, the existence or nature of the potential impact of the proposals on small entities discussed in the analysis, and how to quantify the impact of the proposed amendments. We did not receive any comments specifically addressing the IRFA. We did, however, receive comments from members of the public on matters that could potentially impact small entities. These comments are discussed by topic in the corresponding subsections of Section II above, and we have considered these comments in developing the FRFA.

C. Small Entities Subject to the Amendments

The final amendments will affect some registrants that are small entities. The RFA defines “small entity” to mean “small business,” “small organization,” or “small governmental jurisdiction.”⁴²⁹ For purposes of the RFA, under 17 CFR 230.157, an issuer, other than an investment company, is a “small business” or “small organization” if it had total assets of \$5 million or less on the last day of its most recent fiscal year and is

⁴²⁹ 5 U.S.C. 601(6).

engaged or proposing to engage in an offering of securities not exceeding \$5 million. Under 17 CFR 240.0–10(a), an investment company, including a business development company, is considered to be a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year.

The amendments allow more investors to qualify as accredited investors, which will permit issuers of all types, including small entities, to offer and sell securities in the private markets to more investors. As discussed in Section VI.C.5 above, we expect that small businesses owned by underrepresented minorities and issuers located in geographic areas with lower concentrations of accredited investors may particularly benefit from the amendments. Because potentially affected issuers include both reporting and non-reporting companies, we lack data to estimate the number of such issuers that qualify as small issuers that would be eligible to rely on the amendments.

D. Projected Reporting, Recordkeeping and Other Compliance Requirements

The amendments do not impose any new reporting or recordkeeping requirement, although issuers conducting an unregistered offering involving accredited investors may incur certain compliance burdens, such as the need to file a Form D with the Commission when conducting an offering under the exemptions provided in Regulation D. While small entities will have the option to offer and sell securities to newly qualified accredited investors, they are not required to do so and may continue to comply with existing Commission rules to raise capital. As a result, we do not expect small issuers would seek to offer securities to newly qualified accredited investors unless they determine the benefits of doing so justify any accompanying compliance burdens. We therefore do not

expect the amendments to significantly impact reporting, recordkeeping, or other compliance burdens. Small entities choosing to avail themselves of the amendments may seek the advice of legal or accounting professionals in connection with offers and sales to accredited investors. We discuss the economic impact, including the estimated costs and benefits, of the amendments to all issuers, including small entities, in Section VI above.

E. Agency Action to Minimize Effect on Small Entities

The RFA directs us to consider alternatives that would accomplish our stated objectives, while minimizing any significant adverse economic impact on small entities. In connection with the amendments, we considered the following alternatives:

- establishing different compliance or reporting requirements that take into account the resources available to small entities;
- clarifying, consolidating, or simplifying compliance and reporting requirements under the rules for small entities;
- using performance rather than design standards; and
- exempting small entities from all or part of the requirements.

As noted above, the amendments do not establish any new reporting, recordkeeping, or compliance requirements for small entities. Small entities are not required to offer and sell securities to newly qualified accredited investors. Accordingly, we do not believe the amendments will impose a significant adverse economic impact on small entities. It is therefore not necessary to exempt small entities from all or part of the amendments or to provide different or simplified compliance requirements for these entities. To the extent that issuers may face challenges verifying an accredited investor's status, the amendments provide issuers, including small entities, with additional ways to

meet this verification requirement that are objective and readily verifiable.

IX. Statutory Authority

The amendments contained in this release are adopted under the authority set forth in Sections 2(a)(11), 2(a)(15), 4(a)(1), 4(a)(3)(A), 4(a)(3)(C), 19(a), and 28 of the Securities Act and in Sections 3(a)(51)(B), 3(b), 15(c), 15(g), and 23(a) of the Exchange Act.

List of Subjects in 17 CFR Parts 230 and 240

Reporting and recordkeeping requirements, Securities.

Text of the Amendments

For the reasons set out above, the Commission amends title 17, chapter II of the Code of Federal Regulations, as follows:

Part 230 – GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

1. The authority citation for part 230 continues to read in part as follows:

Authority: 15 U.S.C. 77b, 77b note, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78o-7 note, 78t, 78w, 78ll(d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, and Pub. L. 112-106, sec. 201(a), sec. 401, 126 Stat. 313 (2012), unless otherwise noted.

* * * * *

2. Amend § 230.144A by:
 - a. Revising paragraph (a)(1)(i)(C) and (H);
 - b. Removing the period from the end of paragraph (a)(1)(i)(I) and adding in its place “; and”; and
 - c. Adding paragraph (a)(1)(i)(J) and a note to paragraph (a)(1)(i)(J).

The revisions and addition read as follows:

§ 230.144A Private resales of securities to institutions.

(a) * * *

(1) * * *

(i) * * *

(C) Any *Small Business Investment Company* licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958 or any *Rural Business Investment Company* as defined in section 384A of the Consolidated Farm and Rural Development Act;

* * * * *

(H) Any organization described in section 501(c)(3) of the Internal Revenue Code, corporation (other than a bank as defined in section 3(a)(2) of the Act or a savings and loan association or other institution referenced in section 3(a)(5)(A) of the Act or a foreign bank or savings and loan association or equivalent institution), partnership, limited liability company, or Massachusetts or similar business trust;

* * * * *

(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).

NOTE 1 TO PARAGRAPH (a)(1)(i)(J): An entity seeking qualified institutional buyer status under Rule 144A(a)(1)(i)(J) may be formed for the purpose of acquiring the securities being offered under this section.

* * * * *

3. Amend § 230.163B by revising paragraph (c)(2) and adding a note to paragraph (c)(2) to read as follows:

§ 230.163B Exemption from section 5(b)(1) and section 5(c) of the Act for certain communications to qualified institutional buyers or institutional accredited investors.

* * * * *

(c) ***

(2) Institutions that are accredited investors, as defined in §§230.501(a)(1), (a)(2), (a)(3), (a)(7), (a)(8), (a)(9), (a)(12), or (a)(13).

NOTE 1 TO PARAGRAPH (c)(2): Though the definition of “family client” from Rule 501(a)(13) includes both natural persons and institutions, only family clients that are institutions may be considered institutional accredited investors.

4. Revising § 230.215 to read as follows:

§ 230.215 Accredited investor.

The term *accredited investor* as used in section 2(a)(15)(ii) of the Securities Act of 1933 (15 U.S.C. 77b(a)(15)(ii)) shall have the same meaning as the definition of that term in rule 501(a) under the Act (17 CFR 230.501(a)).

5. Amend § 230.501 by:

- a. Revising paragraphs (a)(1) and (3);
- b. Revising paragraph (a)(5) introductory text;
- c. Adding a note to paragraph (a)(5);
- d. Revising paragraph (a)(6);

- e. Removing the word “and” from the end of paragraph (a)(7);
- f. Removing the period from the end of paragraph (a)(8) and adding in its place a semicolon;
- g. Adding a note to paragraph (a)(8);
- h. Adding paragraphs (a)(9) through (13) with notes to paragraphs (a)(9) and (10); and
- i. Adding paragraph (j).

The revisions and additions read as follows:

§ 230.501 Definitions and terms used in Regulation D.

* * * * *

(a) * * *

(1) Any bank as defined in section 3(a)(2) of the Act, or any savings and loan association or other institution as defined in section 3(a)(5)(A) of the Act whether acting in its individual or fiduciary capacity; any broker or dealer registered pursuant to section 15 of the Securities Exchange Act of 1934; any investment adviser registered pursuant to section 203 of the Investment Advisers Act of 1940 or registered pursuant to the laws of a state; any investment adviser relying on the exemption from registering with the Commission under section 203(l) or (m) of the Investment Advisers Act of 1940; any insurance company as defined in section 2(a)(13) of the Act; any investment company registered under the Investment Company Act of 1940 or a business development company as defined in section 2(a)(48) of that act; any Small Business Investment Company licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958; any Rural Business Investment Company

as defined in section 384A of the Consolidated Farm and Rural Development Act; any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of \$5,000,000; any employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974 if the investment decision is made by a plan fiduciary, as defined in section 3(21) of such act, which is either a bank, savings and loan association, insurance company, or registered investment adviser, or if the employee benefit plan has total assets in excess of \$5,000,000 or, if a self-directed plan, with investment decisions made solely by persons that are accredited investors;

* * * * *

(3) Any organization described in section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, partnership, or limited liability company, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of \$5,000,000;

* * * * *

(5) Any natural person whose individual net worth, or joint net worth with that person's spouse or spousal equivalent, exceeds \$1,000,000;

* * * * *

NOTE 1 TO PARAGRAPH (a)(5): For the purposes of calculating joint net worth in this paragraph (a)(5): joint net worth can be the aggregate net worth of the investor and spouse or spousal equivalent; assets need not be held jointly to be included in the calculation. Reliance on the joint net worth standard of this paragraph (a)(5) does not

require that the securities be purchased jointly.

(6) Any natural person who had an individual income in excess of \$200,000 in each of the two most recent years or joint income with that person's spouse or spousal equivalent in excess of \$300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year;

* * * * *

(8) ***

NOTE 1 TO PARAGRAPH (a)(8): It is permissible to look through various forms of equity ownership to natural persons in determining the accredited investor status of entities under this paragraph (a)(8). If those natural persons are themselves accredited investors, and if all other equity owners of the entity seeking accredited investor status are accredited investors, then this paragraph (a)(8) may be available.

(9) Any entity, of a type not listed in paragraphs (a)(1), (2), (3), (7), or (8), not formed for the specific purpose of acquiring the securities offered, owning investments in excess of \$5,000,000;

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)).

(10) Any natural person holding in good standing one or more professional certifications or designations or credentials from an accredited educational institution that the Commission has designated as qualifying an individual for accredited investor status. In determining whether to designate a professional certification or designation or credential from an accredited educational institution for purposes of this paragraph

(a)(10), the Commission will consider, among others, the following attributes:

(i) 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 educational institution;

(ii) 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;

(iii) Persons obtaining such 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

(iv) An indication that an individual holds the certification or designation is either made publicly available by the relevant self-regulatory organization or other industry body or is otherwise independently verifiable;

NOTE 1 TO PARAGRAPH (a)(10): The Commission will designate professional certifications or designations or credentials for purposes of this paragraph (a)(10), by order, after notice and an opportunity for public comment. The professional certifications or designations or credentials currently recognized by the Commission as satisfying the above criteria will be posted on the Commission's website.

(11) Any natural person who is a "knowledgeable employee," as defined in rule 3c-5(a)(4) under the Investment Company Act of 1940 (17 CFR 270.3c-5(a)(4)), of the issuer of the securities being offered or sold where the issuer would be an investment company, as defined in section 3 of such act, but for the exclusion provided by either section 3(c)(1) or section 3(c)(7) of such act;

(12) Any “family office,” as defined in rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940 (17 CFR 275.202(a)(11)(G)-1):

(i) With assets under management in excess of \$5,000,000,

(ii) That is not formed for the specific purpose of acquiring the securities offered,

and

(iii) Whose prospective investment is directed by a person who has such knowledge and experience in financial and business matters that such family office is capable of evaluating the merits and risks of the prospective investment; and

(13) Any “family client,” as defined in rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940 (17 CFR 275.202(a)(11)(G)-1)), of a family office meeting the requirements in paragraph (a)(12) of this section and whose prospective investment in the issuer is directed by such family office pursuant to paragraph (a)(12)(iii).

* * * * *

(j) *Spousal equivalent*. The term *spousal equivalent* shall mean a cohabitant occupying a relationship generally equivalent to that of a spouse.

* * * * *

PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

6. The authority citation for part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7201 et seq.; and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; and Pub. L. 111-203, 939A, 124 Stat.

1887 (2010); and secs. 503 and 602, Pub. L. 112-106, 126 Stat. 326 (2012), unless otherwise noted.

* * * * *

7. Amend § 240.15g-1 by revising paragraph (b), adding a note to paragraph (b), and revising paragraph (c) to read as follows:

§ 240.15g-1 Exemptions for certain transactions.

* * * * *

(b) Transactions in which the customer is an institutional accredited investor, as defined in 17 CFR 230.501(a)(1), (2), (3), (7), (8), (9), (12), or (13).

NOTE 1 TO PARAGRAPH (b): Though the definition of “family client” from rule 501(a)(13) includes both natural persons and institutions, only family clients that are institutions may be considered institutional accredited investors.

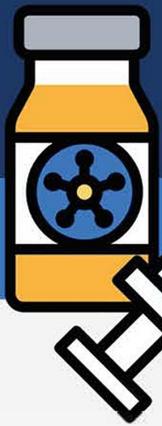
(c) Transactions that meet the requirements of Regulation D (17 CFR 230.500 *et seq.*), or transactions with an issuer not involving any public offering pursuant to section 4(a)(2) of the Securities Act of 1933.

* * * * *

By the Commission.

Dated: August 26, 2020

Vanessa A. Countryman
Secretary



Protect Yourself

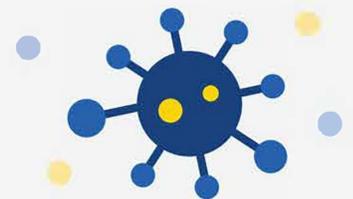
AVOID COVID-19 Vaccine Scams

As COVID-19 vaccine distribution begins, here are signs of potential scams:

- You are asked to pay out of pocket to get the vaccine.
- You are asked to pay to put your name on a vaccine waiting list or to get early access.
- Advertisements for vaccines through social media platforms, email, telephone calls, online, or from unsolicited/unknown sources.
- Marketers offering to sell or ship doses of the vaccine for payment.
- ✓ **Protect Yourself. Do not give out your personal information to unknown sources.**

! If you believe you have been the victim of COVID-19 fraud, immediately report it to:

- HHS-OIG Hotline: **1-800-HHS-TIPS** | tips.hhs.gov
- FBI Hotline: **1-800-CALL-FBI** | ic3.gov
- CMS/Medicare Hotline: **1-800-MEDICARE**



For accurate, up-to-date information about COVID-19, visit:

oig.hhs.gov/coronavirus
fbi.gov/coronavirus
justice.gov/coronavirus



HHS
Office of
Inspector
General



Federal
Bureau of
Investigation



Department
of Justice



SEC Modernizes the Accredited Investor Definition

FOR IMMEDIATE RELEASE

2020-191

Washington D.C., Aug. 26, 2020 — The Securities and Exchange Commission today adopted amendments to the “accredited investor” definition, one of the principal tests for determining who is eligible to participate in our private capital markets. Historically, individual investors who do not meet specific income or net worth tests, regardless of their financial sophistication, have been denied the opportunity to invest in our multifaceted and vast private markets. The amendments update and improve the definition to more effectively identify institutional and individual investors that have the knowledge and expertise to participate in those markets.

“Today’s amendments are the product of years of effort by the Commission and its staff to consider and analyze approaches to revising the accredited investor definition,” said Chairman Jay Clayton. “For the first time, individuals will be permitted to participate in our private capital markets not only based on their income or net worth, but also based on established, clear measures of financial sophistication. I am also pleased that we have expanded and updated the list of entities, including tribal governments and other organizations, that may qualify to participate in certain private offerings.”

The amendments allow investors to qualify as accredited investors based on defined measures of professional knowledge, experience or certifications in addition to the existing tests for income or net worth. The amendments also expand the list of entities that may qualify as accredited investors, including by allowing any entity that meets an investments test to qualify.

* * *

FACT SHEET

Updating the Accredited Investor Definitions

Aug. 26, 2020

The Securities and Exchange Commission adopted amendments to update and improve the definition of “accredited investor” in the Commission’s rules and the definition of “qualified institutional buyer” in Rule 144A under the Securities Act of 1933. The amendments to the accredited investor definition add new categories of qualifying natural persons and entities and make certain other modifications to the existing definition. The amendments to the qualified institutional buyer definition similarly expand the list of eligible entities under that definition.

Background

These amendments are part of the Commission’s ongoing effort to simplify, harmonize, and improve the exempt offering framework, thereby expanding investment opportunities while maintaining appropriate investor protections and promoting capital formation.

In June 2019, the Commission requested public comment on its [Concept Release on Harmonization of Securities Offering Exemptions](#). In the Concept Release, the Commission requested comments on possible approaches to

amending the accredited investor definition, which is a central component of several exemptions from registration, including Rules 506(b) and 506(c) of Regulation D, and plays an important role in other federal and state securities law contexts. The Concept Release was preceded by a Commission staff report issued in December 2015 on the accredited investor definition, which examined the background and history of the definition and considered comments and recommendations on amending the definition.

After taking into account the views expressed by members of the public and recommendations over the years from various Commission advisory committees and the annual SEC Government-Business Forum on Small Business Capital Formation, the Commission proposed in December 2019 to amend the accredited investor definition. In March 2020, the Commission continued the harmonization effort by [proposing amendments](#) to the exempt offering framework.

Highlights

The amendments revise Rule 501(a), Rule 215, and Rule 144A of the Securities Act.

The amendments to the accredited investor definition in Rule 501(a):

- add a new category to the definition that permits natural persons to qualify as accredited investors based on certain professional certifications, designations or credentials or other credentials issued by an accredited educational institution, which the Commission may designate from time to time by order. In conjunction with the adoption of the amendments, the Commission designated by order holders in good standing of the Series 7, Series 65, and Series 82 licenses as qualifying natural persons. This approach provides the Commission with flexibility to reevaluate or add certifications, designations, or credentials in the future. Members of the public may wish to propose for the Commission's consideration additional certifications, designations or credentials that satisfy the attributes set out in the new rule;
- include as accredited investors, with respect to investments in a private fund, natural persons who are "knowledgeable employees" of the fund;
- clarify that limited liability companies with \$5 million in assets may be accredited investors and add SEC- and state-registered investment advisers, exempt reporting advisers, and rural business investment companies (RBICs) to the list of entities that may qualify;
- add a new category for any entity, including Indian tribes, governmental bodies, funds, and entities organized under the laws of foreign countries, that own "investments," as defined in Rule 2a51-1(b) under the Investment Company Act, in excess of \$5 million and that was not formed for the specific purpose of investing in the securities offered;
- add "family offices" with at least \$5 million in assets under management and their "family clients," as each term is defined under the Investment Advisers Act; and
- add the term "spousal equivalent" to the accredited investor definition, so that spousal equivalents may pool their finances for the purpose of qualifying as accredited investors.

The amendment to Rule 215 replaces the existing definition with a cross reference to the definition in Rule 501(a).

The amendments expand the definition of "qualified institutional buyer" in Rule 144A to include limited liability companies and RBICs if they meet the \$100 million in securities owned and invested threshold in the definition. The amendments also add to the list any institutional investors included in the accredited investor definition that are not otherwise enumerated in the definition of "qualified institutional buyer," provided they satisfy the \$100 million threshold.

The Commission also adopted conforming amendments to Rule 163B under the Securities Act and to Rule 15g-1 under the Exchange Act.

What's Next?

The amendments and order become effective 60 days after publication in the Federal Register.

###

Related Materials

- [Final Rule](#)

SME FINANCE

Monica Gupta

Chitkara Business School, Chitkara University- Punjab, India

Dr. Shashi Shekhar

Professor, Quest Group of College, Mohali

Dr. Kavita Aggarwal

Associate Professor, Management Dept., Rayat Bahra University, Mohali

ABSTRACT

SME finance is the funding of small and medium-sized enterprises, and represents a major function of the general business finance market – in which capital for different types of firms are supplied, acquired, and costed or priced. Capital is supplied through the business finance market in the form of bank loans and overdrafts; leasing and hire-purchase arrangements; equity/corporate bond issues; venture capital or private equity; asset-based finance such as factoring and invoice discounting, and government funding in the form of grants or loans. In this research paper focus has been laid down on why is strengthening SME financing in India important to reduce debt gap, what are the Alternate lending platforms for fixing India's financial inclusion problem, becoming enablers for SME funding and the various challenges faced, alternate lending platforms to the rescue, the benefits of financial inclusion for India's MSMEs, innovative early stage financing for SMEs in India and the various MSME finance challenges.

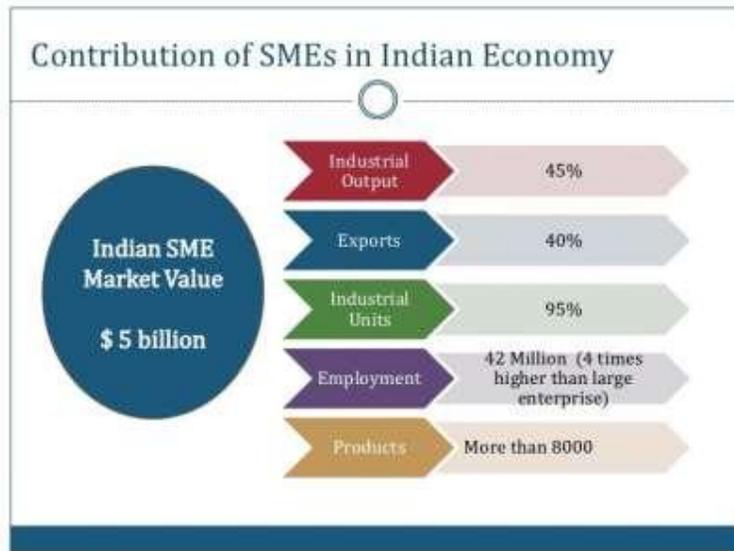
KEY WORDS: Entrepreneurship, social mobility.

Cite this Article: Monica Gupta, Dr. Shashi Shekhar and Dr. Kavita Aggarwal, Sme Finance. *Journal of Management*, 6(3), 2019, pp. 134-139.

<http://www.iaeme.com/jom/issues.asp?JType=JOM&VType=6&IType=3>

1. INTRODUCTION

Small scale businesses are a center of innovation, growth, and employment. In India, SMEs constitute 95% of all industrial units and employ 45% of the nation's total labor force. But, lack of growth of SMEs in India is seen as a serious hindrance to social mobility and poverty elimination. The constraints to firm growth include lack of access to efficient and adequately structured financial services, regulatory and legal constraints and limited access to (well-trained) employees as well as lack of infrastructure.



2. LITERATURE REVIEW

Equity finance is that capital invested in the firm without a specific repayment date, where the supplier of the equity capital is effectively investing in the business” (Ou & Haynes, 2006, p. 156). Capital can be raised either internally or externally.

There are two situations when SMEs pursue financing from equity capital sources in order to meet expansion needs. The first case is when SMEs face financial distress coupled with a lack of alternative sources of finance. The second is when cash outflows exceed the cash inflows generated from regular sources. Ou and Haynes (2006)

Venture capital is that form of financing in which funds are raised from investors and redeployed by investing in high-risk informationally opaque firms which for the most part are young or start-up firms (Potter & Porto, 2007).

Hellmann (1998) explained that the situation in which a company has a sufficiently large incentive for active monitoring takes place only when the venture capitalist has a concentrated stake invested in that company

3. OBJECTIVE OF THE STUDY

The objective of the study is to see that why is it important to strengthen SME financing in India to reduce debt gap, What are the Alternate lending platforms for fixing India's financial inclusion problem, how to become enablers for SME funding and the various challenges faced, what are the various Alternate lending platforms to the rescue, what are the benefits of financial inclusion for India's MSMEs, to study the Innovative Early Stage Financing for SMEs in India and also study the various MSME Financing Opportunities and Challenges.

4. METHODS OF DATA COLLECTION

PRIMARY DATA: Are those which are collected a fresh and for the first time and thus happen to be original in character and known as Primary data.

SECONDARY DATA: Are those which have been collected by someone else and which have already been passed through the statistical process are known as Secondary data.

5. TYPE OF RESEARCH USED

The research will be conducted by means of descriptive research in which main data is taken from the internet and other journals or books. I.e. mainly secondary data will be used. These are already available i.e. they refer to the data which have already been collected and analyzed.

5.1. Strengthening of SME financing in India to reduce debt gap

India is a country with large population; SMEs are providing employment to a large group of people. SMEs have to look toward Government and many other financial institutions for financial assistance. There is also hindrance in the smooth functioning of the operations as there is inadequate supply of skilled people having degree in the relevant area. SMEs face many difficulties in raising finances from bank and financial institutions as they ask for the resources which are available with them including the infrastructure and the inventory. That is why the financial support needs to be strengthened in order to narrow down the debt gap on the nation. Although the banks are working hard to narrow down this debt gap but it is not making a considerable improvement in the economy. Smart entrepreneurs are tapping the potential of digital technology to make this large eco-system of start-ups based on futuristic ideas to flourish with ease of 2-way transactions, yet financial assistance is something that they urgently need. Of the 200 to 245 million and informal enterprises that need credit but can't avail it, more than 90% are MSMEs. Many of these MSMEs are likely to be Indian, given that India's 51 million MSMEs are facing a credit shortfall of an astonishing \$400 billion.

5.2. The challenge

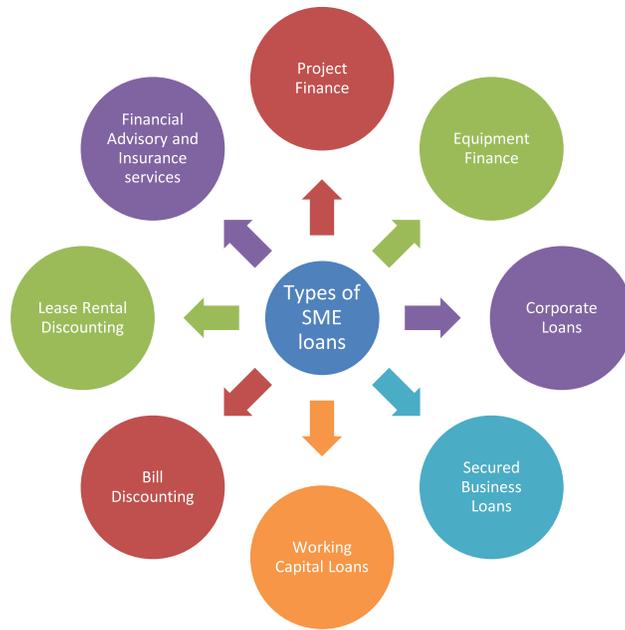
The SMEs have limited access to finance because of two major reasons. First is the lack of a comprehensive credit score and the second is the difficult application filing process to get a loan. Banks and other lenders in India use the credit ratings to determine the creditworthiness of the applicant and most of the borrowers are not able to get the loan as they do not fulfill the minimum eligibility criteria.

5.3. Alternate lending platforms

The new and upcoming startups are taking help of technology-driven solution which are helping them to access credit very easily. NBFCs are already providing 16% of credit to MSMEs. The share of NBFCs in money lending are expected to raise to 22-23% by March 2022. The companies also use cutting-edge AI-driven algorithms to create a credit score for applicants. These credit scores are more holistic, provide a more detailed perspective, and are likely to be substantially more accurate than existing credit scores. The documents of Aadhaar and India Stack, deploying e-KYC are also being used to make application and approval a process that is quick and convenient.

5.4. The benefits of financial inclusion for India's MSMEs

According to a Morgan Stanley report, India's e-commerce market is set to hit \$200 billion by 2026, growing at 30% annually. In large part, this amazing growth is attributed to the greater adoption of technology by consumers in India's tier 2 and tier 3 cities. Further, a BCG report projected that by 2025, these cities will account for 45% of India's consumption.



6. Innovative Early Stage Financing for SMEs in India

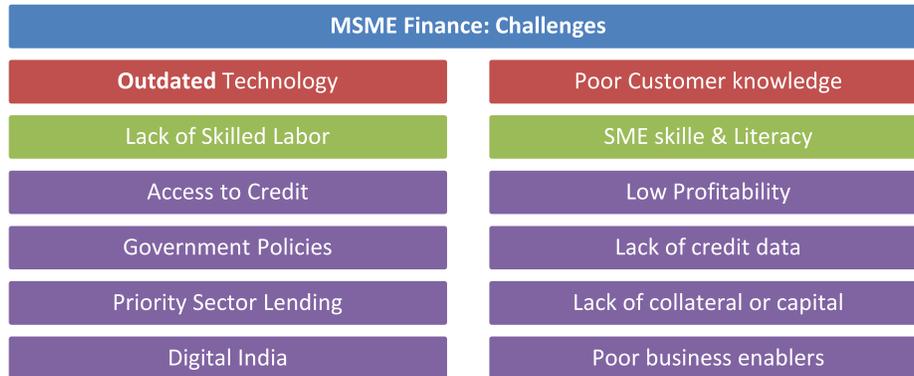
The World Bank has been working with the Small Industries Development Bank of India (SIDBI, the apex development bank for MSMEs), providing a credit line of \$500 million and supporting SIDBI’s efforts in direct and indirect financing, leveraging SIDBI’s role as a “market making” institution to boost private sector financing.

As of March 2017, the MSME project—one of the largest disbursing project in the India portfolio—has disbursed \$265.38 million in facilitating financing to MSME. Enterprises today are busy expanding product lines, updating technology, improving marketing campaigns and hiring new talent to add to their bottom line. Small business loans for MSME/SME provide a simple and low-cost way to borrow for commercial ventures. They help entrepreneurs to plug the sudden gaps in finance and cover a variety of expenses without delays.



7. MSME FINANCE: CHALLENGES

The MSME (Micro, Small and Medium Enterprises) sector is called the backbone of the Indian economy. Also known as the SMEs, this sector is growing at a rapid pace and has, in fact, emerged as one of the fastest growing in the past decade. A report from the Ministry of Micro, Small and Medium Enterprises states that the sector accounts for 45% of manufacturing output, contributes more than 40% to exports and is responsible for 8% of India's GDP. These are impressive statistics, but the SMEs can do much more. India ranks low in World Bank's Ease of Doing Business Index and a lot of things can be done to help small businesses achieve their full potential. Here are some of the challenges that need to be addressed on a war footing for further development of SMEs and subsequently, improve their financing.



8. FINDINGS

- SMEs constitute 95% of all industrial units and employ 45% of the nation's total labor force.
- There is need for strengthening the financial support for the SMEs so as to narrow down the debt gap on the nation. Although various banks in India are making all the possible efforts in bridging this gap, however, their approach is restrictive only.
- The two biggest reasons for the financial exclusion of MSMEs were their lack of a comprehensive credit score, and the long-winded and difficult application process to get a loan.
- Today, several MSME founders and owners are leaning on these platforms for credit, with NBFCs already accounting for more than 16% of the credit extended to MSMEs. The share of lending by NBFCs to MSMEs is projected to rise to 22-23% by March 2022.
- Companies have managed to overcome the credit gap because instead of a bureau and bank account-based credit score, they collect data from other sources and use cutting-edge AI-driven algorithms to create a credit score for applicants.
- India's e-commerce market is set to hit \$200 billion by 2026, growing at 30% annually.
- There are various types of MSME loans which are available now days.
- There are various MSME finance challenges which are being faced and which need to be overcome.

WEB LINKS

- [1] <http://ifmrlead.org/ourworks/sme-finance/>
- [2] <https://yourstory.com/mystory/5c2587b7ed-why-is-strengthening-s>
- [3] <https://economictimes.indiatimes.com/small-biz/sme-sector/alternate-lending-platforms-are-fixing-indias-financial-inclusion-problem-becoming-enablers-for-sme-funding/articleshow/64941891.cms>
- [4] <https://www.mahindrafinance.com/SME-Loans.aspx>
- [5] <https://www.worldbank.org/en/news/feature/2017/08/10/innovative-early-stage-financing-for-smes-in-india>
- [6] <https://www.capitalfloat.com/sme-msme-loan>
- [7] <https://www.siliconindia.com/finance/news/MSME-Finance-Opportunities-and-Challenges-nid-203586.html>
- [8] https://www.google.com/search?q=sme+finance+in+india&rlz=1C1CHBF_enIN713IN713&source=lnms&tbm=isch&sa=X&ved=0ahUKEwjIroPg6JPhAhWHS0KHcceBqIQ_AUIDygC&biw=1346&bih=636#imgrc=jRPuG5-ir_1SVM:
- [9] https://www.google.com/search?q=sme+finance+in+india&rlz=1C1CHBF_enIN713IN713&source=lnms&tbm=isch&sa=X&ved=0ahUKEwjIroPg6JPhAhWHS0KHcceBqIQ_AUIDygC&biw=1346&bih=636#imgrc=GpRYNV1fVPhKBM:
- [10] <file:///C:/Users/arpit/Downloads/26253-95199-1-PB.pdf>