

COMMENT LETTER

March 12, 2020

ICI Files Comment Letter with the SEC on Proposal to Update Accredited Investor and Qualified Institutional Buyer Definitions (pdf)

March 12, 2020 Ms. Vanessa Countryman Secretary Securities and Exchange Commission
100 F Street, NE Washington, DC 20549 Re: Amending the “Accredited Investor” Definition
(File No. S7-25-19) Dear Ms. Countryman: The Investment Company Institute¹ applauds the Securities and Exchange Commission’s efforts to update and improve the definition of “accredited investor” in a manner intended to provide individual investors who do not need the additional protections of federal securities laws greater access to the private market.² In so doing, the Commission should continue to take into account, as it has consistently done, the ability of retail investors to bear the greater risk of loss from such investments. The ideal way to accomplish these goals is to remove regulatory barriers to facilitate registered fund investment in private market offerings.³ As ICI President and CEO Paul Schott Stevens has observed, “Enabling retail investors to gain exposure to [private market] assets through professional investment managers is an important function of [registered] funds in our

1 The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI’s members manage total assets of US\$25.2 trillion in the United States, serving more than 100 million US shareholders, and US\$7.7 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

2 See Amending the “Accredited Investor” Definition, Release No. 33-10734 (Dec. 18, 2019) (“Proposal” or “Proposing Release”), available at <https://www.sec.gov/rules/proposed/2019/33-10734.pdf>.

3 We also recommend that the Commission examine how to encourage more issuers to go public earlier in their life cycle, by, for example, lifting unnecessary regulatory burdens on public market issuers. As Chairman Clayton has recognized, it is important to provide products to Main Street investors on “transparent, information-rich, and fair” terms. See Jay Clayton, Chairman, SEC, Remarks to the Economic Club of New York (Sept. 9, 2019), available at <https://www.sec.gov/news/speech/speech-clayton-2019-09-09>. capital markets. Likewise, when it comes to private holdings, interposing a regulated fund between retail investors and private offerings might provide the best of both worlds for Main Street investors: access to the wealth creation of private markets with the regulatory protections

of public markets.”⁴ To the extent that the Commission is considering permitting retail investors to access private market offerings directly, we recommend that it take steps to more appropriately calibrate the scope of the accredited investor definition. To implement these and other recommendations, we request that the Commission: □ Require retail investors to meet financial thresholds to be deemed accredited investors, even if those investors are advised by registered investment advisers or broker-dealers; □ Adjust the current financial thresholds in the individual accredited investor definition for inflation; □ Encourage retail investors' access to the private market through registered funds; and □ Clarify the accredited investor and qualified institutional buyer (QIB) definitions to include regulated non-US funds.⁵

I. Definition of Accredited Investor Compared to the public market, the private market offers fewer protections, less transparency, and less redeemability – making it a fundamentally riskier marketplace.⁶ The Commission should determine that retail investors have the financial ability to bear these risks before broadening access to private market offerings. To protect retail investors, we recommend that the Commission adjust for inflation the current financial thresholds in the accredited investor definition. For institutional investors that do not require the same level of protection as retail investors, we do not object to the Commission expanding the categories of entities that meet the definition of accredited investor.

⁴ See Paul Schott Stevens, President and CEO, ICI, Speech to 2020 Academic and Practitioner Symposium on Mutual Funds and ETFs (Feb. 21, 2020), available at https://www.ici.org/pressroom/speeches/20_pss_darden.

⁵ “Regulated non-US funds” refer to funds that are organized or formed outside the United States and are substantively regulated to make them eligible for sale to retail investors, such as funds domiciled in the European Union and qualified under the UCITS Directive (EU Directive 2009/65/EC, as amended), Canadian investment funds subject to National Instrument 81-02, and investment funds subject to Hong Kong Code on Unit Trusts and Mutual Funds. The laws of some foreign jurisdictions may allow different forms of legal organization (e.g., trust structure) for funds authorized to sell ownership interests to retail investors.

⁶ See Office of Investor Education and Advocacy, SEC, Investor Bulletin: Private Placements Under Regulation D (Sept. 24, 2014), available at https://www.sec.gov/oiea/investor-alerts-bulletins/ib_privateplacements.html; Office of Investor Education and Advocacy, SEC, Investor Alert: Advertising for Unregistered Securities Offerings (Sept. 23, 2013), available at https://www.sec.gov/investor/alerts/ia_solicitation.pdf.

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A. Consider the Ability of Retail Investors to Sustain Loss

The Commission asked whether a broader range of individuals should be accredited investors.⁷ In addition, the Commission asked whether it should permit an investor who is advised by a registered investment adviser or broker-dealer (“financial intermediary”) to be deemed an accredited investor.⁸ We do not believe that it should.⁹ In identifying accredited investors, the Commission should determine whether an investor can bear loss. As the Commission noted, 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 registration process unnecessary.”¹⁰ Thus, 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.¹¹ Moreover, the track record of financial intermediaries to navigate the private market is mixed.¹² Although the Commission may permit financial intermediaries with designated certifications to be

⁷ See, e.g., Proposal at 38, Requests for Comment 11, 12 (asking whether individuals with certain educational backgrounds or professional experience should qualify as an accredited investor).

⁸ See Proposal at 87-88,

Requests for Comment 60-61. 9 We also would not support allowing individuals to self-certify as accredited investors. Proposal at 39, Request for Comment 14. Self-certification is evidence of neither financial sophistication nor the ability to sustain risk of loss. If it were to allow self-certification, the Commission inexplicably would be abandoning longstanding policy. 10 Proposal at 16 (emphasis added), quoting Regulation D Revisions: Exemption for Certain Employee Benefit Plans, Release No. 33-6683 (Jan. 16, 1987). 11 See Net Worth Standard for Accredited Investors, Release No. 33-9287 (Dec. 21, 2011) (“Net Worth Standards Release”), available at <https://www.sec.gov/rules/final/2011/33-9287.pdf> (“One purpose of the accredited investor concept is to identify persons who can bear the economic risk of an investment in unregistered securities, including the ability to hold unregistered (and therefore less liquid) securities for an indefinite period and, if necessary, to afford a complete loss of such investment”). 12 See Carmen Germaine, Advisors Don’t Know How to Use Alts in Portfolios, Ignites (Nov. 22, 2019), available at https://www.ignites.com/c/2579713/308903/advisors_know_alts_portfolios_blackrock?referrer_module=issueHeadline &module_order=4. See also Mark Schoeff, Jr., Advisers May Not Be Equipped to Help Clients Navigate Private Markets, Investment News (Aug. 9, 2019), available at <https://www.investmentnews.com/>. Further, one study reported that brokers who sold private offerings to individuals were more likely to work at firms with a negative disciplinary history. See Jean Eaglesham and Coulter Jones, Firms with Troubled Brokers Are Often Behind Sales of Private Stakes, Wall St. Journal (June 24, 2018), available at <https://www.wsj.com/articles/firms-with-troubled-brokers-are-often-behind-sales-of-private-stakes-1529838000>. accredited investors themselves and put their own money at risk,¹³ it is a step too far to allow their Main Street retail clients, who may be neither financially sophisticated nor have the ability to sustain economic loss, to put their assets at risk.¹⁴ Finally, expanding the definition of accredited investor to clients of financial intermediaries without sufficient financial resources raises concerns about economies of scale and adverse selection. While 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. Given these concerns, we recommend that the Commission require accredited investors to meet financial thresholds or provide alternative means for less financially qualified investors to access the private market – namely through registered investment companies.¹⁵ B. Modernize the Accredited Investor Financial Thresholds by Adjusting for Inflation The Commission does not propose to modify the accredited investor financial thresholds but requests comment on whether it should index the current financial thresholds in the accredited investor definition on a going-forward basis.¹⁶ We strongly believe it should do so because the financial thresholds have eroded since the Commission set them almost forty years ago.¹⁷ Individuals who meet the accredited financial thresholds now are less wealthy than individuals who met the substantially identical thresholds in 1982. In our response to the Concept Release, we provided data demonstrating that inflationary effects have expanded significantly the pool of investors that ¹³ See Proposal at section II.B.1. ¹⁴ From an economic perspective, permitting retail investors advised by a financial intermediary to be deemed accredited investors also may exacerbate the principal-agent problem between investors and financial intermediaries. The principal- agent problem is a potential conflict in priorities between a principal (i.e., investor) and the representative authorized to act on its behalf (i.e., financial intermediary). Given that the private market lacks standardized disclosure or other overlays of investor protection through regulation, investors will have difficulty monitoring or controlling their financial intermediaries’ decision-making in any meaningful way. The lack of disclosure or other controls can lead to

an investor's portfolio shifting away from the investor's goals over time. See Proposal at 139, Request for Comment 70. 15 See *infra* section II.C. 16 See Proposal at 84, Requests for Comment 50-53. The current individual accredited definition includes an income test (individual income in excess of \$200,000 in each of the two most recent years or joint income with that person's spouse 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) and a net worth test (individual net worth, or joint net worth with that person's spouse, exceeds \$1 million). 17 We recognize that the Commission has adjusted the financial thresholds since 1982 to include a joint income component and exclude the value of a primary residence from counting towards satisfying the financial thresholds. See Regulation D Revisions, Release No. 33-6758 (Mar. 3, 1988); Net Worth Standards Release. Ms. Vanessa Countryman March 12, 2020 Page 5 of 9 qualify as accredited investors. 18 Our independent analysis of both the income and net worth tests in the financial thresholds found: • In 1983, 0.6 percent of US households qualified as accredited investors based on income and 1.7 percent based on net worth. Because some households would have qualified by either test, we estimate that overall, 1.8 percent of households qualified in 1983. • In 2016, because the Commission has not adjusted the tests for inflation, 8.1 percent of households qualified based on income and 8.9 percent on net worth. Overall, we estimate that 11.8 percent of households qualified under either test in 2016. The Commission posits that "in evaluating the effectiveness of the current thresholds, it is appropriate to consider change beyond the impact of inflation, such as changes over the years in the availability of information and advances in technologies ... [including] ... powerful home computers and mobile computing devices, as well as software-based tools with which to evaluate investment opportunities ... [that] were not available to investors at the time the accredited investor definition was promulgated." 19 We agree with the Commission that, in the past 40 years, the internet has changed the amount, speed, and ease of access of information available to investors. However, because private market issuers are under no obligation to provide information to the public, we question its relevance here. 20 Private offering information is simply not available to retail investors or many financial intermediaries. Moreover, no other marketplace developments would protect investors from the risk of sustaining 18 See Letter from Susan Olson, ICI, to Vanessa Countryman, SEC (Sept. 24, 2019) ("ICI Concept Release Letter") at section II.A, available at <https://www.sec.gov/comments/s7-08-19/s70819-6190597-192465.pdf>. For your convenience, we reproduce relevant findings from the ICI Concept Release Letter in Appendix A. See also Concept Release on Harmonization of Securities Offerings, Release No. 33-10649 (Jun. 18, 2019) ("Concept Release"), available at <https://www.sec.gov/rules/concept/2019/33-10649.pdf>. 19 See Proposal at 79. 20 See Why a Lack of Private Market Data Exposes Investors to More Risk, Pitchbook (May 28, 2019), available at <https://pitchbook.com/blog/why-a-lack-of-private-market-data-exposes-investors-to-more-risk>. Even sophisticated investors do not always receive accurate or reliable information from private market issuers concerning important information, like valuation. See Simon Clark, Investors Urge Private-Equity Industry to Improve Transparency, Wall St. Journal (Jan. 8, 2020) ("Many private-equity firms guard information, and currently it is easier for them to push back against investors because strong demand for their funds gives them the upper hand in negotiations"), available at <https://www.wsj.com/articles/investors-urge-private-equity-industry-to-improve-transparency-11578409754>. economic loss. 21 In sum, 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. C. Protect Retail Investors Through Registered Funds As we discussed in our response to the Concept Release, the Commission can best promote and expand

retail investor access to private market offerings through registered funds, and particularly through closed-end funds.²² Doing so would offer investors ready access to the private market without sacrificing important protections. In sharp contrast to investors in private market offerings, a robust regulatory framework protects registered fund shareholders.²³ These funds are staffed with professional managers and can achieve the economies of scale to access higher-quality private market offerings. Registered funds must minimize conflicts of interest and disclose their financial conditions, investment objectives, and investment policies to investors.²⁴ They must provide investors with information in plain English, in a standardized order and format.²⁵ Funds must value their assets according to board-approved valuation procedures and restrict their use of leverage.²⁶ Closed-end funds are one type of registered fund that would be useful for providing investors with access to private market offerings with an investor protection overlay.²⁷ Because a closed-end fund does not need to maintain cash reserves or sell securities to meet redemptions, the fund has the flexibility to

²¹ The Commission also asked whether to adjust the financial thresholds by accounting for the different costs of living in geographic regions. See Proposal at 85-86, Request for Comment 54-55. We urge the Commission not to do so. It would be beneficial for the Commission to act consistently with other federal agencies, which generally make cost of living adjustments at a national and not regional level. See, e.g., Social Security Cost of Living Adjustments, <https://www.ssa.gov/news/press/releases/2019/#10-2019-1> and <https://www.ssa.gov/cola/>; IRS Rev. Proc. 2018-57 (delineating inflation adjustments to household finances, among other areas), available at <https://www.irs.gov/pub/irs-drop/rp-18-57.pdf>. Further, requiring issuers to adjust on a regional basis would create enormous costs for issuers, including for tracking an individual's change in status in moving from one region to another and determining residency for individuals with multiple residences.

²² See ICI Concept Release Letter at section IV.B.1.

²³ Both the Securities Act of 1933 and Investment Company Act of 1940 govern the structure and operations of registered funds.

²⁴ See SEC, The Laws that Govern the Securities Industry (Aug. 2019), available at <https://www.sec.gov/answers/about-lawsshtml.html>; see also Andrew J. Donohue, Director of the Division of Investment Management, SEC, Speech: Investment Company Act of 1940: Regulatory Gap between Paradigm and Reality (Apr. 17, 2009) (discussing “substantive protections beyond the disclosure requirements, including the safekeeping and proper valuation of fund assets, restrictions on transactions among affiliates, and governance requirements”), available at <https://www.sec.gov/news/speech/2009/spch041709ajd.htm>.

²⁵ See, e.g., Securities Act Section 5(b)(2); Form N1-A; Form N-2.

²⁶ Investment Company Act Sections 2(a)(41), 18(f).

²⁷ We present recommendations for changes to make it easier for closed-end fund to invest in private market offerings in the ICI Concept Release Letter section IV.B. Ms. Vanessa Countryman March 12, 2020 Page 7 of 9 invest in less-liquid portfolio securities – such as private market offerings.

²⁸ Since shares of a closed-end fund generally are bought and sold in the open market, shareholders have the ability to exit their investments with greater ease than if invested directly in private market offerings. In addition, target date mutual funds also can make investments in private market offerings. Target date mutual funds, like other open-end funds, are subject to complying with Investment Company Act requirements, including those related to liquidity, redemption, and valuation.

²⁹ Within these requirements, target date mutual funds can provide retail investors with access to private market offerings alongside robust investor protection.

D. Clarify the Accredited Investor Definition for Institutional Investors The Commission proposed to extend the definition of accredited investor for institutional investors to include additional categories of entities: registered investment advisers, limited liability corporations, and rural business investment companies. The Commission also proposed a “catch-all” category for other types of entities owning investments in excess of \$5 million

and “not formed for the specific purpose of acquiring the securities being offered.”³⁰ We support this aspect of the Commission’s proposal. As the Commission notes, the current accredited investor definition encompasses US-registered investment companies, but generally does not encompass entities organized under the laws of a foreign country, such as regulated non-US funds.³¹ It is not clear, however, whether the Commission’s proposed “catch-all” category would encompass these funds because they are formed for the specific purpose of acquiring securities even though they are not “formed for the specific purpose for acquiring the securities [being] offered.”³² Yet, treating them as accredited investors would be consistent with the Commission’s intent, given their similarities to registered investment companies.³³ We therefore request that the Commission either add regulated non-U.S. funds to the definition of accredited investor, or, alternatively, clarify that they are permitted to rely on the “catch-all” category.

28 ICI, A Guide to Closed-End Funds (Jul. 2019), available at https://www.ici.org/cef/background/ci.bro_g2_ce.print. 29 See, e.g., Investment Company Act Rule 22e-4 (prohibiting holding more than 15 percent of open-end fund net assets in illiquid investments); Rule 22c-1 (requiring open-end funds to sell and redeem fund shares at a price based on NAV). 30 Proposed Rule 501(a)(9). 31 See Proposal at 55. 32 Proposed Rule 501(a)(9) (emphasis added). 33 We believe the Commission intended to include regulated non-US funds in this category. Proposal at 56-57 (“Proposed Rule 501(a)(9) is intended to capture all existing entity forms not already included in Rule 501(a) ... as well as those entity types that may be created in the future”).

II. Qualified Institutional Buyer Definition Rule 144A provides a limited safe harbor for resale of unregistered securities to QIBs. The Commission proposed to expand the QIB definition to entities that meet the institutional accredited investor definition, as proposed, so long as those entities meet the additional threshold of having \$100 million in securities owned and invested.³⁴ We agree that the QIB definition should be expanded to include institutional accredited investors who meet the substantive requirements of Rule 144A, regardless of legal form of organization.³⁵ Meeting the institutional accredited investor status along with the \$100 million in securities owned and invested test properly identifies “a class of investment that can be conclusively assumed to be sophisticated and in little need of the protection afforded by the Securities Act registration provisions.”³⁶ We have one recommendation to promote consistency in the treatment of investors under Rule 144A. We ask that the Commission permit regulated non-US funds to qualify as QIBs using the “family of investment companies” test, as it currently permits for registered investment companies.³⁷ As discussed above, regulated non-US funds share the substantive characteristics of registered investment companies. We therefore see no reason for the Commission to treat regulated non-US funds differently under Rule 144A. * * * ICI and its members appreciate the opportunity to comment on the SEC’s proposal. If you have any questions with respect to this comment letter, please contact me at (202) 218-3563 or Bridget Farrell at (202) 218-3573. Sincerely, /s/ Dorothy Donohue Dorothy Donohue Deputy General Counsel, Securities Regulation

34 Proposed Rule 144A(a)(1)(j). As discussed above, the Proposal would expand “institutional accredited investors” to include any entity not formed for the specific purpose of acquiring the securities offered, owning investments in excess of \$5 million. Proposed Rule 501(a)(9). 35 See ICI Concept Release Letter at 8, note 35. 36 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) 37 See Rule 144A(a)(1)(iv) (defining “family of investment companies” as any two or more registered investment companies that have the same investment adviser, or their advisers are majority-owned subsidiaries of the same company, or if one adviser is a majority-owned subsidiary of the other adviser).

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Page 9 of 9 cc: The Honorable Jay Clayton The Honorable Hester M. Peirce The Honorable Elad L. Roisman The Honorable Allison Herren Lee William Hinman Director, Division of

Corporation Finance Dalia O. Blass Director, Division of Investment Management Appendix A Our independent analyses of household finances using SCF data over the period from 1983 to 2016 find: □ In 1983, 0.6 percent of US households qualified as accredited investors based on income and 1.7 percent based on net worth. Because some households would have qualified by either test, we estimate that overall, 1.8 percent of households qualified in 1983. □ In 2016, because the Commission has not adjusted the tests for inflation, 8.1 percent of households qualified based on income and 8.9 percent on net worth. Overall, we find 11.8 percent of households qualified under either test in 2016. □ If the test thresholds had been adjusted for inflation from 1983 to 2016, between 1.9 and 2.2 percent of households would have qualified based on income, and between 4.7 and 5.6 percent based on net worth. Overall, we estimate that between 5.0 and 6.0 percent of households would have qualified for accredited investor status had the Commission adjusted the tests for inflation – about half as many households that qualified in 2016 under the unadjusted tests.

Figure 1 Inflation Has Moved Many More Tax Returns over the \$200,000 Income Threshold Percentage of tax returns reporting Adjusted Gross Income of \$200,000 or more, tax years 1982–2016 Note: Data from 1982 through 2015 are from Justin Bryan, “High-Income Tax Returns for Tax Year 2015,” Statistics of Income Bulletin, Internal Revenue Service (Fall 2018), available at <https://www.irs.gov/pub/irs-soi/soi-a-hint-id1806.pdf>. Real data for 2016 were derived by ICI computation of IRS data using IRS' method for estimation. IRS 2016 nominal data are from SOI individual income tax returns tables, available at https://www.irs.gov/statistics/soi-tax-stats-individual-high-income-tax-returns#_tables. Data for CPI-U are from the Bureau of Labor Statistics, available at <https://www.bls.gov/data/>. Sources: ICI analysis using data from IRS Statistics of Income and Bureau of Labor Statistics. 0.2 4.6 1.2 1982 1988 1995 2002 2009 2016 Actual Adjusted for inflation We also estimate what the income and net worth tests would have been in 2016 if the same percentage of US households were to qualify as accredited investors then as qualified in 1983. The individual income threshold would have been roughly \$1.2 million, and the net worth threshold would have been \$5.9 million. Using these test thresholds, 1.8 percent of households would have qualified overall as accredited investors in 2016.

Figure 2 Accredited Investor Thresholds in 1983 and 2016 Under current thresholds Number of qualifying households Qualifying households as a percentage of US households (nominal dollar values) 1983 Income of \$200,000 or more 0.5 million 0.6% Net worth of \$1 million or more 1.4 million 1.7% Overall 1.5 million 1.8% (nominal dollar values) 2016 Income of \$200,000 or more 10.2 million 8.1% Net worth of \$1 million or more 11.3 million 8.9% (excluding home equity) Overall 14.9 million 11.8% Conditional on 1983 thresholds being indexed for inflation to 2016 (real dollar values) 2016 Income of \$200,000 or more PCE \$433,500 2.8 million 2.2% CPI-U \$497,000 2.4 million 1.9% Net worth of \$1 million or more (excluding home equity) PCE \$2,167,500 7.1 million 5.6% CPI-U \$2,485,000 5.9 million 4.7% Overall PCE 7.6 million 6.0% CPI-U 6.3 million 5.0% Conditional on percentage of households being maintained at 1983 levels (nominal dollar values) 2016 Income of \$1,195,900 or more 0.8 million 0.6% Net worth of \$5,886,500 or more 2.1 million 1.7% (excluding home equity) Overall 2.3 million 1.8% Sources: ICI tabulations of Survey of Consumer Finances data, available at <https://www.federalreserve.gov/econres/scfindex.htm>; calculation of inflation based on data for CPI-U from the Bureau of Labor Statistics, available at <https://www.bls.gov/data/>; and data for the PCE from the Bureau of Economic Analysis, available at <https://www.bea.gov/data/personal-consumption-expenditures-price-index>.

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