



July 8, 2014

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

Re: File No. S7-06-13: Recommendations Regarding Accredited Investor Definition

Dear Chairman White:

We appreciate the opportunity to comment on the definition of “accredited investor” under Rule 501 of Regulation D in connection with the review of such definition mandated by the Dodd-Frank Act.

[SeedInvest](#) operates a leading accredited investor funding platform which serves over 15,000 investors and entrepreneurs across the country. Generally, SeedInvest enables startups to take advantage of new Rule 506(c) of Regulation D to utilize general solicitation in compliance with the provisions thereof. Since implementation of Rule 506(c) nine months ago, SeedInvest has facilitated hundreds of accredited investor verifications pursuant to the new rules. Our founders and advisors were instrumental in the signing of the JOBS Act and we have previously voiced our findings on this topic at the Treasury Department, the White House and the SEC. SeedInvest was also one of the first three accredited investor platforms accepted into the [Angel Capital Association](#).

Our research indicates that an increase to the accredited investor thresholds would be disastrous for startups and small businesses, thereby greatly reducing new job creation in the United States. Moreover, our experience with Rule 506(c) offerings indicates that most of the inherent problems with Rule 506(c) could be eliminated by adopting knowledge and experience based pathways to becoming an accredited investor.

Specifically, in this letter, we request (i) that the SEC refrain from increasing the financial thresholds set forth in the accredited investor definition; and (ii) implementation of knowledge and experience based standards for becoming an “accredited investor” as further described herein.

The Current Definition

An [accredited investor](#) is a person deemed sophisticated enough to be able to “fend for themselves” with respect to investments decisions and therefore does not need additional protections under certain securities laws.¹ Currently, to be an accredited investor, a natural person must (1) earn

¹ Ralston Purina Co., 346 U.S. 119 (1953) (holding that if an offering is made to those that are not able to “fend for themselves” then it is a public offering and thus requiring protections of registration under the 1933 Act.)

\$200,000 (or \$300,000 jointly with your spouse) in income over the last 2 years or (2) \$1 million in net worth (excluding primary home value).

A Large Increase in the Accredited Investor Dollar Thresholds would be Disastrous

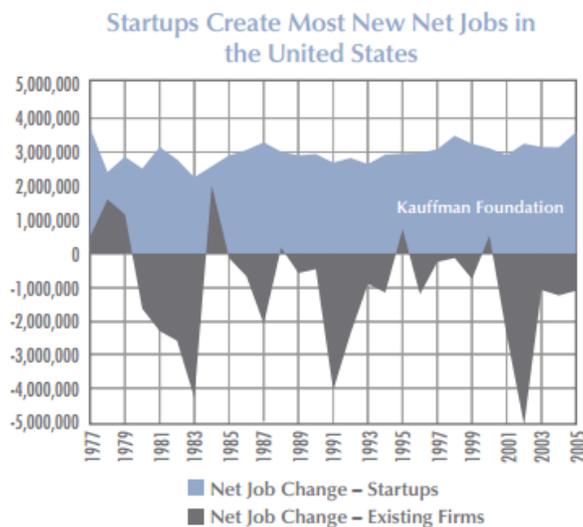
We understand that the Commission is considering whether to increase the foregoing financial thresholds. We believe this would be disastrous. [Analysis by the General Administrative Office \(GAO\)](#) of federal data on household net worth showed that adjusting the \$1 million minimum threshold to approximately \$2.3 million, to account for inflation, would *decrease the number of households qualifying as accredited from approximately 8.5 million to 3.7 million.*²

The U.S. Startup Funding Ecosystem is the Envy of the World

The American startup funding markets are the envy of the world -- global talent and capital flock to US startups. Communities around the world are [trying to replicate Silicon Valley](#) in their own countries. Moreover, angel investor communities are not only active in Silicon Valley, but also in [communities across the country \(both rural and urban\) here at home](#), including active groups like the [Upstate Carolina Angel Network](#) (Greenville, SC) and [New Mexico Angels](#) (Albuquerque, NM). According to the [Angel Capital Association](#), nearly “one-third of ACA Members in [areas outside of the major tech centers] would no longer qualify [as accredited investors].” The loss of this capital in these areas where traditional venture capital is limited would be devastating to economic growth in these communities across the country.

The Stakes are High

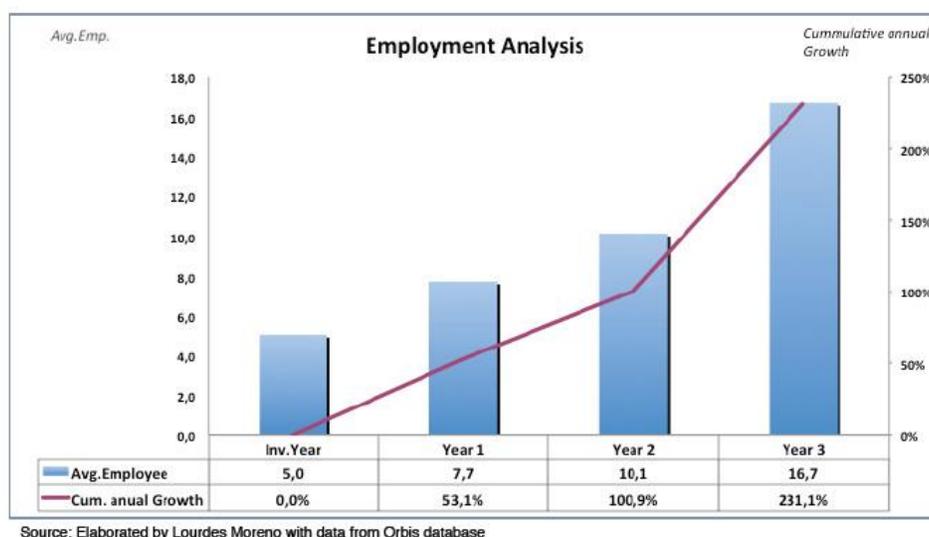
“According to the Center for Venture Research, 70,730 entrepreneurial ventures received angel funding in 2013... Kauffman Foundation research has established that were it not for new businesses, there would be no net job growth in the U.S. Economy.”³



² GAO Report to Congressional Committees, GAO-13-640 Accredited Investor Study, July 2013.

³ See Comment Letter from Kauffman Foundation to the Securities and Exchange Commission (July 2, 2014, available at <http://www.sec.gov/comments/s7-06-13/s70613-539.pdf>)

Furthermore, according to a just released report by the European Trade Association for Business Angels, “**on average, the employment rate more than triples**” for companies that take on angel investments. “While the average number of employees was five at the time the first angel investment, this figure grew 231% by year three when on average the same companies employed 16.7 people.”⁴



Bottom Line: Angel funded companies hire often and hire aggressively for high quality jobs

An increase in the accredited investor thresholds would substantially disrupt the startup funding ecosystem, destroying jobs and the U.S.’s competitive advantage. Ultimately, such a change could lead to a stagnated U.S. economy, diverting talent and capital to other parts of the world.

No Tangible Benefit to Increase

At the core of any policy decision is a cost-benefit analysis. We have not seen any evidence that an increase to these thresholds would have any substantial positive effect on investor protection.

According to the GAO, investor and industry associations say that “any changes to the thresholds might provide only marginal increases to investor protection” and that “increasing the thresholds would limit capital formation.”

The Wrong Metrics

Moreover, the definition of accredited investors relies solely on financial metrics and fails to consider any of the other relevant factors to determining sophistication. Consider that the following people are probably not accredited investors (i.e. deemed by the government to not be sophisticated enough to protect themselves):

⁴ See The Economic Impact of Angel Investment, July 1, 2014, available at http://www.eban.org/research-the-economic-impact-of-angel-investment/?utm_source=EBAN+Subscribers&utm_campaign=ff8fdd33a2-EBAN_Flash_July_2014&utm_medium=email&utm_term=0_a77c25eb47-ff8fdd33a2-299671285#.U7w5T7FBkgt

- A U.S. Congressman (the annual salary \$174,000)
- An experienced securities lawyer (outside of major markets of NY, SF, LA, CHI etc.)
- Average Harvard Professor (\$151,262)
- Federal District Court Judge (\$186,000)
- A licensed stock broker (\$131,000)

Some of these people are charged with protecting other members of the public, yet they are not deemed to be able to protect themselves.

The definition is fundamentally flawed in assuming that a person's wealth or income determines their financial sophistication and whether they are, in the words of the U.S. Supreme Court, able to "fend for themselves."⁵ A person's experience, knowledge and credentials should also be determinative of their need for protection from the government, not how much money they have.

Unequal Treatment under the Law

Additionally, a pure financial standard does not treat all citizens equally. It ignores cost of living discrepancies across the country. \$200,000 in New York City is a lot different than \$200,000 in Houston, TX. The standard disproportionately excludes people in lower cost of living areas. People in Houston in the same financial condition should have the same opportunities to invest in startups as people in New York. Even more stark, the joint marriage threshold (i.e. \$300,000 jointly for married couples) [inappropriately excludes certain same sex couples](#).

People falling outside of the "accredited investor" definition are not allowed to invest in any private companies. Thus, the current definition of accredited investor disproportionately affects individuals in lower cost-of-living areas or same-sex couples (in civil unions or domestic partnerships) by prohibiting their participation in the wealth creation occurring in the private markets (see [WhatsApp: acquired for \\$19 billion](#) without ever touching the public markets).

The ultimate goal here should be to refine the accredited investor definition (i) so as to treat people fairly and equitably based on metrics more indicative of financial sophistication and (ii) such that is based on publicly available or non-sensitive information so that people will be comfortable verifying their accredited investor status.

The only way to treat people equally under the law is to adopt knowledge and experience based standards.

Knowledge and Experience Based Standards should Prevail

Here are some proposed categories of people who should be deemed able to "fend for themselves" and therefore should be included in the accredited investor definition:

- **Passing a Test.** Individuals who pass a standardized accredited investor test with publicly available test results.

⁵ Ralston Purina Co., 346 U.S. 119 (1953)

- **Advanced Degrees.** Individuals holding an advanced degree in business/law related fields (i.e. MBA, J.D., Masters or PhD in Finance, Economics, Business, etc.)
- **Professional Designations.** Individuals with **Professional Designations** (i.e. J.D., CPA, CFA, CISP, etc.)
- **Securities Licenses.** Individuals who hold **Securities Licenses** (Series 7, Series 63, etc.)
- **Acting through Registered Investment Advisor or Broker-Dealer.** An individual who has consulted a licensed expert and acts in accordance with their recommendations should be deemed to be able to “fend for themselves.”
- **By Order of a Court, the Commission, a State Securities Administrator or other governmental entity.** An established governmental authority should be able to determine that a person is capable of fending for themselves with respect to investments. This would allow for more of a real-world practical approach to the application of the definition.

These items are far more likely to indicate financial sophistication versus a blanket financial threshold. Individuals may have acquired wealth by inheritance or may have saved their entire lives to accumulate \$1M in net worth. Those individuals are no more likely to be sophisticated than, for example, a person with an MBA degree.

Experience under newly enacted Rule 506(c) of Regulation D

There has been a lot of uproar about [new rules requiring additional steps to verify accredited investor status \(i.e. checking tax returns\)](#) as a condition to using the [new 506\(c\) rules permitting general solicitation](#).

Again, the real problem here is that the definition of accredited investor is out of touch with reality and is based on very sensitive personal financial information without any real rationale.

Because the test is based on this sensitive financial information, it adds unnecessary friction to the investing process. Most people are reluctant to turn over tax returns or net worth or brokerage statements. As a result, far fewer startups are taking advantage of Rule 506(c) than would otherwise be the case, thus limiting the rule’s intended effect on job creation.⁶

At [SeedInvest](#), we’ve facilitated hundreds of accredited investor verifications under Rule 506(c) using our online, automated accredited investor verification process. Using our system, an investor can easily allow us to pull electronic tax records from the IRS, email their lawyer/accountant for a verification or use our online wizard to upload the necessary documents for verification.

While many verifications have been processed smoothly, the strictness of this rule has led to **some confusion and unintended consequences, including the following:**

⁶ See, Keith F. Higgins, Director, Division of Corporation Finance, Keynote Address at the 2014 Angel Capital Association Summit, indicating \$10B raised using 506(c) vs. \$922B raised using 506(b) between September 2013 and April 2014, available at <http://www.sec.gov/News/Speech/Detail/Speech/1370541320533#.U7srHLFBkgs>.

- **Net Income Verification is very difficult in January – May of each year.** Tax transcripts or records for a given year are not generally available until June of the following year. There are 5 months every year where it is difficult to follow the net income safe harbor by reviewing tax returns for the previous 2 years.
- **It is impossible to truly verify net worth.** Verifying net worth requires verification of a person’s outstanding liabilities. It is practically impossible to conduct a comprehensive third party verification of liabilities and therefore one can only rely on information provided by the investor. This makes such a third party verification illusory by its nature and not significantly better than an absolute self-certification.
- **Individuals are hesitant to provide personal financial information.** The time and effort required to get over this hump will cost millions of dollars in time wasted and legal fees and will dissuade many potential accredited investors from participating in the private placement market.
- **Renewing a third party verification every 3 months is extremely inefficient.** With respect to net income, a 3 month renewal is completely repetitive. With respect to net worth, the likelihood of any substantial change within 3 months is negligible. The result is wasted time and money with no real benefit.
- **An experienced securities lawyer was not allowed to invest** because he “only” makes \$150,000/year.
- **No flexibility.** A sophisticated fund manager, who earned \$500,000 in year 1, \$199,000 in year 2, and an expectation of earning over \$500,000 in the current year, was not allowed to invest.
- **A parallel venture capital fund can be very difficult to verify.** Parallel funds of big venture capital funds are often under \$5M in assets and therefore would require an issuer to verify every individual investor in the parallel fund. This is a nonstarter for most venture capital funds.
- **Marriage within the last 3 years can frustrate accredited investor verification.** The definition does not allow for switching between the individual (\$200k) and married (\$300k) threshold tests.
- **Asking about financial status leads to questions about sensitive personal issues like divorce (including division of assets) and death.**
- **For entities with assets less than \$5M, the “all equity holders are accredited investors” standard can require an endless amount of diligence.** Very small ownership percentages together with unreachable equity holders can make verification of entities extremely difficult. We’ve witnessed this problem with an entity related to a very large and prominent university endowment fund.

- **Advisors Don't Want to Incur Liability.** Many lawyers, broker-dealers, certified public accountants, and registered investment advisors are reluctant to provide a third party certification even when they have personal knowledge due to liability and compliance concerns. The staff should consider a safe harbor for these advisors where they have acted reasonably in good faith.
- **Startups are still struggling with the definition of “general solicitation.”** There is still great uncertainty on what activities constitute “general solicitation.” Many startup do not know whether they should raise capital under Rule 506(b) or 506(c) and some have inadvertently ended up with 506(c) offerings.

All of these problems go away with an additional knowledge/experience based standard, which would cause much less friction and provide for greater accuracy on who needs protection. This would dramatically increase the viability of Rule 506(c) and allow the rule to fulfill its original congressional intent, namely to create jobs.

SeedInvest's Proposed Revised Accredited Investor Definition

Based on the foregoing, we propose the following modifications to the definition of “accredited investor” under Rule 501(d) of Regulation D:

1. a bank, insurance company, registered investment company, business development company, or small business investment company;
2. an employee benefit plan, within the meaning of the Employee Retirement Income Security Act, if a bank, insurance company, or registered investment adviser makes the investment decisions, or if the plan has total assets in excess of \$5 million;
3. a corporation, limited liability company, partnership, or charitable organization, ~~corporation, or partnership~~ with assets exceeding \$5 million;
4. a director, executive officer, or general partner of the company selling the securities;
5. an entity business in which all the equity owners are accredited investors;
6. a natural person who has individual net worth, or joint net worth with the person's spouse, that exceeds \$1 million at the time of the purchase, excluding the value of the primary residence of such person;
7. a natural person with income exceeding \$200,000 ~~in each of the two most recent years~~ or joint income with a spouse (or with a partner in a civil union or domestic partnership) exceeding \$300,000, in each of the two most recent years ~~for those years~~ and a reasonable expectation of the same income level in the current year; ~~or~~
8. a natural person who holds or who has held one of the following professional licenses:
 - a. License to practice law in any state of the United States or foreign jurisdiction.
 - b. Certified Public Accountant (CPA)
 - c. Chartered Financial Analyst (CFA)
 - d. Registered agents of registered broker-dealers
 - e. Representatives of registered investment advisors
 - f. Series 7, 63, or 66 licenses

9. a natural person who has received one of the following degrees from an accredited educational institution:
- a. Masters of Business Administration (MBA)
 - b. Masters or doctorate (PhD) in finance, economics, business or a related field of study
 - c. A Juris Doctor (J.D.);
10. a natural person who is deemed to be an “accredited investor” in writing by order of a court, the Securities and Exchange Commission, or a state securities administrator;
- ~~8.11.~~ a natural person who passes an accredited investor exam promulgated and sanctioned by the Commission or its designee;
- ~~9.12.~~ a natural person purchasing the applicable securities based on the advice of a registered investment advisor or registered broker-dealer; or
- ~~10.13.~~ a trust with assets in excess of \$5 million, not formed to acquire the securities offered, whose purchases a sophisticated person makes.

Conclusion

In light of the foregoing, we, on behalf of the thousands of investors and entrepreneurs in our network, urge the Commission to:

- Restrain from increasing the dollar thresholds of the accredited investor definition. If such an increase is required, it must be indexed to inflation starting from today and not retroactively.
- Modify the definition to provide for additional knowledge and experience mechanisms to becoming an accredited investor as described above.

We look forward to the ongoing conversation and welcome the opportunity to provide additional details or market data to the Commission and its staff.

Respectfully,

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Marianne Hudson, Executive Director, Angel Capital Association
Representative Patrick McHenry