PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION
1225 West Main Street, Suite 126 | Norman, OK 73069
Toll Free (888) 621-7484 | Fax (405) 360-2063
www.piaba.org

March 16, 2020

Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F St NE
Washington, DC 200549-1090
rule-comments@sec.gov

RE: Proposed amendments to the definition of "accredited investor"
File No. S7-25-19

Dear Ms. Countryman:

I write on behalf of the Public Investors Arbitration Bar Association ("PIABA"), an international bar association comprised of attorneys who represent investors in securities disputes all across the nation. Since its formation in 1990, PIABA has promoted the interests of the public investor in all dispute resolution forums, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in rules promulgated by the U.S. Securities & Exchange Commission (the "SEC" or the "Commission") relating to investor protection.

PIABA appreciates the opportunity to comment on the Commission's proposed amendments to the definition of "accredited investor" ("Amendments to the Accredited Investor Definition") and notes that the Amendments to the Accredited Investor Definition follow the SEC's related June 18, 2019 concept release on harmonization of securities offering exemptions (the "Concept Release"). As such, much of this comment letter pertaining to the Amendments to the Accredited Investor Definition echoes PIABA's position on the Concept Release as stated in PIABA's September 24, 2019 comment letter (PIABA's September 24 letter).[1]

PIABA is concerned its comments in the September 24, 2019 letter have been disregarded in the Commission's current rulemaking. In its proposal, the Commission is wholly focused on increasing the number of individuals who may participate in the private securities markets. While increasing the numbers of "eligible" investors may expand businesses' access to capital, our members have seen all too often this easier access results in rampant abuses that rob investors of their hard-earned savings. This is especially true of older investors, who often meet the very lax financial definition of "accredited investor", even though they are completely unsophisticated. ***PIABA again stresses and reminds the Commission of its primary objective of protecting investors.*** While access to capital and capital formation are laudable goals for the Commission, its main obligation is to protect investors. Simply put, PIABA believes the Amendments to the Accredited Investor Definition will actually undermine investor protection.

[1] *See* PIABA letter dated September 24, 2019, attached hereto as Exhibit 1.

Officers and Directors
President: Samuel B. Edwards, TX
EVP/President-Elect: David P. Meyer, OH
Secretary: Adam Gana, NY
Treasurer: Darlene Pasieczny, OR
Hugh D. Berkson, OH
Michael S. Edmiston, CA
Benjamin P. Edwards, NV
Marnie C. Lambert, OH
Christine Lazaro, NY
Thomas D. Mauriello, CA
David P. Neuman, WA
Timothy J. O'Connor, NY
Joseph C. Peiffer, LA
Jeffrey R. Sonn, FL
Andrew J. Stoltmann, IL
Robin S. Ringo, *Executive Director*

As the Commission points out in the Amendments to the Accredited Investor Definition, its review of the definition of accredited investor is mandated by the Dodd-Frank Act, passed in the aftermath of the 2008 financial crisis.[2] Dodd-Frank calls for the definition of accredited investor to be reviewed every four years to determine whether it "should be adjusted or modified for the ***protection of investors, in the public interest, and in light of the economy***." (Emphasis added). As described throughout this and PIABA's September 24 letter, the Amendments to the Accredited Investor Definition directly contradict Congresses' mandate in Dodd-Frank as they fail to protect investors and nothing has happened in the economy that justifies the substantial increase in risk to investors that the Commission suggests.

The Amendments to the Accredited Investor Definition fail to address numerous serious issues with the current definition of accredited investor. For instance, the financial standard included in the accredited investor definition has not been updated in 37 years. The income and net worth thresholds set in 1982 and existing today define an accredited investor as an individual with a net worth of $1 million or more, or with an individual income in excess of $200,000 per year or joint income with a spouse in excess of $300,000 per year. As the Commission notes, historically, the definition of accredited investor "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." However, the Commission gives little concern to the fact that what it meant to have $1,000,000 or make an annual income of $200,000 in 1982 is far different than what it means today, especially if those numbers are being used to identify investors with "financial sophistication" who can presumably "fend for themselves."

In 1982, only 1.8% of households could meet either of the financial thresholds of an accredited investor. Now, 13% of households qualify under these threshold. Moreover, the experience of our members is that those who qualify under this standard are often older, retired investors who have saved through a 401k for their entire lives and accumulated this money from long work histories, not prior investment experience. Furthermore, that level of wealth, in the experience of our members, rarely coveys any appropriate level of sophistication. To the contrary, many of those who meet the current accredited investor definition are undeniably unsophisticated and, if the rule is adopted, even more people will unknowingly be losing the protections of the securities laws. This simply is not what Congress intended when it enacted Dodd-Frank and when it instructed the Commission to revisit this standard every four years.

Far from the only organization expressing surprise about the Commission's failure to change the income and net worth thresholds associated with being an accredited investor, even large Registered Investment Advisors ("RIAs") expressed surprise that 1982 levels of income and net worth still pass muster according to the Commission. According to Gerard Klingman of Klingman & Associates:

> While we believe allowing more private market access to experienced investors is a good thing, the SEC must take a long-term approach to protecting smaller and less-knowledgeable investors. To our surprise, the SEC did not propose changes to the minimum threshold limits: over $200,000 income ($300,000 joint) or $1 million net worth. In fact, the SEC has not increased these thresholds since introducing them in 1982, ignoring nearly 40 years of inflation. We recently read that in 1982, around 0.5% of U.S. citizens met the income limit, while nearly 9% do today — an 18-fold increase.
>
> The SEC is now at a crossroads as the rising number of eligible accredited investors is coinciding with the rising general interest in private markets. If we use history as a guide, investors will undoubtedly need to be protected from themselves, particularly in these less liquid and transparent markets. While these proposed rules move forward to ensuring investors understand the potential risks, they still need to ensure investors are financially equipped to withstand their potential fallout.[3]

[2] SEC, "Amending the "Accredited Investor" Definition," 85 Fed. Reg. 2574, 2575 (Jan. 15, 2020).
[3] Godt, Nick, "Top Advisors Weigh In: Should the SEC Expand the Accredited Investors Pool?" *Financial Advisor IQ*, 19 Feb. 2020.

The Commission's explanation as to why the reduction of investor protection over the past 37 years is acceptable is quite concerning. Specifically, the Commission argues that advances in the internet and social media somehow mitigate the need for the protection of the securities laws.[4] This premise is misguided, at best. First, while the Commission is correct in noting that the development of the internet and social media has resulted in more information being available to investors, the Commission ignores that those same developments have resulted in far more *misinformation* bombarding the investing public. Many known fraudsters have used these mediums to purposely mislead investors and fleece them of millions of dollars. Second, many investors who meet the accredited investor financial threshold are senior citizens who may not be utilizing the internet and social media for investment research. The Commission has provided no support that this group of investors, which is substantially larger than when Rule 501 was first adopted, does not need the protections of the Securities Act.

In addition, the Commission has expressed concerns that if the financial thresholds are increased, it may disproportionately impact certain geographical regions in which households have less wealth but also lower costs of living.[5] However, the Commission's concerns do not adequately address the concerns raised above that substantially larger numbers of individuals now qualify as accredited investors than when the financial thresholds were initially adopted. The Commission's concerns about geographical differences in net worth and income surely were the same in 1982, yet standard thresholds have been used for the past 37 years. This rationale does not justify making ***no*** adjustment to the financial thresholds.

Even more troubling than the Commission's decision to make no changes to the financial thresholds is it consideration of expanding the definition of accredited investor to include those advised by RIAs or broker-dealers. PIABA strongly opposes this suggestion. If the Commission were to take this action, it would render the individual accredited investor definition meaningless, making RIAs and broker-dealers the arbiter of all securities protections to investors. This is completely unacceptable and, especially in light of the Commission's failure to adopt a universal fiduciary standard for all those who provide investment advice to retail customers, would be a disaster for investor protection.

Moreover, the Commission claims that it is "not aware from our enforcement experience or otherwise of disproportionate fraud in this expanded space."[6] However, PIABA's letter of September 24, 2019 contained almost three pages of bullet points describing fraudulent private placements, all of which were enforcement actions taken by the Commission. The vast majority of these investments were purchase through RIAs and broker-dealers. These fraudulent private placements were "sold, not bought" as a result of the efforts of RIAs and broker-dealers and a rule that would allow this to happen to every investor through a RIA or broker-dealer would surely result in an entirely new list of fraudulent private placements that rob mom and pop investors of their life savings. The lure of large commissions makes it too tempting for unscrupulous financial advisors to solicit these investments to unsophisticated investors. The Commission's consideration here would essentially impart the sophistication level of any unscrupulous financial advisors to their victimized clients. This proposal takes away even the appearance of protection to vulnerable investors and cannot possibly be supported under Dodd-Frank.

PIABA is also greatly concerned with the Commission's focus on supporting issuers at the detriment of investors. For example, the Commission worries that increasing the financial thresholds to the accredited investor definition could have disruptive effects on the Regulation D market. That market currently raises ***$1.7 trillion per year***. The fact that Regulation D is such a large portion of capital formation is evidence in and of itself that private offerings have become more available than they were otherwise intended. Expanding those offerings to more unsophisticated investors will both decrease investor protection and also hurt capital markets as expanding the investor base for private placements will almost surely encourage fewer companies to take on the effort to "go public" and provide the necessary information for the SEC to regulate them. This will neither be good for investors nor the capital markets.

---

[4] *Supra* note 2 at 2594.
[5] *Id.* at 2595.
[6] *Id.* at 2600.

In closing, PIABA reiterates its offer to engage with the Commission on this issue, including providing access to our clients who have been harmed by the wrongful sales of private offerings. PIABA believes it would be very helpful for the Commission to get to know the investors it is now willing to deem sophisticated and not in need of the protections of the securities laws. PIABA feels confident that if the Commission meets these individuals and hears their stories, the Commission will better understand PIABA's grave concerns.

Sincerely,

Samuel Edwards,
President

PUBLIC INVESTORS ADVOCATE BAR ASSOCIATION
1225 West Main Street, Suite 126 | Norman, OK 73069
Toll Free (888) 621-7484 | Fax (405) 360-2063
www.piaba.org

sent by email to:
rule-comments@sec.gov

September 24, 2019

Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F St NE
Washington, DC 200549-1090

RE: Concept Release on Harmonization of Securities Offering Exemptions File No. S7-08-19

Dear Ms. Countryman:

I write on behalf of the Public Investors Advocate Bar Association ("PIABA"), an international bar association comprised of attorneys who represent investors. Since its formation in 1990, PIABA has promoted the interests of the public investor in all dispute resolution forums, while also advocating for public education regarding investment fraud and securities industry misconduct. Our members and their clients have a strong interest in rules promulgated by the Securities and Exchange Commission (the "Commission") relating to investor protection.

PIABA appreciates the opportunity to comment on the Concept Release on Harmonization of Securities Offering Exemptions (the "Concept Release") and notes its general agreement with the Commission that simplifying and improving the framework of exempt offerings is a noble goal. However, it appears the Commission has lost sight of its primary objective – protecting investors – in the Concept Release. With few exceptions, each section of the Concept Release – from its discussion of the "accredited investor" definition to Secondary Trading of Certain Securities – is more concerned with providing greater access to funds for exempt offering issuers than it is in providing necessary protections to public investors. Expansion of exempt offerings to retail investors will almost certainly increase the risks to which retail investors are exposed while decreasing the information available to investors attempting to perform due diligence. It will also substantially increase the number of instances in which investors fall prey to fraudulent investment schemes. These implications are significant and must be addressed if the Commission is to honor its mission of protecting the investing public. If the Commission is to expand the pool of investors who may be eligible to invest in exempt offerings, it must simultaneously improve investor protections for those who are eligible to invest.

Officers and Directors
President: Christine Lazaro, NY
EVP/President-Elect: Samuel B. Edwards, TX
Secretary: David Meyer, OH
Treasurer: Michael S. Edmiston, CA
Hugh D. Berkson, OH
Benjamin P. Edwards, NV
Adam Gana, NY
Marnie C. Lambert, OH
Thomas D. Mauriello, CA
David P. Neuman, WA
Timothy J. O'Connor, NY
Darlene Pasieczny, OR
Joseph C. Peiffer, LA
Jeffrey R. Sonn, FL
Andrew J. Stoltmann, IL
Robin S. Ringo, *Executive Director*

PIABA offers comments on the topics set forth in the Concept Release below. We have chosen to focus on a few questions specifically relating to the current exempt offering framework.

Generally, investors are not adequately protected under the existing exempt offering framework. The exempt offering framework should only be amended to the extent such amendments strengthen investor protections. With the understanding that registration is a key component of the American securities regulation system, and that disclosure of key information should be a crucial part of an investor's decision-making process, we recognize that there currently exists a well-established framework regarding regulation requirements and exemptions therefrom. PIABA is concerned that modifications to that system that would make it easier to avoid registration, or more pointedly, allow de-facto continuous unregistered security sales, would run afoul of the purpose underlying the current framework.

I. Non-Accredited Investor Participation in the Exempt Offering Market

PIABA believes that non-accredited investors should be able to participate in private securities transactions under only exceptional circumstances. The exempt offering framework assumes that the investors to whom exempt offerings are sold do not need the full protections of the securities laws. We note, however, that those investors are generally not in a financial position to bear the risk associated with private placements. The problem is compounded when many private securities exemptions do not restrict dollar amounts that non-accredited investors can invest, but rather, only restrict the number of non-accredited investors that can participate. The limits on the number of non-accredited investors who may participate in an exempt offering provides little protection to those who are investing. To the extent the Commission believes that non-accredited investors should continue to be allowed to invest in exempt offerings, it should consider placing limitations on the amount any individual non-accredited investor may invest.

II. Accredited Investor Definition

The purpose of providing exemptions from registration under Regulation D is to allow smaller, private companies to raise capital without incurring the considerable expense and time of complete registration of the offering with the Commission. While the assumption of Regulation D is that "accredited investors" have both the sophistication to comprehend the risks and characteristics of said limited offerings and also have the financial means to withstand the potential financial losses posed by private placement investments, PIABA's members have all too often found that those who meet the current definition of "accredited investors" have neither the sophistication to understand nor the means to withstand losses in Regulation D investments.

Regulation D offerings now raise in excess of $1.5 trillion a year. While a certain proportion of those offerings are offered to institutional investors and financial professionals, many Regulation D offerings are actively sold to retail investors around the nation. Increasing the thresholds or other "accredited investor" requirements would help to protect the most vulnerable public investors from being victimized by these investments.

a. Concerns with the Existing Accredited Investor Definition

PIABA believes that the definition of "accredited investor" is long overdue for revision, most significantly because efficacy of the income and net worth thresholds for financial eligibility to invest in Regulation D offerings have been diminished due to the passage of time and the impact of inflation since they were put in place in 1982. Since that time, income and net worth thresholds have been used to define individual accredited investor as follows: an individual with a net worth in excess of $1 million, or with an individual income in excess of $200,000 or joint income with his or her spouse in excess of $300,000, is deemed an "accredited investor."

Now, some 37 years later, these standards have not been substantially modified from a time when a newspaper cost 20 cents, and a can of Coke from a vending machine cost 35 cents. In short, due to the passage of time and inflation, there are more people than ever who qualify as "accredited investors." According to the SEC's review in connection with the Accredited Investor Staff Report, the census data from 1983, a year after the thresholds were established, demonstrated that only 0.5% of households met the individual income threshold, only 1.7% met the net worth threshold, and only 1.8% met either threshold. Now, according to census data cited by the Concept Release, 8.9% of households qualify based on the individual income threshold of $200,000, 4.6% of households qualify based on the joint income threshold of $300,000, 9.4% of households qualify based on the net worth threshold of $1 million, and, overall, 13.0% of United States households qualify as accredited investors. In short, thanks exclusively to inflation and the passage of time, more than 7 times as many investors qualify as "accredited investors" today compared to the time the regulation was first put in place. Conspicuously absent from that increase is any sort of meaningful improvement in financial literacy for retail investors.

While there has been a significant increase in the number of "accredited investors," a large number of these investors are not genuinely in a position to take on the risks typically associated with Regulation D investments. For example, a retiree with a net worth of $1 million might be relying on that net worth to generate income to supplement the investor's social security payment to cover their basic living expenses (without regard to exceptional expenses). While the investor has the necessary net worth to qualify as an accredited investor, this person is not able to bear the risk associated with investment in a private placement. This investor cannot bear to lose any principal. Additionally, that $1 million net worth could have easily been achieved through long-term participation in a company retirement plan that was likely administered by someone other than the retiree. The person could easily be a line worker from a manufacturing company that worked a very long time and earned that retirement amount. However, that is not the type of person who would generally be considered a "sophisticated" investor who does not need the protection of the securities laws. This is clearly not what was intended when the original financial thresholds were put in place almost 40 years ago, yet it is where natural forces of inflation have brought the investing public.

b. Those Engaged in Fraud are Drawn to the Larger Pool of Available Participants in Exempt Offerings

In addition to being concerned about investors being unable to understand the risks and characteristics of Regulation D offerings, PIABA is particularly concerned about the use of these offerings to defraud innocent investors. It is important to note that the current accredited investor standard, in creating a

comparatively large pool of investors qualified to be offered Regulation D securities, makes these offerings a particularly attractive tool to promote fraudulent schemes. Our members have seen investors harmed by a string of Regulation D offerings in the last 10 years that have turned out to be nothing more than Ponzi schemes.

The following make up a small sampling of the litigation and press releases of SEC enforcement actions targeted at private offerings over the past decade:

- **SEC Obtains Asset Freeze in $485 Million Nationwide Offering Fraud**[1]
  The Commission alleged that Provident Royalties LLC made a series of fraudulent offerings of preferred stocks and limited partnership offerings to more than 7,700 investors between 2006 and 2009.

- **SEC Obtains Asset Freeze Against Co-Founder of Canopy Financial in $75 Million Offering Fraud**[2]
  The Commission alleged that between 2008 and 2009, Canopy Financial solicited approximately $75 million from investors for a private placement offering for preferred shares of Canopy.

- **SEC Charges Two Florida Men in Ponzi Scheme Defrauding Teachers and Retirees**[3]
  The Commission alleged that two men raised approximately $22 million from over 100 investors, many of them Florida teachers or retirees. The men allegedly operated a Ponzi scheme disguised as a private equity fund.

- **SEC Charges Chicago-Based Investment Firm with Misleading Investors in Private Equity Offerings**[4]
  The Commission alleged that Advanced Equities Inc., a broker dealer and investment advisory firm, misled investors in connection with two private equity offerings in 2009 and 2010. The firm agreed to a $1 million penalty.

---

[1] Press Release, SEC, SEC Obtains Asset Freeze in $485 Million Nationwide Offering Fraud (July 7, 2009), https://www.sec.gov/news/press/2009/2009-151.htm.
[2] Press Release, SEC, SEC Obtains Asset Freeze Against Co-Founder of Canopy Financial in $75 Million Offering Fraud (Dec. 2, 2009), https://www.sec.gov/news/press/2009/2009-257.htm.
[3] Press Release, SEC, SEC Charges Two Florida Men in Ponzi Scheme Defrauding Teachers and Retirees (Aug. 29, 2011), https://www.sec.gov/news/press/2011/2011-171.htm.
[4] Press Release, SEC, SEC Charges Chicago-Based Investment Firm with Misleading Investors in Private Equity Offerings (Sept. 12, 2012), https://www.sec.gov/news/press-release/2012-2012-191htm.

- **SEC Charges Atlanta-Based Adviser with Operating Ponzi-Like Scheme Involving Private Investment Funds**[5]
  The Commission alleged that a private fund manager defrauded investors through a fund of funds, and the creation of two private funds. The Commission further alleged that investors lost an estimated $17 million.

- **SEC Charges Sarasota-Based Private Fund Manager with Stealing Investor Money and Conducting Ponzi Scheme**[6]
  The Commission alleged that a fund manager raised $3.8 million from investors between 2008 and 2013 by soliciting them to invest in notes in his private investment funds. Many of the investors were individuals the fund manager met through his church.

- **SEC Charges Chicago-Based Investment Fund Manager with Stealing Investor Money and Conducting Ponzi Scheme**[7]
  The Commission charged a fund manager with operating a Ponzi scheme after he raised more than $11.4 million from investments in four private funds he managed.

- **Atlanta Businessman Charged in Nursing Home Investment Scheme**[8]
  The Commission charged an Atlanta-based businessman with fraud after he raised nearly $190 million through dozens of municipal bond and private placement offerings. The investors were purportedly to earn interest from revenues generated by a nursing home, assisted living facility, or other retirement community investment. The Commission alleged that, instead, the man diverted funds to other business ventures and personal expenses.

- **SEC Charges Operators of $1.2 Billion Ponzi Scheme Targeting Main Street Investors**[9]
  The Commission filed charges against a group of unregistered investment companies, the Woodbridge Group of Companies LLC, for allegedly bilking thousands of investors in a $1.2 billion Ponzi scheme. Sales agents pitched the investments to investors, many of whom were seniors, as low cost, conservative investments. In 2019, a federal court in Florida ordered the company to pay $1 billion in penalties and disgorgement.[10]

---

[5] Press Release, SEC, SEC Charges Atlanta-Based Adviser with Operating Ponzi-Like Scheme Involving Private Investment Funds (Sept. 19, 2012), https://www.sec.gov/news/press-release/2012-2012-192htm.
[6] Press Release, SEC, SEC Charges Sarasota-Based Private Fund Manager With Stealing Investor Money and Conducting Ponzi Scheme (May 21, 2014), https://www.sec.gov/news/press-release/2014-103.
[7] Press Release, SEC, SEC Charges Chicago-Based Investment Fund Manager With Stealing Investor Money and Conducting Ponzi Scheme (May 29, 2014), https://www.sec.gov/news/press-release/2014-108.
[8] Press Release, SEC, Atlanta Businessman Charged in Nursing Home Investment Scheme (Nov. 20, 2015), https://www.sec.gov/news/pressrelease/2015-264.html.
[9] Press Release, SEC, SEC Charges Operators of $1.2 Billion Ponzi Scheme Targeting Main Street Investors (Dec. 21, 2017), https://www.sec.gov/news/press-release/2017-235.
[10] Press Release, SEC, Court Orders $1 Billion Judgment Against Operators of Woodbridge Ponzi Scheme Targeting Retail Investors (Jan. 28, 2019), https://www.sec.gov/news/press-release/2019-3.

- **SEC Obtains Judgments against Stephen DiCarmine and Joel Sanders**[11]
  In 2018, a federal court entered judgements against two former Dewey & LeBoeuf, LLP executives in connection with a fraudulent $150 million bond offering. The Commission alleged that one of the men falsified financial statements which were incorporated into a private placement memorandum for the offering.

- **SEC Charges San Diego-Based Investment Adviser with Running a Ponzi Scheme**[12]
  The Commission charged an investment adviser and the companies he controlled with soliciting investments in tax-free private placements. The Commission alleged that the adviser's clients included school district employees and veterans. He raised $7 million for the investments, which were allegedly a Ponzi scheme.

Collectively, these allegedly fraudulent investment schemes raised over $2 billion from investors. More recent private placements such as those issued by GPB Capital (which reportedly raised proceeds of over $1.8 billion, largely from retail investors) have exhibited significant signs of distress and may also end up resulting in near-total losses for investors.

Private placements are often heavily marketed through independent broker-dealer networks and are "sold, not bought." Financial professionals push these products to unsophisticated investors – those same investors do not beg their advisors for access to non-public investments. PIABA's members see the investments presented as alternative income investments appealing to elderly investors often living on a fixed income. Unscrupulous financial advisors pitch the products as offering income higher than what is available in conventional fixed-income securities, and/or also providing diversification to the investor's portfolio because their value is not correlated to the stock market or other conventional asset classes. Many clients solicited to invest in these types of products end up losing their entire investment. In fact, the Commission itself warns investors that it "may be difficult or impossible to recover the money you invest in an offering that turns out to be fraudulent."[13]

So long as the bright-line tests of net worth and income are used to define "accredited investors," an ever-larger group of retail investors have been exposed to the common mis-application of the intention underlying the rule. For the protection of the investing public, this needs to change.

c. Changes to the Definition of Accredited Investor

PIABA believes that the current definition of "accredited investor" is outdated. The income and net worth thresholds established in 1982 suggest a considered policy judgment that Reg. D investments were meant for a very small percentage of the investing public. While imperfect, the thresholds served as a pragmatic rule of thumb that limited investments in Reg. D offerings to those investors who, on some level,

---

[11] Litigation Release No. 24119, SEC, SEC Obtains Judgments against Stephen DiCarmine and Joel Sanders (Apr. 23, 2018), https://www.sec.gov/litigation/litreleases/2018/lr24119.htm.
[12] Litigation Release No. 24461, SEC, SEC Charges San Diego-Based Investment Adviser with Running a Ponzi Scheme (Apr. 26, 2019), https://www.sec.gov/litigation/litreleases/2019/lr24461.htm.
[13] SEC, Investor Bulletin: Private Placements Under Regulation D (Sept. 24, 2014), https://www.sec.gov/oiea/investor-alerts-bulletins/ib_privateplacements.html.

could financially afford to withstand the potential losses posed by private placement investments. Accordingly, PIABA supports the proposal contained in the Accredited Investor Staff Report that would raise the net worth threshold and the income threshold for accredited investors. The U.S. Government CPI data reveals that the cumulative rate of inflation since 1982 is more than 2,490%. While PIABA recognizes that raising the thresholds by that amount may be unpalatable, it suggests that raising the net worth threshold to $2.5 million and income threshold to $500,000/$750,000 for individuals and couples would be a meaningful step forward in moving back to the original intention of limiting the pool of accredited investors.

Moreover, PIABA supports a regular review and adjustment of these thresholds. ***After being increased to new higher thresholds as suggested above,*** these thresholds should then be reviewed every few years and adjusted to account for inflation. PIABA recommends that the thresholds be automatically adjusted every four years based on the Consumer Price Index, in conjunction with the periodic review of the accredited investor definition mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank"). Automatic adjustment of the thresholds every four years would keep the thresholds reasonably in line with inflation without creating unnecessary administrative issues. The periodically adjusted thresholds would thus remain a useful, if imperfect, rule of thumb.

d. Other Options for Accredited Investor Determination

PIABA does not believe there should be exceptions to the accredited investor financial thresholds based on other measures of sophistication, other than those currently in place for non-individual investors such as banks, broker-dealers, and insurance companies not currently subject to any assets test. Adding subjectivity to the standards would almost certainly lead to uncertainty and abuse.

However, and in additional to the net worth and income thresholds, there should be some sophistication qualification for individual investors who meet the definition of an accredited investor. Investors who otherwise meet the requisite net worth threshold may not be sophisticated enough to appreciate the significant risks of investing in private placements and limited offerings. This is especially true as the population ages and many face cognitive impairment issues. It therefore makes sense to include a requirement that the accredited investor be sophisticated enough to gauge the risks inherent in the investment. The analysis can be somewhat objective to the extent it relies upon the prospective investor's profession (including *when* the investor practiced in that profession), or their prior investing experience. However, a sophistication qualification should supplement, not replace, the bright-line income and net worth requirements.

The Concept Release asked whether the Commission should "permit an investor… that is advised by a registered financial professional to be considered an accredited investor?" PIABA's response to this question is a resounding "No." In our members' experience, the involvement of registered representatives of a broker-dealer or Investment Adviser Representatives is too often the problem, and not the solution. This is especially true as private placements typically pay much higher commissions to the financial professionals who sell them than do more traditional investments. Commission-motivated investment professionals too often indiscriminately recommend Regulation D offerings to retail investors and use Regulation D qualifications without regard to any suitability analysis whatsoever. Substituting registered financial professional advice for the other standards to establish accrediting investor status would swallow

the rule and eliminate the protections of the accredited investor definition for those who need it most - retail investors who risk being steered into private placements that they do not understand by trusted advisors.

e. Further Protections

All too often, financial professionals and others who offer investment advice conflate the "accredited investor" definition with the suitability standard. That is, if a customer qualifies for the private placement, many financial professionals wrongly believe the investment is, by definition, an appropriate investment for that customer. The accredited investor definition is often treated by investment professionals and the financial firms charged with supervising them as a *de facto* suitability affirmation, arguing that the Regulation D definition confirms that the investment was suitable for *any* investor who qualified and purchased the private placement. The argument has been too often compellingly persuasive for unsophisticated arbitrators, resulting in public investors losing arbitrations related to obviously inappropriate investments. Raising the thresholds and adding additional non-financial criteria should protect investors from that flawed defense. But, the Commission also needs to make clear to brokers and others who manage client investments that the "accredited investor" definition is *not* a replacement to the obligation to make only suitable recommendations to clients that are in the client's best interests. A simple statement from the Commission that accreditation as an "accredited investor" does not mean that a private placement investment is *de facto* suitable for an investor would be tremendously helpful to public investors.

Additionally, PIABA supports the idea that there should be a verification of an investor's accredited status. Too often account paperwork for investment accounts may be signed while blank or filled in by registered representatives in a self-serving manner that overstates the customer's income, net worth, and investing experience. By requiring simple verification, the Commission will likely reduce the risk that investors' eligibility for Regulation D offerings may be fudged by unscrupulous salespeople. The verification process need not be unduly complicated and should include simple steps like the review of W-2s, tax returns, bank and brokerage statements, credit reports and the like (as currently set forth in Rule 506(c)).

Despite guidance from the Commission as to what methods of verifying accredited investor status are acceptable, many issuers, particularly those who are selling their investment without the assistance of a broker-dealer, still rely on accredited investor questionnaires as the sole method of verification. PIABA believes the Commission should impose stronger penalties on issuers that fail to properly verify accredited investors status. These penalties could include fines but could also provide for relief available to civil litigants, such as personal liability of the officers of the issuers.

III. Expanding Exempt Offerings

PIABA does not believe the exempt offerings framework should be further expanded. For example, PIABA does not believe it is prudent to increase the $5 million limit for Regulation D's Rule 504 offerings. The Commission has not offered any particularly compelling arguments regarding why the increase is required. Rather, such an increase would simply expose more retail investors to potential abusive sales practices.

Moreover, PIABA opposes any effort to expand which companies are eligible to use Rule 504 exemptions. Investment companies such as closed-end mutual funds, open-end mutual funds, and UITs (Unit Investment Trusts) are currently ineligible for Rule 504 exemptions. Many investors, including those considered to be unaccredited and unsophisticated, invest in products like mutual funds and UITs and may not be aware of the further risk associated with the expanded use of Rule 504 by investment companies. Considering how often the investing public invests in investment company products, these companies should remain ineligible under Rule 504.

Additionally, PIABA is opposed to the growth of unregulated crowdfunded offerings. Our members often find that unsophisticated retail investors are the ones more likely to fall victims to fraudulent offerings. The Commission should not increase or waive the current annual cap on investors, accredited or not. More control and review will protect investors, therefore PIABA supports increasing offering document disclosure and auditing as well as regulating or limits on promotion and advertising.

The Commission also seeks comment on whether it should create a new exemption for micro-offerings. While a micro-offering (which the Commission proposes to cap at $250,000) could allow small business access to investors' capital, businesses seeking relatively small amounts of capital should use traditional forms of financing, like commercial loans. The risk inherent in micro-offerings is not the type of risk that should be passed onto investors. Further, the ability of a business to issue a new micro-offering every thirty to ninety days would create a loophole for fraudsters to exploit, allowing them to raise larger amounts of capital than should be allowed under a micro-offering exemption.

IV. Disclosure Obligations

While unlawful conduct by financial professionals cannot be "cured" by disclosures in offering materials, PIABA emphasizes the importance of public access to accurate, complete financial information and disclosures about a potential investment. This is particularly true when considering any illiquid or restricted investment purchase, and regardless of whether an investor meets the "accredited investor" qualifications. Disclosures should emphasis the difficulty of further re-sale, provide relevant and current financial disclosures by the issuer, and be provided at or before the time of solicitation. If information is available on-line through a centralized directory, disclosures should provide a clear, direct, and accurate link to such information.

PIABA does not support any proposed measure that would diminish the amount of information required to be given to investors prior to making private investments. To the contrary, PIABA believes that better information should be provided to investors. The information that often accompanies private investments is written in technical language and small print, making it very difficult for the average investor to understand and read. Moreover, the disclosures are often hundreds of pages long. Often, an investor is presented with these documents and then immediately asked to sign a subscription agreement or other document indicating that the investor read everything and understood it. Knowing the investor never read the prospectus or offering circular, the financial advisor is happy to secure the signed acknowledgement to close the sale and receive the enhanced commission such investments often offer.

Disclosure is not effective when presented in this manner. The Commission should not only strengthen requirements related to the quality of information, but also, place time restrictions on when the

information must be provided and require a cooling off period to allow Investors a better evaluation of the information they have been provided.

V. Integration Standards

In simple terms, PIABA contends that relaxing the integration standards, or expanding the safe harbor provisions, would unquestionably cause retail investors harm.

The Commission asks whether the six-month integration safe harbor set forth in Regulation D's Rule 502(a) should be shortened to ninety or even thirty days. PIABA's members' clients have repeatedly fallen victim to Ponzi schemes whereby a continual stream of unregistered securities is offered, with each new offering funding the payoff of an older, maturing one. Registration is avoided by carefully minding the six-month measure. Just such a scheme was used by the fraudsters behind the Medical Capital debacle, who raised billions of dollars in the process. Shortening that period will undoubtedly serve to promote those Ponzi schemes, allowing unscrupulous issuers to issue a never-ending stream of securities to fund older issues. The schemes will run well for a while if the wrongdoers know they will have access to fresh capital every thirty or ninety days. The constant inflow will provide a stream of "returns" to the early investors – which streams will be used to promote the future offerings and thereby bring a host of new victims into the scheme. This is, effectively, how all Ponzi schemes work and reducing the time period between these issuances will only serve to hurt more investors.

While PIABA takes no issue with any rule changes that promote clarity and thereby make it easier for issuers to determine, early in the process and in a conclusive manner, whether registration is required, we cannot support any changes that would loosen the existing strictures and make it easier to issue unregistered securities absent the institution of appropriate measures to fight fraud and promote investor protection.

VI. Secondary Trading of Securities Issued Pursuant to an Exemption

PIABA does not believe that a reduction of minimum holding periods, from either six months or one year, to, respectively, three months or six months, in order to qualify for the safe harbor resale exemptions under Rule 144 and Section 4(a)(1), will provide any benefit to most retail investors. It is unlikely that a retail investor, especially a "buy and hold" investor, will base their decision on whether to invest in an exempt offering on how long they must hold the securities.

More often, PIABA members see cases where the investor is unaware of the liquidity or illiquidity of an investment which they are holding. Investors believe their financial advisor has sold them an appropriate investment and discover that the investment is illiquid when they attempt to sell the investment.

The Commission also asks whether secondary trading opportunities should be created for closed end funds or BDCs. While a secondary market will certainly address certain liquidity issues inherent in those investments, PIABA cautions that any purchasers within the secondary market be held to the same standards used for the original purchasers. It is important that downstream investors have the same protections as the original investors.

Further, PIABA does not believe that the Commission should extend federal preemption to secondary sales of exempt offerings. PIABA is concerned that extension of federal preemption may put into question state law that offers even greater protection to retail investors.

Conclusion

Once again, PIABA appreciates the opportunity to respond to the Commission's Concept Release. We urge the Commission to remember its central and primary mission to investors while it tackles the legitimate goal of simplifying the exempt offering framework. Although increasing the efficiency of the capital markets and ability of companies to raise money is a laudable goal, it cannot be done at the expense of investor protection.

PIABA would be happy to engage with the Commission further on this issue, including working with the Commission to provide access to investors who have been hurt by the wrongful sale of various exempt offerings so that the Commission can fully understand the personal costs when investor protection fails the public.

Sincerely,

Christine Lazaro,
PIABA President

Samuel Edwards,
PIABA Executive Vice-President/President-Elect