



ANGEL CAPITAL ASSOCIATION

February 28, 2014

The Honorable Mary Jo White
Chairman
US Securities and Exchange Commission
100 F St NE
Washington, DC 20549

RE: Accredited Investor Definition Comment and Recommendations

Dear Chairman White:

The Angel Capital Association (ACA) appreciates the opportunity to comment regarding the accredited investor definition. The SEC is required under Dodd-Frank to review this definition in 2014 to determine whether it should be adjusted for the “protection of investors, in the public interest, and in light of the economy.”

ACA has studied this issue at length, and recommends that the SEC make no change to the existing financial thresholds¹ for a natural person, in light of the massive growth in size of the exempt market and its critical importance to the economy – particularly in job creation. Increasing the thresholds for income and net worth for inflation would significantly decrease the pool of capital for job-creating startups, and would further limit by as much as 60%, the population eligible as accredited investors to participate in the \$1.4 trillion exempt market.

ACA understands the SEC may consider the concept of “sophistication” in the definition. ACA supports this approach to broaden the accredited investor universe to include those with requisite sophistication, but who do not meet the financial thresholds. An example of an Investor Qualifying Questionnaire is appended that contains criteria that may be useful in developing this approach.

Current Accredited Investor Definition Works Well, Creating Jobs and Innovation

Early stage companies – and the accredited angel investors who support them – have relied on the current definition for decades, building a strong capital network that fosters job-creation and innovation nationwide. Accredited angels are the primary source of capital for these innovative companies that account for most of the net new job growth in the United States in the last 25 years.² These startups are also a key growth engine for established companies that today increasingly rely on these early-stage enterprises to function as outsourced research and development labs – especially in the life science and technology sectors.

Loss of support for this vital market sector would be devastating. The General Accounting Office (GAO)³ and the Commission estimate that an inflation-based adjustment to net worth would eliminate approximately 60% of current accredited investors. Today, only 7.2% of US households qualify. Inflation

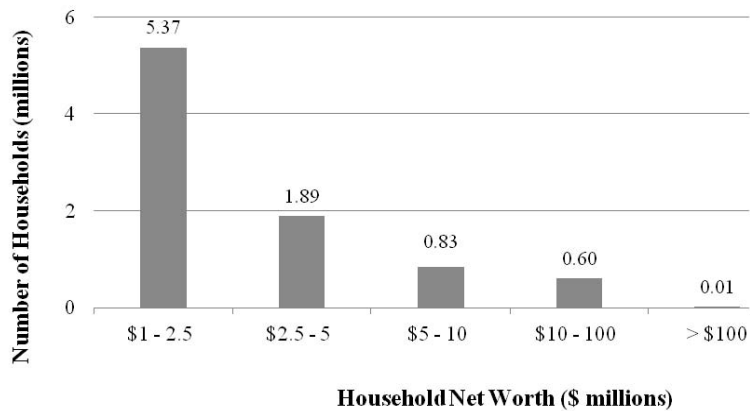
¹ \$200,000 in income (\$300,000 for married persons) or \$1 million in net worth (excluding a primary residence)

² John Haltiwanger, Ron Jarmin, and Javier Miranda, [Jobs Created from Business Startups in the United States](#), 2008

³ GAO Report to Congressional Committees, GAO-13-640 Accredited Investor Study, July 2013.

adjustment would lower that number to just 3%, when public markets are increasingly driven by algorithmic trading and are less hospitable to retail investors than ever, and while the vast majority of companies now raise capital under Regulation D. In addition, the definition in 2010 was tightened to exclude a primary residence from the wealth test. This major change has already substantially diminished the accredited investor pool that serves the rapidly expanding startup economy.

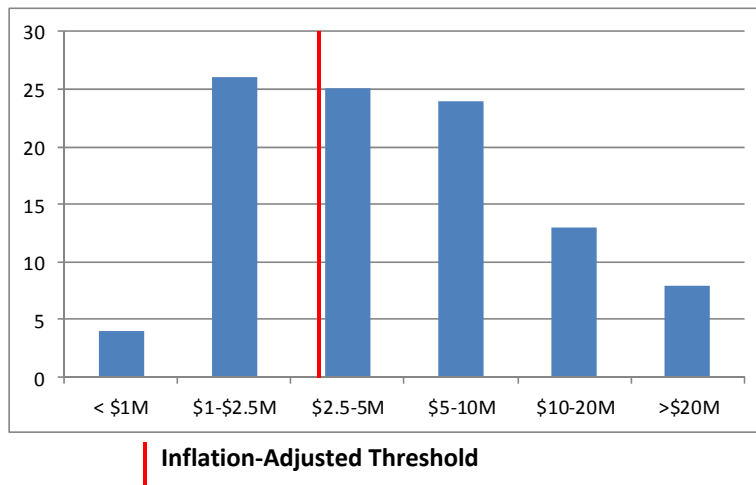
Number of U.S. Households that Qualify as Accredited Investors Based on 2010 Net Worth⁴



Importantly, among seasoned “professional” angel investors who constitute ACA’s 12,000+ members, a survey⁵ conducted in January 2014 indicates that more than a fourth of these active investors would fall below the thresholds if the income and net worth criteria were simply adjusted for inflation.

This most active group of angels represents a bellwether for the potential decline in support for the exempt market.

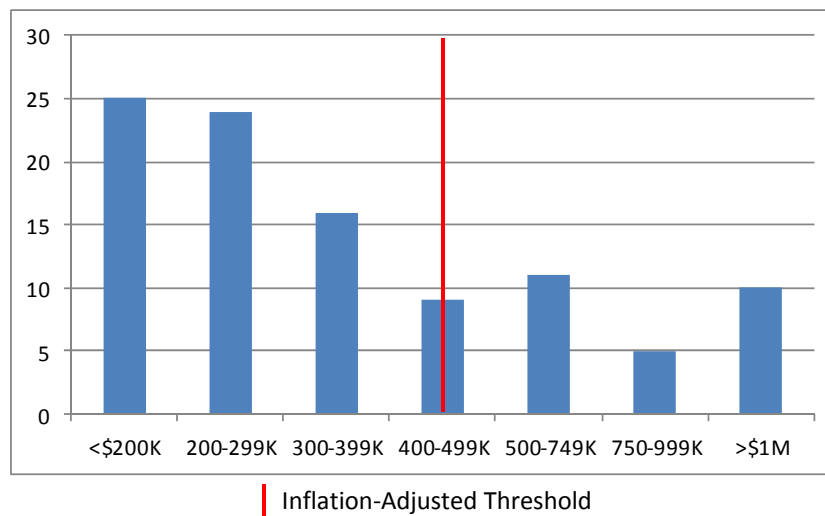
Percent of Surveyed ACA Members Who Qualify as Accredited Investors Based on 2013 Net Worth



⁴ SEC Release No. 33-9415, Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Economic Analysis, page 75.

⁵ Survey included 1009 responses from ACA members in 41 states. Of that total, 26.4% had net worth of less than \$2.5M and also income of less than \$400,000 – approximating the thresholds cited by the GAO as representing an inflation-adjustment based on the Consumer Price Index.

Percent of ACA Members Who Qualify as Accredited Investors Based on 2013 Income



The startup ecosystem would face grave disruption from a dramatic shrinkage of this vital investor pool, especially in regions where venture capital is not prevalent (almost everywhere other than Silicon Valley, Boston and metropolitan New York). A major contraction in angel investing could stall local economic development, university tech transfer initiatives, and other key components of our innovation economy.

Regions outside key start-up centers would sustain a far larger loss of accredited investors if the thresholds were raised. The ACA survey indicates that 32% of investors outside of New York, Boston, and California had net worth of less than \$2.5 million, compared to 25.9% in those regions. In terms of income, 66% of angels in the outlying regions had annual income less than \$400,000, compared with 59.8% in the three major centers.

The Exempt Market is Too Large to Exclude the Vast Majority of Households

The vast majority of young companies have little or no access to the public markets for capital, nor can they obtain bank loans. According a 2013 Grant Thornton study⁶, the number of public, exchange-listed companies in the U.S. has declined 44.3% since 1997, from 8,823 to 4,916, and this market is “effectively closed to 80% of the companies that need it.”⁷ Companies that have been unable or unwilling to enter the public market instead are raising more than a trillion dollars annually via exempt offerings

Exempt offerings are now the de facto market for capital formation, and rival public markets in size:

- More than 200,000 accredited investors participate in angel investments annually,⁸ investing more than \$23 billion in the growth engine of seed-stage companies.
- More than 31,000 offerings were issued under Reg D in 2012, compared to just 954 registered public equity offerings⁹.

⁶ David Weild, Edward Kim and Lisa Newport, Grant Thornton, Making stock markets work to support economic growth: Implications for governments, regulators, stock exchanges, corporate issuers and their investors, Capital Markets Series July 2013.

⁷ Ibid.

⁸ Center for Venture Research, University of New Hampshire, Analysis Reports, <https://paulcollege.unh.edu/research/center-venture-research/cvr-analysis-reports>. 2002-2013.

- While exempt offerings often have higher risk, there has been a remarkable absence of fraud¹⁰, particularly in angel investments. This is a result of the concerted due diligence, strong term sheets, and ongoing mentoring that is the hallmark of angel investing. Members of an Established Angel Group¹¹ (EAG), in particular, are well-versed that exempt offerings are illiquid investments that need diligent attention in addition to funds.

Exempt Markets Today Are Increasingly Regulated

The private offering arena is massively larger and very different than in 1952, when the Supreme Court opined that such offerings should be made only to those able to “bear the loss” of risky investments. Today, regulation of exempt offerings has in fact become far more aligned with that of SEC registrants.

Investor protection in the exempt market includes:

- More than 80% of the \$3.4 trillion raised under Reg D from 2009-2012 was raised by funds that are regulated under the Private Funds Investment Advisers Registration Act, and subject to reporting, recordkeeping and examination requirements, “as necessary and appropriate in the public interest and for the protection of investors”¹².
- Most Reg D offerings have restrictions on resale – such as the one-year limit under Rule 506, to prevent abuses such as rapid purchase and sale schemes known as “pump and dump.”
- Rule 506(b) currently allows up to 35 non-accredited investors, with substantial reporting requirements for those purchasers. Accredited angel investors gain access to similar disclosures by requiring information rights in exchange for investment.
- Pending crowdfunding rules introduce ongoing reporting and audited financials for issuers raising funds through portals. Proposed Reg CF would allow issuers to simultaneously raise funds via Rule 506 – logically extending such disclosures to the issuer’s accredited investors.
- Pending rules on Regulation A will create a public market for offerings up to \$50 million, with disclosure requirements similar to those of full SEC registrants.

Conclusion

Given the economic realities and burgeoning growth in the exempt market, the need for capital formation in the early-stage sector and the need to balance access to investment opportunity with investor protection, ACA recommends the following:

- Maintain the current financial thresholds (\$200,000 income per individual; \$300,000 for joint filers, or \$1 million net worth not including primary residence) for individuals to qualify as accredited investors who may invest unlimited amounts in exempt offerings.
- Enable individual investors to certify accredited status using an expanded, detailed, Investor Qualifying Questionnaire (see example below) that requires substantive qualitative information about the purchaser well beyond a simple “check-the-box” certification. This questionnaire

⁹ Vladimir Ivanov and Scott Bauguess, Division of Economic and Risk Analysis, SEC: Capital Raising in the U.S.: An Analysis of Unregistered Offerings Using the Regulation D Exemption, 2009-2012, July 2013. Total capital raised through Reg D offerings was \$903 billion in 2012, an amount nearly four times the \$240 billion raised in the public equity markets. Total exempt offerings in 2012 of \$1.7 trillion, exceeded total registered offerings of \$1.2 trillion, including public debt

¹⁰ U.S. Securities and Exchange Commission Office of Inspector General, Office of Audits. Regulation D Exemption Process, Report No. 459 March 31, 2009.

¹¹ www.angelcapitalassociation.org/data/Documents/Public%20Policy/GuidanceonEAG09_03_13.pdf

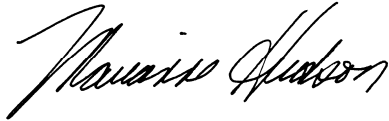
¹² Vijay Seckhon, Can the Rich Fend for Themselves, Hastings Business Law Journal, Winter 2011. (Seckhon currently is senior counsel to the office of the general counsel of the SEC. His views do “not necessarily represent the views of the Commission.”)

should be *deemed to satisfy the principles-based methodology for an issuer to “take reasonable steps to verify” the accredited status of investors under Rule 506(c).*

- Add a category for “sophisticated investors” who have the requisite knowledge and experience to invest in exempt offerings, irrespective of financial thresholds.

Again, ACA greatly appreciates the opportunity to provide these comments and recommendations to the SEC as it undertakes its review of the Accredited Investor Definition.

Sincerely,



Marianne Hudson – Executive Director



David Verrill – Chairman of the Board



Mike Eckert – Chair, Public Policy Committee



Jean Peters – Member of the Board

EXAMPLE

Individual Investor Qualification Questionnaire

This questionnaire meets Federal securities law requirements for determining Accredited Investor status of a natural person. Please complete and return.

Name: _____

Address: _____

Phone: _____

ACCREDITED INVESTOR TYPE

Which of the following, if any, applies to the investor:

A natural person whose individual net worth, or joint net worth with that person's spouse, at the time of purchase exceeds \$1,000,000. "Net worth" means the excess of total assets at fair market value, excluding a primary residence, over total liabilities, including a mortgage or other liability secured by a primary residence only if and to the extent that it exceeds the value of the primary residence.

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

INVESTOR BACKGROUND INFORMATION

Please indicate which of the following categories, if any, applies to the investor. This information may be used by the issuer in its determination as to the accredited investor status of the purchaser.

Previous/current investor in an exempt offering under Regulation D

Previous/current member of an Established Angel Group

Previous/current C-Suite executive, financial officer or member of the board of directors of a private or public for-profit entity

Previous/current CEO or executive of a for-profit entity in which I had Profit & Loss responsibility

Received a Certificate of Education from the Angel Capital Association, the Angel Resource Institute, or similar professional training from an Established Angel Group (EAG)

Holder of relevant degree such as MBA, accounting, finance, etc. Please specify:

Current or former holder of registration such as Certified Financial Adviser, Certified Public Accountant or similar registration. Please specify:

Current or former registered broker dealer, financial advisor or similar designation. Please specify:

BAD ACTOR EXCLUSION

I hereby certify that I am not now, nor have I ever been, considered a "bad actor" as defined under SEC Rule 506, and/or that I am purchasing a minority share that is less than 20% of the total voting securities of the issuer.

SIGNATURES

Print Name of Investor

Signature

_____ Date of Execution: _____
Title (if applicable)