



**Consumer Federation of America**



June 16, 2015

The Honorable Jeb Hensarling, Chairman  
The Honorable Maxine Waters, Ranking Member  
Committee on Financial Services  
United States House of Representatives  
Washington, DC 20515

Dear Chairman Hensarling and Ranking Member Waters:

This week the Capital Markets and Government Sponsored Enterprises Subcommittee has scheduled a hearing at which it will consider legislation (H.R. 2187) that would dramatically expand the categories of individuals who are permitted to invest in private offerings issued under Regulation D of the securities laws. We are writing on behalf of the Consumer Federation of America (CFA)<sup>1</sup> and Americans for Financial Reform (AFR)<sup>2</sup> to express our strong opposition to the legislation as currently drafted.

The accredited investor definition plays an important role in defining the boundary between public and private offerings. Its purpose is to ensure that private offerings are sold only to those individuals who can fend for themselves without the protections of the public markets, including full disclosure of all material facts about the offering. As such, it is a crucial protection for ordinary Americans seeking to safeguard their investment capital, and a linchpin of the SEC disclosure regime that has been central to our securities markets since the 1930s.

There are a number of ways in which the accredited investor definition could and should be updated and improved. Changes designed to enable certain knowledgeable and experienced investment professionals and individuals to become accredited investors could be included in any such revisions.

Unfortunately, as currently drafted, HR 2187 serves not to reform the accredited investor definition, but to undermine and greatly weaken it. This legislation would thus unacceptably increase the risk that individuals without the financial expertise to understand the risks of unregistered offerings or the financial wherewithal to withstand potential losses would be exploited by unscrupulous individuals seeking to profit at investor expense.

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<sup>1</sup> CFA is an association of nearly 280 nonprofit consumer organizations that was established in 1968 to advance the consumer interest through research, advocacy and education.

<sup>2</sup> Americans for Financial Reform is a nonpartisan and nonprofit coalition of more than 200 civil rights, consumer, labor, business, investor, faith-based, and civic and community groups. Formed in the wake of the 2008 crisis, AFR works to lay the foundation for a strong, stable, and ethical financial system – one that serves the economy and the nation as a whole

H.R. 2187 is entitled the “Fair Investment Opportunities for Professional Experts Act,” but its scope is much broader. Not only would it allow individuals who self-certify that they are broker-dealers, investment advisers, licensed attorneys or certified public accountants to qualify as accredited investors, but it would also define as an accredited investor any individual who self-certifies that he or she “has retained and used the services” of such an individual to make an investment in a Reg D offering. In addition, the legislation directs the SEC to establish an exam that individuals who do not meet the income and net worth thresholds could take to become licensed as an accredited investor. As discussed below, each of these provisions is seriously flawed.

Demonstrated relevant knowledge and expertise in financial matters may a reasonable basis for considering exceptions to net worth requirements, but that is not in fact the standard that the bill proposes. Many of the individuals permitted to self-certify under this bill could lack relevant knowledge and expertise in financial matters. Broker-dealers and investment advisers who pass securities licensing exams and are legally qualified to recommend such offerings to their customers can presumably be trusted to determine whether such investments are appropriate for themselves. However, it is unclear why one would believe that *any* licensed attorney or CPA would be similarly qualified. For example, a securities attorney would have vastly different qualifications in this regard than an attorney who specialized in personal injury lawsuits. An auditor would likely have far greater expertise than a CPA whose practice consists of income tax preparation.

Even more troubling, however, is the provision that would allow any individual, regardless of income, net worth or financial sophistication, to qualify as an accredited investor simply by virtue of retaining and using the services of a broker-dealer, an investment adviser, a licensed attorney, or a CPA. We are open to the concept of allowing individuals to qualify as accredited investors by virtue of relying on the advice of a financial professional *subject to appropriate conditions*. But this legislation fails to impose any such conditions. It therefore risks exposing unsophisticated investors to exploitation by individuals who may themselves lack the requisite expertise and many of whom are not even subject to securities laws.

Any attempt to expand the accredited investor definition to permit reliance on outside advice would, at a minimum, have to specifically require that:

- 1) the purchase is made in reliance on *advice* from a registered investment adviser or broker-dealer,
- 2) that the advice is delivered under a *fiduciary standard* of care and *in the best interests of the client*,
- 3) and that the investment adviser or broker-dealer offering the advice *does not have a material financial stake* in the investment being recommended.

Such conditions are necessary to help ensure that private offerings are sold only to those for whom they are an appropriate investment as part of a diversified portfolio and under circumstances in which securities regulators can oversee that advice to verify that the interests of investors are protected.

Although we question how widely it would be used, we have no objection in principle to the proposition that experienced investors could qualify as accredited based on criteria including successful completion of an exam demonstrating the requisite expertise. For this approach to be acceptable, the test would have to be rigorous enough to indicate a reasonable level of financial expertise. In order to ensure that the individual has practical as well as book knowledge, it should be combined with a requirement that the

individual have relevant professional experience or experience as an investor. Among other things, this would create a mechanism for licensed attorneys and CPAs who wish to qualify as accredited investors without meeting the financial thresholds in existing rules to do so without giving them a blanket accreditation. It is entirely unreasonable, however, to suggest that the SEC could adopt such a test within the six-month time frame provided under the statute.

Finally, the legislation relies extensively on individuals to self-certify that they meet the standards. But none of the criterion established in the legislation – from status as a licensed professional to successful completion of an exam – would be difficult to verify. The legislation should be amended to require verification, rather than self-certification, to provide an additional assurance that the provisions will not be gamed.

H.R. 2187 does not adequately ensure that all those classified as accredited investors under its terms would have the requisite knowledge and expertise to legitimately qualify as an accredited investor. In particular, its provision enabling individuals to qualify simply by virtue of retaining and using a financial professional, without any additional conditions or protections, would open these individuals to exploitation and abuse which securities regulators would in many cases be powerless to prevent.

We therefore urge you to reject this legislation. While we believe that the approach in this legislation is fatally flawed, we stand ready to help devise a legislative approach that would serve to enable sophisticated investors to qualify as accredited investors without opening the doors to exploitation of more vulnerable individuals.

Sincerely,

Lisa Donner  
Executive Director  
Americans for Financial Reform

Barbara Roper  
Director of Investor Protection  
Consumer Federation of America

Cc: Members of the House Financial Services Committee