MERCER ADVISORS™

March 11, 2020

Via E-Mail to rule-comments@sec.gov

Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090
Attn: Vanessa Countryman, Secretary

Re: File No. S7-25-19
SEC Proposed Rule: Amending the "Accredited Investor" Definition

Dear Ms. Countryman,

Thank you for the opportunity to comment on SEC Release Nos. 33-10734; 34-87784 (January 15, 2020) (the "Proposing Release"), in which the Securities and Exchange Commission ("SEC" or the "Commission") proposed to amend the definition of "accredited investor" under Rule 501 of Regulation D adopted by the SEC pursuant to the Securities Act of 1933, as amended (the "Securities Act").[1] Mercer Advisors' comments focus solely on the updates to the accredited investor definition; we are not commenting on the updates to the qualified institutional buyer definition at this time.

Mercer Advisors welcomes the efforts taken by the SEC to enhance the regulations for investments in private, unregistered funds in an effort to further the SEC's three-part mission: to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.

I. Introduction

Established in 1985, Mercer Global Advisors Inc. ("Mercer Advisors") is a total wealth management firm that provides comprehensive, fee-based investment management, financial planning, family office services, retirement benefits and distribution planning, estate and tax planning, asset protection expertise, and corporate trustee and trust administration services. Mercer Advisors is one of the largest independent SEC-Registered Investment Advisers and financial planning firms in the U.S. with nearly $18.5 billion in client assets.[2] Headquartered in Denver, Mercer Advisors is privately held, has over 400 employees, and operates nationally through 47 offices across the country.

Mercer Advisors serves as a trusted steward and fiduciary of our clients' wealth, with a focus on being innovative and responsive to developments and trends in the markets and using

[1] References below to page numbers of the Proposing Release are to the page numbers of the Federal Register version of the Proposing Release: FR Document: 2019-28304, Citation: 85 FR 2574.

[2] Company data as of March 1, 2020. "Client Assets Managed" includes assets gained from recent acquisitions where the advisory agreements have been properly assigned to Mercer Global Advisors Inc., but the custodial accounts have yet to be transferred and/or the accounts have yet to be migrated to our portfolio management system.

technology, data analytics, and human capital to improve our performance and manage our internal resources and risks.

As one of the largest independent SEC-registered Investment Advisers ("Advisers"), Mercer Advisors believes we have a responsibility to add our voice to the regulatory discourse, both for our firm and our clients. We are happy to provide our response to the proposals below.

II. Background

Mercer Advisors wants to stress the importance of the proposed rule. Absent an available exemption, the Securities Act requires that offers and sales of securities be registered with the SEC. Securities Act Section 4(a)(2), an exemption from the registration requirements of Section 5 of the Securities Act, provides that the Securities Act does not apply to transactions by an issuer that do not involve a public offering.[3]

Registration is intended to provide investors with full and fair disclosure of material information so that they can make their own investment decisions.[4] Under the Securities Act, the exemptions were created for certain situations where there is no practical need for registration or the public benefits from registration are too remote.[5]

III. Policy Implications

The proposed "accredited investor" definition change presents several policy considerations. These considerations include whether the proposal does enough to address investor protection, whether the proposal strikes the proper balance for sophisticated, but less affluent investors, and whether the removal of the current bright-line standards will lead to implementation issues.

a. Investor Protection

The "accredited investor" definition is "intended to encompass those persons whose financial sophistication and ability to sustain the risk of loss of investment or ability to fend for themselves render the protections of the Securities Act's registration process unnecessary."[6]

It is important to note that this definition is conjunctive – it requires financial sophistication **and** the ability to sustain risk of loss of the investment. A basic canon of statutory construction is that words should be interpreted as taking their ordinary and plain meaning.[7] However, although words should generally be given their plain and ordinary meaning, that meaning must be in accord

[3] 15 U.S.C. § 77d(a)(2).
[4] Commissioner Francis M. Wheat, *Disclosure to Investors - A Reappraisal of Federal Administrative Policies under the '33 and '34 Acts* (Mar. 1969).
[5] H.R. Rep. No. 73-85 (1933).
[6] Regulation D Revisions; Exemption for Certain Employee Benefit Plans, Release No. 33-6683 (Jan. 16, 1987) [52 FR 3015] (the "Regulation D Revisions Proposing Release").
[7] Perrin v. U.S., 444 U.S. 37, 42 (1980).

with the intent of the legislature.[8] Courts must always construe a federal statute so as to give effect to the intent of Congress.[9] The Supreme Court has been clear on this point by stating that when courts construe a statute, the objective "is to ascertain the congressional intent and give effect to the legislative will"[10] and "[s]tatutory construction … is a holistic endeavor."[11] While Mercer Advisors believes that there may be situations where Congressional language needs to be flexibly interpreted to ascertain the clear intention of the legislature,[12] Congressional intent is clear in this case.

This canon of interpretation is supported by other sections of the Securities Act. Section 28 of the Securities Act, which was added by the National Securities Markets Improvement Act of 1996 ("NSMIA"),[13] authorizes the SEC to "conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of [the Securities Act] or of any rule or regulation issued under [the Securities Act], to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors."[14]

It is also supported by Supreme Court precedent. In *S.E.C. v. Ralston Purina Co.*, the Supreme Court established the basic criteria for determining the availability of Section 4(a)(2).[15] The Court held that the availability of Section 4(a)(2) should turn on whether the particular class of persons affected need the protection afforded by the Securities Act. The Court found that an offering to those who are shown to be able to fend for themselves is a transaction not involving any public offering.[16]

Consistent with this view, Regulation D,[17] the most widely used transactional exemptions for securities offerings by issuers, originated as an effort to facilitate capital formation, consistent with the protection of investors, by simplifying and clarifying existing rules and regulations, eliminating unnecessary restrictions those rules and regulations placed on issuers, particularly small businesses, and achieving uniformity between federal and state exemptions.[18]

---

[8] U.S. v. Cook, 384 U.S. 257, 262-63 (1966).
[9] Train v. Colo. Pub. Interest Research Group, Inc., 426 U.S. 1, 9-10 (1976).
[10] Philbrook v. Glodgett, 421 U.S. 707, 713 (1975).
[11] United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., 484 U.S. 365, 371 (1988).
[12] In *US v. Fisk*, 70 U.S. (3 Wall.) 445, 447 (1865), the Supreme Court stated that "[i]n the construction of statutes, it is the duty of the court to ascertain the clear intention of the legislature. In order to do this, courts are often compelled to construe 'or' as meaning 'and' and again 'and' as meaning 'or.'" The Supreme Court further stated that "[a]s is often the case in statutes, though the intention is clear, the words used to express it may be ill chosen."
[13] Pub. L. No. 104-290, 110 Stat. 3416 (Oct. 11, 1996).
[14] 15 U.S.C. § 77z-3.
[15] 346 U.S. 119 (1953).
[16] *Id.*
[17] Regulation D – Rules Governing the Limited Offer and Sale of Securities Without Registration Under the Securities Act of 1933, 17 CFR 230.500 through 230.508.
[18] Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales, Release No. 33-6389 (Mar. 8, 1982) [47 FR 11251] (the "Regulation D Adopting Release").

Mercer Advisors' view is further informed by recent SEC staff guidance. In its recently released "Frequently Asked Questions on Regulation Best Interest," the staff of the Division of Trading and Markets state that Regulation Best Interest applies to broker-dealers that make recommendations of private placements to accredited investors.[19]

Broadening of the definition could subject more retail investors to private placements' risk exposures, which investors may not be able to tolerate. The existing accredited investor criteria do not adequately protect wealthy but unsophisticated investors (including many senior citizens who rely on existing net worth as their sole source of financial security) from the higher risks that often accompany private securities offerings.

Mercer Advisors believes that the current proposal does not adequately ensure investor protection and any final rule must require accredited investors to be financially sophisticated and able to sustain the risk of loss of the investment made.

b. Caveat Emptor

Congress has stated, and the courts have affirmed, that a fundamental purpose of the securities laws is to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry.[20]

Under the federal securities laws, a company may not offer or sell securities unless the offering has been registered with the SEC; however, the company may offer such a security if an exemption from registration is available. Private placements are not subject to some of the laws and regulations that are designed to protect investors, such as the comprehensive disclosure requirements that apply to registered offerings.[21]

The Private Placement Memorandum (PPM) can illustrate this issue. The PPM is a complex legal disclosure document which relies on the Securities Act to permit securities offerings to specific parties which are exempt from registration with the SEC. Notices included in the PPM should (or may be required to) include a statement that the fund is not registered and which exemption is being utilized. The PPM will also include statements that there is no public market for the securities; there is a high degree of risk for the investment; the issuer is not providing legal, business, or tax advice; and the right of the issuer to modify or withdraw the offering.

---

[19] SEC, "Frequently Asked Questions on Regulation Best Interest," https://www.sec.gov/tm/faq-regulation-best-interest (last accessed Feb. 19, 2020).

[20] SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963) (citing H. R. Rep. No. 85, 73d Cong., 1st Sess. 2).

[21] The disclosure requirements that apply to registered offerings, mirror the disclosure requirements of Regulation A, or Part I of the SEC's Form S-1 used for filing a prospectus as part of a registration statement for a publicly traded company. These requirements are extensive. They include descriptions of the company's current business operations, past business performance, the use of proceeds, total number of units or shares being sold and price per share, information about the officers and managers, executive compensation, audited financial statements, risks, and tax and legal status of the business.

While issuers often provide a PPM, it is not legally required by the SEC[22] and even if a PPM is present, it is not submitted to the SEC, typically not reviewed by any regulator, and may not present the investment and related risks in a balanced light.[23]

It is important to note that all securities transactions, even exempt transactions, are subject to the antifraud provisions of the federal securities laws, meaning that even companies offering private placements will be responsible for false or misleading statements that they make regarding the company, the securities offered, or the offering. However, as the SEC states on its own website, investors should be aware that it may be difficult or impossible to recover the money they invest in an offering that turns out to be fraudulent.

c. Increased Risk of Fraud

The lack of transparency in the private placement market has allowed it to become a fertile breeding ground for fraud. For the past decade, private placements have generated large numbers of investor and regulatory complaints. As FINRA Chairman Rick Ketchum announced on April 20, 2010, "An increase in investor complaints regarding private placements, as well as SEC actions halting sales of certain private placement offerings, led FINRA to launch a nationwide initiative that involves active examinations and investigations of broker-dealers engaged in retail sales of private placement interests. That initiative has uncovered misconduct, including fraud and sales product abuses."[24]

In June 2018, the Wall Street Journal (WSJ) reviewed records of firms who were selling private placements. WSJ found securities firms with an unusually high number of troubled brokers are selling tens of billions of dollars a year of private stakes in companies, often targeting seniors – specifically the WSJ identified over a hundred firms where 10% to 60% of the in-house brokers had three or more investor complaints, regulatory actions, criminal charges or other red flags on their records.[25]

More recently, in February 2020, the SEC filed a complaint against Criterion Wealth Management Insurance Services, Inc.[26] According to the complaint filed by the SEC, Criterion orchestrated a scheme whereby they funneled their clients' money into four private placement funds without

[22] A PPM may be required by a particular state's Blue-Sky law. Pursuant to Section 18(a)(1) of the Securities Act (15 U.S.C. § 77r), Rule 506 preempts state registration requirements, whereas Rule 504 does not.

[23] A PPM is not required for every capital raise. While Rule 506 of Reg D and the antifraud provisions of the federal securities laws mandate that issuers disclose truthful and accurate information to investors, there is no requirement to provide any specific information or disclosures to accredited investors.

[24] FINRA Sets Regulatory Guidance for Investigating Private Placements, *available at* https://www.finra.org/media-center/news-releases/2010/finra-sets-regulatory-guidance-investigating-private-placements.

[25] Jean Eaglesham and Coulter Jones, Firms With Troubled Brokers Are Often Behind Sales of Private Stakes, Jun. 24, 2018, WSJ, *available at* https://www.wsj.com/articles/firms-with-troubled-brokers-are-often-behind-sales-of-private-stakes-1529838000.

[26] Complaint, SEC v. Criterion Wealth Management Insurance Services, Case 2:20-cv-01402 (C.D. Cal. Feb, 12, 2020).

disclosing that the fund managers, with whom they were personal friends, paid them compensation in excess of $1 million for doing so.

In February 2020, the SEC also announced an emergency enforcement action and a temporary restraining order and asset freeze against Florida-based private real estate firm EquiAlt LLC, its CEO Brian Davison, and its Managing Director Barry Rybicki, in connection with an allegedly fraudulent unregistered securities offering that raised more than $170 million from at least 1,100 investors, a number of whom invested their retirement funds.[27]

d. Access to Investment Opportunities

Mercer Advisors believes that investor protection in any final rule is paramount; however, the current definition may unduly restrict opportunities for sophisticated, but less affluent, investors to invest in private placements.

Asset allocation has historically focused on traditional asset classes—equities, fixed income and cash instruments; however, a well-diversified portfolio should contain investments in a wide variety of asset classes, potentially including private placements that are less correlated with equity and fixed income. Private placements have different roles to play in a portfolio, from enhancing return to diversifying risk to increasing income.

In the case of private equity, one motivation for investing is potential return enhancement. Over the long term (10 years or more), research reflects that private equity can outperform traditional public equity markets.[28] The research may not tell the full story – private equity investment performance is dependent upon several factors, including the business cycle, the receptivity of public debt and equity markets, and capital flows into the private equity market. In addition, illiquidity and contractual obligations of commitments limit the ability to tactically enter and exit the market. A systematic and consistent approach to private equity is vital, regardless of an investor's wealth.

e. Inflation Adjustment

Other than expanding the income test to include a joint income component and excluding the value of one's primary residence from the net worth calculation, the SEC has not revised the income and net worth tests since 1982.[29]

---

[27] Press Release, SEC Charges Real Estate Company and Executives With Defrauding Retail Investors, Obtains Emergency Relief, Feb. 18, 2020, *available at* https://www.sec.gov/news/press-release/2020-35.

[28] Paul Gompers, Steven N. Kaplan and Vladimir Mukharlyamov, "What do private equity firms say they do?" Journal of Financial Economics, 2016, Vol. 121, Issue 3, 449-476 (citing Harris, R., Jenkinson, T., Kaplan, S., 2014. "Private equity performance: what do we know?" Journal of Finance 69, 1851–1882; Higson, C., Stucke, R., 2012. "The performance of private equity." Unpublished working paper. London Business School; and Robinson, D., Sensoy, B., 2013. "Do private equity fund managers earn their fees? Compensation, ownership, and cash flow performance." Review of Financial Studies 26, 2760–2797).

[29] Net Worth Standard for Accredited Investors, Release No. 33-9287 (Dec. 21, 2011) [76 FR .81793 (Dec. 29, 2011)] ("Regulation D 2011 Adopting Release").

According to the Consumer Price Index (CPI) Inflation Calculator, which extracts data from the Bureau of Labor Statistics, the purchasing power of $200,000 in 1982 is equal to $547,128 in 2020.[30] As discussed later in the letter, while the impact of inflation is cause for concern, in addition to indexing the monetary thresholds to inflation on a going forward basis, Mercer Advisors is requesting that the SEC consider an alternative method of defining the monetary threshold for net worth.

f. Implementation Concerns

If the SEC removes the bright-line standards currently in place (net worth, income, specified entities), it may become more difficult to monitor compliance with the definition. Any new non-quantitative criterion to capture financial sophistication could blur the boundaries of the accredited investor definition, potentially leading to operational delay or ambiguity.

IV. Request for Comments

Comment #1 (SEC Requests #1, 3, 8, and 9)

Mercer Advisors supports the addition of professional designations and certifications (referred to collectively as credentials) and licenses to gain accredited investor status, paired with proper investment limitations.

Mercer Advisors generally agrees with the SEC's proposed criteria: the credential arises out of an examination or series of examinations administered by a self-regulatory organization or other industry body or is issued by an accredited educational institution; the examination or series of examinations is designed to reliably and validly demonstrate an individual's comprehension and sophistication in the areas of securities and investing; and an indication that an individual holds the certification or designation is made publicly available by the relevant self-regulatory organization or other industry body.

Mercer Advisors believes additional criteria should be added for credentials to qualify for accredited investor status. It is important to note that these criteria only relate to credentials provided by private organizations, not licenses provided by governmental authorities, including self-regulatory organizations such as FINRA.

For background and context, as of March 2020, there are more than 150 different credentials for financial professionals listed on the FINRA website,[31] which tracks designations and certifications. Yet, there is no regulation nor uniformity among the credentials and the related standards: each boasts different requirements for obtaining the credential, the investor complaint process, the

[30] CPI Inflation Calculator, https://data.bls.gov/cgi-bin/cpicalc.pl?cost1=200000&year1=198201&year2=202001.
[31] FINRA, https://www.finra.org/investors/professional-designations (last visited Feb. 20, 2020).

public disciplinary process, and accreditation.[32] FINRA is clear on this point, stating that it does not approve or endorse any credential.

First, the credential should require a continuing education (CE) component. This will ensure that the individual has a current working knowledge acceptable to meet the sophistication requirement – for example, there may be a certification obtained in the early 1990's but has not required the individual to engage in any ongoing education, which would limit the effectiveness of the credential as a tool for measuring sophistication.

Second, the credential should require a minimum level of education, namely a bachelor's degree or equivalent. Third, the credential should have an investor complaint process. Fourth, the credential should have a published list of disciplined professionals, or, in the alternative, a way for investors to verify an individual's disciplinary history online. By providing this level of transparency, a credential promotes its ethical standards and level of conduct.

Mercer Advisors also agrees with the requirement that the credential be active and in good standing. As noted by the SEC and similar to Mercer Advisors' proposal to require CE, this will allow issuers to meet their obligations under Rule 506(c)[33] and better ensure that individuals relying on the credential and/or license to meet the accredited investor definition have the requisite financial sophistication.

Mercer Advisors suggests one approach would be to mirror the exemption for state registration as an investment adviser representative. State securities regulators view five specific credentials as meeting or exceeding the registration requirements for investment adviser representatives and allow these credentials to satisfy necessary competency requirements for prospective investment adviser representatives. The five credentials recognized as such are Certified Financial Planner®, Chartered Financial Consultant®, Personal Financial Specialist, Chartered Financial Analyst, and Chartered Investment Counselor.[34]

---

[32] A January 2011 U.S. Government Accountability Office (GAO) report found that "[t]he criteria used by organizations that grant professional designations for financial professionals vary greatly . . . [P]rivately conferred designations range from those with rigorous competency, practice, and ethical standards and enforcement to those that can be obtained with minimal effort and no ongoing evaluation."

[33] 17 C.F.R. § 230.506(c).

[34] It is important to note that the Series 65 exam is a test of both an individual's knowledge of investing principles and the state law governing investment advisers (particularly the ethics provisions of the Uniform Securities Act as modified by NASAA policies and rules). When NASAA reviewed what individuals had to know in order to get different professional designations, it found that the AICPA's Personal Financial Specialist (PFS) designation satisfied the criteria, but not the CPA certification alone.

Comment #2 (SEC Request #10)

Mercer Advisors supports a limit on investments in private placements for accredited investors who do not meet the net worth or income thresholds. We request that the SEC limit an investor's aggregate exposure to private placements to no more than 20% of their documented liquid net worth, with a limit of 5% to any single private placement. Mercer Advisors requests that the net worth limitation should be defined as liquid net worth.

Mercer Advisors believes, as noted above, the intent of the legislature in creating the accredited investor definition was to only allow those individuals who are financially sophisticated and able to sustain the risk of loss of the investment. Individuals who do not meet the current monetary thresholds, while possibly financially sophisticated, could not sustain larger losses from these types of investments.

As a hypothetical, imagine we have an individual who has $3 million dollars net worth and an individual who has $300,000. Each of the individuals invests $50,000 into a private placement. If the private placement suffers a total loss, the $3 million dollar investor would only have suffered a 2% loss while the $300,000 dollar investor would have suffered a 17% loss. If we were to increase the investment to $100,000, it would create an even larger discrepancy, 3% versus 33%, and if increased to $200,000, would be 7% versus 67%.

As noted previously in the letter, Mercer Advisors believes that a well-diversified portfolio should contain investments in a wide variety of asset classes, potentially including private placements that are less correlated with equity and fixed income. However, this would reflect that any asset class, private or otherwise, would not be over weighted in a portfolio.

Mercer Advisors respectfully requests the SEC impose a limit on private placements for investors who do not meet the monetary thresholds. We request that the SEC limit an investor's aggregate exposure to private placements to no more than 20% of their documented liquid net worth, with a limit of 5% to any single private placement. Mercer Advisors proposes that the SEC require, as part of a private placement's subscription documents or other separate accredited investor document, a confirmation that the investment does not exceed the proposed thresholds. While this will not absolutely preclude investments that are greater than the proposed limit, it will increase investor protection.

Mercer Advisors believes that the limitation should be based upon liquid net worth. Mercer Advisors defines liquid net worth[35] as that portion of net worth (total assets minus total liabilities) that is comprised of real estate held for investment purposes, commodity interests held for investment purposes, cash, cash equivalents, and readily marketable securities.[36]

---

[35] Mercer Advisors looks to the definition of "Investments" and "investment purposes" in the Investment Company Act of 1940 under 17 C.F.R. § 270.2a51-1(b) and (c).

[36] Mercer Advisors relies on the definition of "security" in the Securities Act under 15 U.S.C. § 77b(a)(1). This would explicitly exclude "restricted securities" as defined in the Securities Act under 17 C.F.R. § 230.144(a)(3).

While the value of the primary residence has been excluded from the net worth calculation, other non-financial assets have not. As a result, the current definition of net worth does not guarantee that the individual accredited investor will in fact have sufficient liquid financial assets to ensure either that they can hold the securities indefinitely or that they can withstand a significant loss on those investments.

Mercer Advisors' position is supported by current SEC regulations. This includes both Regulation A+[37] and securities-based crowdfunding.[38]

As amended, Regulation A+ provides an exemption for U.S. and Canadian companies to raise up to $50 million in a 12-month period. The new rules modernize the existing Regulation A framework by, among other things, requiring disclosure documents be filed on EDGAR, allowing the confidential review of offering documents, and permitting certain "testing the waters" communications.[39]

Regulation A+ provides two tiers of offerings: Tier 1, which consists of securities offerings of up to $20 million in any 12-month period, and Tier 2, which consists of securities offerings of up to $50 million in any 12-month period. Under both tiers, the issuer must file an offering statement on Form 1-A with the SEC.[40]

Tier 2 offerings impose an investment limit for non-accredited investors. A non-accredited investor may invest no more than: (1) 10 percent of the greater of annual income or net worth (for natural persons); or (2) 10 percent of the greater of annual revenue or net assets at fiscal year-end (for non-natural persons). The investment limit does not apply if the securities are to be listed on a national securities exchange at the consummation of the offering.[41]

Under rules adopted by the SEC in 2015, the general public can participate in the early capital raising activities of start-up and early-stage companies and businesses by way of crowdfunding. Companies can use securities-based crowdfunding to offer and sell securities to the investing public. Because of the risks involved with this type of investing, however, investors are limited in

---

[37] Before the JOBS Act was enacted, Section 3(b) of the Securities Act gave the SEC rulemaking authority to exempt securities offerings of up to $5 million from Securities Act registration if the SEC found that registration was unnecessary for the public interest and protection of investors. The former Regulation A (Rules 251 through 263 under the Securities Act) was a set of rules the SEC adopted under its Section 3(b) authority. Former Regulation A provided an exemption from Securities Act registration for offerings of up to $5 million in any 12-month period, including no more than $1.5 million in resales by selling security holders.

[38] 17 C.F.R. § 227.100.

[39] The JOBS Act was enacted in 2012 to expand and ease methods of capital raising by, and relax the regulatory burden on, smaller companies. Title IV of the JOBS Act, Small Company Capital Formation, directed the SEC to amend Regulation A under the Securities Act of 1933 or adopt a new, similar regulation that exempts from Securities Act registration certain offerings of up to $50 million. The SEC adopted final rules and forms implementing this directive by amending Regulation A (SEC Release No. 33-9741 (adopting release)). These final rules and forms became effective on June 19, 2015.

[40] 17 C.F.R. § 230.251(a).

[41] 17 C.F.R. § 230.251(d)(2)(i)(c).

how much they can invest during any 12-month period in these transactions. The limitation on how much an investor can invest depends on their net worth and annual income.[42]

If the investor's annual income or net worth is less than $107,000, then during any 12-month period, the investor can only invest up to the greater of either $2,200 or 5% of the lesser of the investor's annual income or net worth. If the investor's annual income and net worth are equal to or more than $107,000, then during any 12-month period, the investor can invest up to 10% of annual income or net worth, whichever is lesser, but not to exceed $107,000.[43] It is important to note that when determining the investment limit for a natural person, the SEC looks to the accredited investor definition.[44]

Current rules and regulations illustrate the SEC's belief that individuals who currently do not meet the monetary thresholds cannot sustain the risk of loss of private placements and are limited in the amounts they may invest. Mercer Advisors respectfully requests the SEC impose a limit on private placements for investors who do not meet the monetary thresholds. We believe that this limitation can strike a balance by better protecting investors without unnecessarily shrinking the pool of accredited investors.

Comment #3 (SEC Request #13)

Mercer Advisors supports the creation of an "Accredited Investor" examination as an alternative method to determining investor sophistication; however, we do not support self-certification.

The examination could provide a more accurate picture of investor sophistication. One of the key reasons for investor sophistication is to assess the ability of individuals to be able to distinguish information that is useful from that which is not. In *Doran v. Petroleum Management Corp.*,[45] a sophisticated investor purchased securities in an oil-drilling venture. Drawing on the reasoning in *Ralston Purina*, the court held that if the offeree simply had access to the information, as would be required in a registration statement, the relationship between the offeree and the issuer gains special importance. Specifically, the offeree must have sufficient competence "to ask the right questions and seek out the relevant information."[46] Thus, sophistication isn't merely necessary to access information; it is needed to access "relevant information."[47]

The examination could include several topics on private placements:

- What does it mean for an offering to be unregistered?
- What are the different types of unregistered offerings?
- What does it mean for the securities to be restricted?
- What does it mean to be a limited partner?

[42] 17 C.F.R. § 227.100.
[43] 17 C.F.R. § 227.100(a)(2).
[44] 17 C.F.R. § 230.501(a).
[45] Doran v. Petroleum Mgmt. Corp., 545 F.2d 893, 903 (5th Cir. 1977).
[46] *Id.* at 905.
[47] *Id.*

- What rights will I generally have as a limited partner?
- What legal recourse do I have against the issuer of the private placement?

Mercer Advisors believes investors should not be allowed to self-certify. For example, in the United Kingdom, investors can provide documentation that they are "self-certified sophisticated investors."[48] We do not believe that this certification is sufficient to meet the investor protection goals of the rule.

Federal securities laws require companies raising money through private placements, where they generally solicit, to verify that their investors are "accredited investors."[49] Companies must take "reasonable steps" to verify the investors are "accredited investors" with potentially serious consequences for failing to do so.

Mercer Advisors believes that a similar verification could exist for the examination. Under the current regulations, third-party verification can be conducted by an Adviser, broker-dealer, licensed attorney, or CPA.[50] Mercer Advisors suggests one proposal could be that the verification would require an attestation from a third-party verifying the results of the examination. As discussed below, Mercer Advisors does not believe that clients of registered entities should be deemed accredited investors unless they meet the accredited investor definition criteria through other means, but if the client passes the examination and it is verified by the registered entity, this will provide issuers with additional assurances that the investor meets the required criteria.

The SEC should also research whether an independent third-party, whether regulatory or private, would be appropriate to serve as a clearinghouse for accredited investors so the issuer can go to a single source to determine who has passed the examination.

It is important to note that, as discussed above, Mercer Advisors requests the SEC impose a limit on private placements for investors who do not meet the monetary thresholds, regardless of which method is utilized to satisfy the accredited investor definition.

Comment #4 (SEC Request #19)

Mercer Advisors supports adding a note to Rule 501 to clarify that the calculation of ''joint net worth'' for purposes of Rule 501(a)(5) can be the aggregate net worth of an investor and his or her spouse (or spousal equivalent if ''spousal equivalent'' is included in Rule 501(a)(5), as proposed), and that the securities being purchased by an investor relying on the joint net worth test of Rule 501(a)(5) need not be purchased jointly.

The SEC notes that this is consistent with an existing SEC staff interpretation[51] and Mercer Advisors supports its codification in the final rule.

---

[48] COBS § 4.12.8R.
[49] 17 C.F.R. § 230.506(c).
[50] *Id.*
[51] *See* question number 255.11 of Securities Act Rules Compliance and Disclosure Interpretations, *available at* https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm.

Comment #5 (SEC Request #20)

Mercer Advisors supports including SEC and state-registered investment advisers in Rule 501(a)(1) as entities that qualify as accredited investors.

Currently, banks, insurance companies, certain employee benefit plans, investment companies, small business investment companies (''SBICs''), savings and loan associations, credit unions, and registered broker-dealers all qualify as accredited investors under the Securities Act.

Mercer Advisors agrees with the SEC that Advisers have the requisite financial sophistication needed to conduct meaningful investment analysis and sees no valid reason why Advisers should not qualify as accredited investors.

Comment #6 (SEC Request #40)

Mercer Advisors supports allowing natural persons to include joint income from spousal equivalents when calculating joint income under Rule 501(a)(6), and to include spousal equivalents when determining net worth under Rule 501(a)(5).

Currently, references to ''spouse'' in Rule 501 include individuals married to persons of the same sex. Mercer Advisors believes the current definition conflicts with legal precedent subsequent to the addition of the joint income test to the accredited investor definition in 1988.

The proposal would define spousal equivalent as a cohabitant occupying a relationship generally equivalent to that of a spouse. The SEC has previously used this definition of spousal equivalent.[52]

Mercer Advisors agrees with the SEC that the current rule erects unnecessary barriers to investment opportunities for spousal equivalents and there is no reason to distinguish between different types of relationship structures for the purpose of the rule.

Comment #7 (SEC Requests #50, 51, 52)

Mercer Advisors respectfully requests that the SEC consider utilizing a liquid net worth test to replace the current net worth test. We also support the SEC staff recommendation to index any financial thresholds included in the definition to inflation on a going forward basis.

Mercer Advisors believes that the net worth threshold should be based upon documented[53] liquid net worth. While the value of the primary residence has been excluded from the net worth calculation, other non-financial assets have not. As a result, the current definition of net worth does not guarantee that the individual accredited investor will in fact have sufficient liquid

[52] 17 C.F.R. § 227.501(c); JOBS Act Section 302(e)(1)(D); SEC Rule 202(a)(11)(G)1(d)(9).

[53] This could be in the form of a comprehensive financial plan, statement of financial position, or other document reflecting a person's liquid net worth. The document would need to be supported by evidence which could include bank statements, tax statements, brokerage statements, etc.

financial assets to ensure either that they can hold the securities indefinitely or that they can withstand a significant loss on those investments.

Mercer Advisors' position is supported by previous SEC rulemakings related to private placements. In 2007, the SEC proposed an "investments owned" test as an alternative basis for determining accredited investor status in its release, *Revisions of Limited Offering Exemptions in Regulation D*.[54] In this rulemaking, the SEC proposed an alternative test under Rule 501(a) based upon the investments owned by an investor.

Mercer Advisors agrees with the SEC that "an investments-owned standard may reduce and simplify compliance burdens for companies by providing an alternative standard that may be assessed more easily than the current assets or net worth or annual income standards."[55]

Mercer Advisors supports the SEC staff recommendation to index any financial thresholds included in the definition to inflation on a going forward basis. The staff has provided a prudent approach, timing the adjustment to coincide with the requirement to study the definition every four years and rounding the thresholds to the nearest $10,000.

Mercer Advisors believes that more moderate, regular adjustments will allow the SEC to avoid the material discrepancy associated with an abrupt adjustment to compensate for many years of inflation.

Comment #8 (SEC Request #59)

Mercer Advisors supports the use of the Personal Consumption Expenditures: Chain-type Price Index (PCE) as the inflation adjustment index.

Mercer Advisors supports the use of the PCE. First, as the SEC notes, it would be consistent with current SEC rules and regulations that utilize the PCE.[56]

Second, the Federal Reserve's Federal Open Market Committee (FOMC) also utilizes the PCE as an accurate measure of inflation. Prior to 2000, the FOMC utilized the CPI, but after further analysis, changed to PCE inflation. The FOMC found that the expenditure weights in the PCE can change as people substitute away from some goods and services toward others, the PCE includes more comprehensive coverage of goods and services, and historical PCE data can be revised (more than for seasonal factors only).[57]

[54] Release No. 33-8828; IC-27922; File No. S7-18-07; 72 FR 45116 (Aug. 10, 2007).
[55] 72 FR at 45123.
[56] 17 § C.F.R. 275.205-3(e).
[57] Board of Governors of the Federal Reserve System, *Monetary Policy Report to the Congress Pursuant to the Full Employment and Balanced Growth Act of 1978*, Feb. 17, 2000, *available at* https://www.federalreserve.gov/boarddocs/hh/2000/February/FullReport.pdf.

Comment #9 (SEC Requests #60, 61)

Mercer Advisors does not support the proposal to allow investors advised by an Investment Adviser or Broker-Dealer to be deemed accredited, unless the investor also meets one of the other proposed methods for attaining accredited investor status. While we do not support the proposal in its current form, if the proposal is included in the final rule, Mercer Advisors requests restrictions be placed on registered entities who can qualify.

Mercer Advisors believes that the proposal to allow all clients of Advisers and broker-dealers to be deemed accredited investors, in its current form, is too broad and could undermine investor protection.

As of March 2020, there are over 13,000 SEC-registered investment advisers, over 17,000 state-registered investment advisers, and over 3,000 FINRA-registered broker-dealer firms. While investment advisers are subject to a fiduciary duty and broker-dealers will be subject to a new "best interest" standard under SEC's Regulation Best Interest, there is too much differentiation in sophistication in the industry for any assurance that an investor will be sufficiently informed of the risks of investing in a private placement, just by virtue of working with a registered professional.

For example, an investor who works with a solo or smaller Adviser, who has no legal experience and/or little experience advising on private placements, would be just as qualified as an investor who works with a large firm, with a legal and compliance department who conducts comprehensive due diligence on all private placements and has advisors who can walk the investor through the offering documents. To be clear this is not singling out small firms as you could have larger firms with the same lack of legal acumen and experience with private placements.[58]

While the private placements are investments, they are also legally binding agreements between the investor and the issuer. Outside of the investment restrictions, there are also significant legal implications from the purchase of private placements.

While we respectfully object to the proposal in its current form, if the SEC moves forward with the proposal in the final rule, we request several safeguards be put in place to protect investors.

First, unless the investor meets the proposed monetary thresholds, the SEC should limit an investor's aggregate exposure to private placements to no more than 20% of their documented liquid net worth, with a limit of 5% to any single private placement.

[58] The recent Wells Fargo SEC enforcement action is a good example of this. From the SEC Order: "Due to Wells Fargo's inadequate training, compliance policies and procedures, and supervision, in the offer and sale of single-inverse ETFs, certain financial advisors made unsuitable recommendations to buy and hold single-inverse ETFs to certain retail clients with nondiscretionary advisory accounts." SEC Order, In re Wells Fargo Clearing Services, LLC, Release No. IA-5451 (Feb. 27, 2020), *available at* https://www.sec.gov/litigation/admin/2020/34-88295.pdf.

Second, the firm must provide written documentation of the due diligence conducted on the private placements. The firm must attest that the offering documents (Private Placement Memorandum, Limited Partnership Agreement, Subscription Documents, etc.) have been reviewed, either by internal staff or through a third-party, such as a law firm or compliance consultant.

The firm should request the issuer provide Institutional Limited Partners Association ("ILPA")[59] reporting framework[60] and provide the ILPA Due Diligence Questionnaire (ILPA DDQ).[61] The principles are structured around the "three guiding principles" which, in ILPA's view, form the essence of an effective private equity partnership: alignment of interests; partnership governance; and reporting transparency. Broadly, ILPA expects the general partner of the fund to make decisions considering the benefit to the partnership as a whole; to provide timely, clear and not misleading disclosures to investors; and to charge reasonable fees.

Mercer Advisors believes there could be other methods for conducting due diligence on private placements but believes that the ILPA reporting framework and due diligence questionnaire are regarded as a "gold standard" for the industry.

Third, the client must have been with the firm for at least 60 days.[62] This will provide greater assurance that the firm conducts a proper inquiry on the client's financial situation and provides time for the firm to perform an adequate analysis on whether the private placement is being advised to the client in their best interest.

Fourth, the firm must have a comprehensive written financial plan or similar document on file for the client. This will provide greater assurance that the private placement is suitable for the investor and is being offered as part of a holistic financial plan – as discussed previously, private placements can be an important element of a diversified portfolio.

Fifth, the firm cannot have a disqualifying event as defined in Rule 506(d).[63] Under Rule 506(d), as a result of bad actor disqualification, an offering is disqualified from relying on Rule 506(b) and 506(c) of Regulation D if the issuer or any other person covered by Rule 506(d) has a relevant criminal conviction, regulatory or court order or other disqualifying event.

---

[59] ILPA was set up to represent the institutional investors who act as limited partners of private equity funds. These include public and corporate pension funds, insurers, hedge funds and others. Over 500 institutions are members of ILPA, representing over $2 trillion worth of private equity assets under management.

[60] ILPA, ILPA Principles 3.0: Fostering Transparency, Governance and Alignment of Interests for General and Limited Partners, *available at* https://ilpa.org/wp-content/uploads/2019/06/ILPA-Principles-3.0_2019.pdf.

[61] ILPA, Due Diligence Questionnaire, *available at* https://ilpa.org/wp-content/uploads/2018/09/ILPA_Due_Diligence_Questionnaire_v1.2.pdf.

[62] Mercer Advisors looks to previous SEC guidance on the "pre-existing, substantive relationship" criterion for demonstrating an absence of a general solicitation under SEC Rule 502(c). https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm#256.23.

[63] 17 C.F.R. § 230.506(d).

MERCER ADVISORS™

Mercer Advisors requests that the "covered persons" be more restrictive than the definition under Rule 506(d) and only include the registered entity and any director, executive officer, general partner, or managing member of the entity.

Mercer Advisors also requests that the SEC use the look-back periods under Rule 506(d), that waivers can be granted by the SEC for good cause,[64] and that registered entities must certify that they are not subject to the disqualification provisions.[65]

The purpose of disqualification provisions is to punish bad actors by preventing them from relying on certain accommodations provided in the securities laws. Mercer Advisors understands that by imposing disqualification on registered entities, we are affecting the investors who would otherwise rely on the registered entity to obtain accredited investor status. However, we believe this concern is greatly outweighed by investor protection concerns. Additionally, this is only one of several avenues for an investor to obtain accredited investor status under the proposed rules, so will not necessarily prevent an investor from becoming an accredited investor.

V. Conclusion

Mercer Advisors sincerely appreciates the opportunity to comment and your consideration of these views. We stand ready to provide any additional information or assistance that the SEC might find useful. Please do not hesitate to contact William Nelson, Chief Compliance Officer, at 720-500-8186 or wnelson@merceradvisors.com with any questions.

Sincerely,

William Nelson, J.D., LL.M.
Chief Compliance Officer
Mercer Advisors

cc: The Honorable Jay Clayton
The Honorable Allison H. Lee
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman

[64] 17 C.F.R. § 230.506(d)(2).
[65] 17 C.F.R. § 230.506(d)(2)(ii).