

Statement of Michael J. Canning
SEC Investor Advisory Committee
September 21, 2023

I. Introduction and Disclaimer.

Good afternoon. My name is Mike Canning and since October 2021 I have served as the Principal and Founder of LXR Group, LLC, a public policy consulting firm that focuses on capital markets policy and financial services regulatory policy.

Prior to launching LXR Group, I served for a roughly a decade as the Director of Policy and Government Affairs for the North American Securities Administrators Association (NASAA). Prior to NASAA, I spent roughly nine years working as a Congressional staffer, during which time I had an opportunity to work extensively on financial regulatory policy issues.

I'm honored to have the opportunity to speak with you today about the Accredited Investor definition and adjacent policy issues related to the participation by natural persons in the private placement markets.

Before I begin my statement, I want to disclose that in my capacity as a public policy consultant, I have currently or formerly have done work for several of the organizations represented on the IAC.

Specifically, AARP is a consulting client of LXR Group, and NASAA was a client of LXR Group prior to March 2022. In addition, in my personal capacity, I serve as a Senior Congressional Fellow with Americans for Financial Reform.

None of these organizations I have worked with been consulted regarding my testimony today, nor have any other clients of LXR Group. The views I will express today are entirely my own.

II. Regulation D and Accidental Character of Today's Private Markets

As we heard from Prof. Rodrigues, the contours of today's private placement marketplace, and the accredited investor definition itself, were forged by Regulation D ("Reg. D"), which the SEC adopted in 1982.

Reg. D, in turn, reflected an effort by the Commission to reconcile ambiguities in the Securities Act with judicial rulings tracing back to the early 1950s, particularly with regard to the “private offering” exemption.

Reg. D includes two particularly potent SEC registration exemptions – known as Rule 506(b) and Rule 506(c) – you may have heard of them.

- Both 506(b) and Rule 506(c) allow issuers to raise unlimited amounts of capital from an unlimited number of accredited investors.¹
- Neither require issuers to provide any substantive disclosure – not to purchasers, not to the Commission.
- Further securities offered or sold pursuant to either exemption are automatically deemed “covered securities,” and therefore exempt from registration requirement imposed by state “Blue Sky” laws.
- Rule 506(c) – which was mandated by the JOBS Act of 2012 and instituted in 2014 - allows issuers to conduct unlimited general solicitation.

Now, given the extent to which the features of Rule 506 are designed from top to bottom to reflect the priorities of securities *issuers*, rather than *investors*, it is easy to why Rule 506(b) and Rule 506(c) have become the preferred source of capital for many businesses and issuers of all sizes, and why issues sold pursuant to these exemptions account for the bulk of investment capital raised by U.S. issuers.²

The conversation about the accredited investor definition, and about the growth of private markets, and about the decline in the number of publicly listed companies and IPOs, have always been the same conversation. However, with the recent and accelerating boom in private offerings shifting issuer behavior in fundamental and irreversible ways, it has taken on a new urgency.

Adding to this urgency is the fact that a policy discussion is now underway in Congress and the Commission relating to modernization of the accredited investor

¹ <https://www.sec.gov/oiea/investor-alerts-and-bulletins/private-placements-under-regulation-d-investor-bulletin>

² <https://www.sec.gov/files/litigation/litreleases/2019/33-10649.pdf> (P. 63)

definition.³ And any policy decisions that flow from it are poised to have lasting implications for the future of the *public* markets in addition to private offering regime.

Importantly, public markets and private markets are *not* homologous. They are not merely different flavors of the same ice cream, or different breeds of the same species.

Rather, they are entirely different beasts, with diametrically opposed priorities and assumptions and goals.

Given this, while I agree that acknowledging and understanding the profound differences between the public and private markets is necessary, it is not sufficient.

The policy debate over public vs. private markets has one correct answer.

From a standpoint of investor protection specifically, and public policy broadly, *public markets are vastly superior to private markets.*

Frankly, this is not a controversial point: the U.S. largely abandoned private markets nearly a century ago for a plethora of good reasons.⁴

III. The Public Markets are Public Goods

The public markets are and have always been the only securities markets where ordinary “mom and pop” investors can invest with the protection of the federal securities laws and the knowledge that they will more or less be treated fairly.⁵

However, as the SEC’s most important advisory committee, and the advisory committee primarily responsible for ensuring that the Commission “keeps the interests of ordinary investors front-and-center,” the IAC has a special obligation to defend the public securities markets.

³ During the first half of 2023 the House of Representatives approved three bills relating to the accredited investor definition. An additional five bills pertaining to the definition have been heard or considered by the House Financial Services Committee. Additional information about these bills is included in Addendum A of my written statement.

⁴ See H.R. Rep. No. 84, 73d Cong., 1st Sess. (1933) (describing “irresponsible selling of securities,” and providing that “[w]hatever may be the full catalogue of the forces that brought to pass the present depression, not least among these has been this wanton misdirection of the capital resources of the Nation”); H.R. Rep. No. 1383, 73d Cong., 2d Sess. (1934) (“Just as artificial manipulation tends to upset the true function of an open market, so the hiding and secreting of important information obstructs the operation of the markets as indices of real value.”);

⁵ See SEC Commissioner Allison Herren Lee, “Statement on the Investor Advisory Committee Nomination Process,” August 5, 2020. “The Investor Advisory Committee (IAC) plays a crucial role in ensuring that the Commission keeps the interests of investors front and center.” Accessible at <https://www.sec.gov/news/public-statement/lee-statement-investor-advisory-committee-nominating-process>

The IAC must not be timid and shy. The IAC must therefore offer a full-throated defense of the public markets and must put its weight and its voice behind policies that will check the growth of private markets, which over the long term must undermine the interests of ordinary investors, as well as the public markets.

IV. Lessons from the IAC's 2014 Accredited Investor Recommendation.

On October 9, 2014, the IAC made a series of recommendations regarding the accredited investor definition. The IAC's 2014 recommendations were thoughtful, comprehensive, and rendered in good faith. They reflected a desire by the IAC to accommodate a variety of perspectives and to recommend reforms that would benefit both investors and issuers.

Notably, the 2014 recommendations endorsed an expansion of the universe of accredited investors through the creation of new categories of accredited investors based on factors other than income and net worth, such as professional expertise. At the same time, the 2014 recommendations expressed support for thoughtful reforms that would have resulted in the removal of some individuals from the pool of accredited investors, such as through the indexing of the income and net-worth thresholds, and the exclusion of nonfinancial assets and retirement accounts from the calculations used to satisfy the income and net worth thresholds.

I personally don't view the 2014 recommendations as contradictory. Yes, from a purely *quantitative* standpoint, some of the 2014 recommendations would have shifted policies in a direction that would have shrunk the private markets, whereas others might have modestly grown them. But each stood to *qualitatively* improve the pool of accredited investors, better aligning the pool with requirement the accredited investors possess financial sophistication and ability to withstand loss.

However, policymakers and advocates increasingly view the debate over the accredited investor definition (and other policy questions related to private markets) in binary, partisan terms. You're either for private markets, or you're against them, and there is not a lot room for nuance.

That is a shame but it's the reality right now. If you don't believe me just look at the legislation summarized in Addendum I of my written testimony.

The IAC's 2014 strategy of producing a comprehensive and balanced package of recommendations for modernizing the definition seemed reasonable at the time the recommendations were approved by the IAC. Yet whereas the authors of the 2014 recommendation presumably hoped that their ability to forge consensus regarding

comprehensive modernization of the definition would inspire policymakers to a similar consensus, that did not happen, and *the fact that it did not should inform any strategy that the IAC takes should it pursue recommendations in 2023.*

From my perspective, the IAC's key error in 2014 may have been in approaching and developing its recommendations in a manner more akin to a committee with a true policymaking function than a committee with an advisory or advocacy function. Should the IAC tackle the issue of modernizing the accredited investor definition in 2023, I suggest it address only those issues where it can speak clearly, and loudly, and from a perspective that unabashedly pro-investor.

VI. Recommendations.

1. The IAC must use its considerable platform to go-to-bat for the public securities markets. The IAC must not be timid or silent in the face of unprecedented legislative efforts to continue weaken the private offering regime and expand private markets at the expense of the public markets.
2. The IAC should promptly approve a formal recommendation to the Commission that addresses the disequilibrium that has characterized virtually all policy action by Congress and the Commission for the preceding decade and urge specific steps to restore an appropriate balance.
 - 1) Exclude retirement assets and retirement income from the definition for purposes of meeting the income and net worth standards;
 - 2) Index the income and net worth standards to account for inflation on a going-forward basis; and
 - 3) Enact a one-time increase to the income and net-worth standards to account for some or all of the erosive effects of inflation over the past 41 years since the definition was adopted in 1982.
3. The IAC should formally request that the Commission schedule a vote to propose rules to amend the accredited investor definition and the exempt offering regime. Both of these items have been on the SEC's consolidated rulemaking agenda for more than two years but have to date seen no action.

4. The IAC should speak clearly to forestall any mischaracterization or “cherry picking” of its recommendations.

Thank you again for the opportunity to share my perspective on modernization of the accredited investor definition. I will be happy to answer any questions.

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ADDENDUM I

Legislation Considered by the House in 2023 Amending Accredited Investor Definition

Relevant legislation approved by the full House of Representatives in 2023.

1. [H.R. 2797](#), the *Equal Opportunity for All Investors Act*, sponsored by Rep. Mike Flood (NE-01), would increase the number of pathways to qualify as an accredited investor by instituting a test administered by FINRA, allowing sophisticated-but-not-wealthy individuals to access high-growth asset classes that would not otherwise be available to them. H.R. 2797 passed the House by a recorded vote of 383 – 18 on May 31, 2023.
2. [H.R. 835](#), the *Fair Investment Opportunities for Professional Experts Act*, sponsored by Rep. French Hill (R-Ark), would permit brokers and investment advisers registered with the Securities and Exchange Commission, Financial Industry Regulatory Authority or a state securities authority to qualify as an accredited investor. It would also allow “any natural person the Commission determines, by regulation, to have demonstrable education or job experience to qualify such person as having professional knowledge of a subject related to a particular investment. The bill would also require the SEC to adjust the definition’s income and net-worth thresholds every every 5 years to the nearest \$10,000 to account for inflation on a going forward basis. H.R. 835 passed the House by voice vote on June 5, 2023.
3. [H.R. 1579](#), the *Accredited Investor Definition Review Act*, sponsored by Rep. Bill Huizenga (MI-04), updates the list of certifications that an investor must satisfy to qualify as an accredited investor to ensure that more Americans have an opportunity to participate in the growth and success of our economy. H.R. 1579 passed the House by voice vote on June 5, 2023.

Legislation Approved by the House Financial Services Committee in 2023.

1. [Title II](#) of [H.R. 2799](#), the *Expanding Access to Capital Act*, sponsored by HFSC Chair Patrick McHenry (R-NC), would add clients of registered advisers to the definition of accredited investors, provided they do not invest more than 10% of their net worth or gross income into private securities. This bill was approved by the HFSC in April. It has not yet passed the House.
2. [Title IV](#) of [H.R. 2799](#), the *Expanding Access to Capital Act*, sponsored by HFSC Chair Patrick McHenry (R-NC), would expand the definition of accredited investor to encompass “any individual receiving individualized investment advice or individualized investment recommendations with respect to the applicable transaction from an [individual](#) described under section 203.501(a)(10) of title 17, CFR.

Legislation officially noticed in connection with a hearing held by the House Financial Services Committee in 2023.

1. [Discussion draft](#) legislation entitled “*The Accredited Investor Self Certification Act*,” would require the SEC to create a form that would allow individuals qualify as an “accredited investor” by self-certifying that they understand the risks of investment in private issuers. This bill was noticed in connection with a hearing of the HFSC’s Subcommittee on Capital Markets held on February 3, 2023.

2. **Discussion draft** legislation entitled “**To require the Securities and Exchange Commission to revise the definition of accredited investor to exclude Retirement Assets and Retirement Income Assets, and for other purposes,**” was noticed in connection with a hearing of the HFSC’s Subcommittee on Capital Markets on April 19, 2023.

3. **Discussion draft** legislation entitled “**To require the Securities and Exchange Commission to revise the definition of an Accredited Investor to include a natural person that passes an examination established and administered by the Commission, and for other purposes,**” was noticed in connection with a hearing of the HFSC’s Subcommittee on Capital Markets on April 19, 2023.