Written Statement of Michael J. Canning

SEC Investor Advisory Committee

September 21, 2023

I. Introduction

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 roughly a decade as the Director of Policy and Government Affairs for the North American Securities Administrators Association (NASAA). Prior to working at 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 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 have 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. A Dark Decade for Capital Markets Policy (2012-Present)

The past decade has seen policymakers at the Commission and in Congress enact a host of major policy changes to grow the private offering regime and expand its role in our capital markets, including but by no means limited to changes to the accredited investor definition.

A little over a decade ago, Congress passed two packages of bills that informally are called the JOBS Act 1.0 and the JOBS Act 2.0 (together, the "JOBS Acts"). The JOBS Acts included a mix of changes working at cross purposes to grow the public markets while expanding private markets at the same time.[1] In particular, the JOBS Act raised the number of holders of record that a company can have, from 500 to 2,000, before it is required go public; removed a long standing prohibition against the use of general solicitation for private offerings under Regulation D, Rule 506 and 144A; raised offering limits from $5 million to $50 million under Regulation A; preempted state registration of Regulation A+ offerings, if the securities are offered or sold to a

[1] See Jumpstart Our Business Startups Act (the "JOBS Act 1.0"), Pub. L. No. 112-106, 126 Stat. 306 (Jan. 3, 2012). Following the 2012 JOBS Act, Congress passed the Fixing America's Surface Transportation Act (the "FAST Act"), Pub. L. No. 114-94 (Dec. 4, 2015), which was unofficially dubbed "JOBS Act 2.0."

qualified purchaser; created a new exemption for crowdfunding; and relieved emerging growth companies from certain regulatory and disclosure requirements during an initial public offering.

In 2015, the FAST Act created a new Section 4(a)(7) under the Securities Act, which preempted state law to establish a nonexclusive safe harbor for private resales under the so-called "Section 4(a)(1½)" exemption to facilitate secondary trading. Collectively, these changes made it easier for companies to raise money outside the registration framework and further reduced incentives for companies to go public.

Another contributing and notable factor during this period was the issuance of SEC no-action letters that paved the way for expansive offerings under the private offering exemptions beyond what was contemplated under Sec. 4(a)(2) of the Securities Act of 1933.[2] In recent years, the staff have further contributed to the liberalization of the prohibition on general solicitation through the publication of Compliance and Disclosure Interpretations.[3]

On June 18, 2019, the SEC requested comments on the Concept Release on Harmonizing Exempt Offerings.[4] And on August 26, 2020, the SEC announced amendments to the definition of an "Accredited Investor", to take effect 60 days after the Final Rule's publication in the Federal Register. These amendments revise Rule 501(a), Rule 215, and Rule 144A of the Securities Act. Rule 215 has been revised to replace the existing definition, replaced by a cross reference to Rule 501(a). Rule 144A has been revised to expand the definition of "qualified institutional buyer," to include limited liability companies ("LLCs") and rural business investment companies ("RBICs"), among other institutional investors, so long as they satisfy the $100 million threshold. Most notably, the amendments revised and expanded Rule 501(a) to include "certain professional certifications, designations or other credentials issued by an accredited educational institution, which the Commission may designate from time to time by order." These include holders in good standing of the Financial Industry Regulatory Authority ("FINRA") Series 7, Series 65, and Series 82 licenses.

The unprecedented growth of the private securities marketplace in recent years coincided with a decline in IPOs during the same period. There has been much discussion of the decline in IPOs by policymakers, including in previous hearings held by the House Financial Services Committee.[5] Nevertheless, the most significant factor, by far, seems to be the ability for many companies to access virtually unlimited amounts of private capital without ever having to register with the SEC, or engage in ongoing reporting under the Exchange Act.

---

[2] See, e.g., SEC No-Action Letter, Bateman Eichler, Hill Richards, Inc., 1985 WL 55679 (Dec. 3, 1985) (the prohibition on general solicitation in an exempt private offering is not violated where a broker-dealer uses generic advertisements to solicit prospective investors if it waits to make a specific offering to the investor until after it has gathered information about the prospective investor's sophistication and financial circumstances); SEC No-Action Letter, IPONET, 1996 WL 431821 (Jul. 26, 1996) (dissemination of offering through internet platform does not violate the prohibition on general solicitation where prospective investors cannot view offerings until after an investor questionnaire is completed).

[3] https://www.sec.gov/divisions/corpfin/guidance/fast-act-interps.htm

[4] *See* SEC Concept Release on Harmonization of Securities Offering. Accessible at https://www.sec.gov/files/rules/concept/2019/33-10649.pdf

[5] See HFSC Subcommittee on Capital Markets, Securities, and Investment hearings entitled, "Legislative Proposals to Help Fuel Capital and Growth on Main Street" (May 23, 2018) and "The JOBS Act at Five: Examining Its Impact and Ensuring the Competitiveness of the U.S. Capital Markets" (Mar. 22, 2017).

Throughout this entire period, neither Congress nor the SEC took any meaningful steps to address investor protection concerns associated with either the accredited investor definition or the exempt offering regime more broadly.

III. The Policy Paradox of Private Securities Markets

The present debate over the role and regulation of private markets – of which the question of modernizing the accredited investor definition is a central feature – has its roots in the enactment of the federal securities laws and advent of the public offering regime in the 1930s. While the policy landscape in 2023 is unique in many respects, as we will discuss, this is far from the first time that policymakers have wrestled with the questions about the appropriate role for opaque and illiquid private offerings within a broader framework that is designed to prioritize efficiency and transparency. Indeed, while today's private markets are larger, more vibrant and more important than they have ever been, they are remnants of an old and deliberately discarded paradigm.

Private securities markets are the antithesis of the public markets. They do not reflect any policy design; they are the "dark default" of an unregulated market where information is scarce and access to it is controlled by issuers. They are illiquid, difficult to value, and require investors to fend for themselves. As such are not suitable for most investors.

Importantly, private offerings once comprised just a small fraction of the overall market for securities, but today, they serve as the primary source of investment capital for many businesses and vastly exceed the capital raised in public markets. This means that today, the majority of capital raised by businesses is done outside the protections provided through the regulatory framework of public offerings. At the same time, because the accredited investor definition is essentially the valve that controls the flow of capital from individual investors into the private securities markets, any discussion of policy reforms that can or should be taken to modernize the accredited investor definition are inexorably tied to the broader policy questions surrounding the appropriate role and size and regulatory treatment of private offerings.

The public securities markets were designed to serve the needs of all investors and above all the needs of retail investors. They are a public good and should be protected as such.

The public securities marketplace is comprised of securities that are registered with the SEC under the Securities Act and subject to ongoing reporting obligations under the Exchange Act. Specifically, the Securities Act requires that every offer and sale of securities be registered with the SEC or qualify for an exemption. The purpose of registration is to provide investors with "full and fair disclosure" of material information so that they are able to make their own informed investment and voting decisions. The Exchange Act works in tandem with the Securities Act and requires ongoing reporting of sufficiently "large" and widely held companies.

America's public markets are characterized by abundant information, competitively determined prices, transparent valuations, and timely reporting of material information about the future prospects of businesses. The 1-2 punch of initial and ongoing disclosure and governance requirements provided by the federal securities laws laid a foundation for the emergence of

public securities markets in the U.S. that were and remain the envy of the world. Time and experience have affirmed that whereas the various features of U.S. public markets convey benefits in their own right, when taken together they are capable of producing benefits vastly exceeding the sum of their parts. The result is the provision of virtually unlimited profitable and liquid investment opportunities suitable for all individuals, households, and institutions.

At best, private securities markets augment the capital formation that takes place within the public markets and the manner in which they are regulated reflects that assumption.

Even as Congress was designing the framework for the public securities markets that would be codified in 1933 and 1934, it recognized the registration and reporting framework being put into place by the Securities Act and the Exchange Act would not be suitable for *every* instance in which a security is offered and purchased. It therefore authorized the SEC to adopt specific exemptions to the law's registration requirement through exercise of rulemaking and included several statutory exemptions in Sections 3 and 4 of the Securities Act. One such statutory registration exemption, which sought to exempt from registration "transactions by an issuer not involving any public offering" did not define key terms in this phrase, and would spark litigation that would put the SEC on the path that would lead it to embrace the "accredited investor" definition in 1982.[6] The accredited investor definition, in turn, played a key role in establishing the contours and character of the new market for unregistered securities that would emerge in the 1980s and 1990s, and that by the 2010s, come to rival and ultimately eclipse the public markets as a source of investment capital for many companies. It continues to play that role today.

The contours of today's private marketplace, and the accredited investor definition, were forged by Regulation D. Regulation D, in turn, reflects an effort by the SEC to reconcile ambiguities in the Securities Act and judicial rulings tracing back to the early 1950s.

The largest and most significant transactional exemption afforded by the federal securities laws is SEC Regulation D ("Reg. D").[7] Reg. D reflects the Commission's effort to provide clarity around the scope and application of the private offering exemption. Reg. D includes two particularly key SEC registration exemptions – known as Rule 506(b) and Rule 506(c) – which allow issuers to raise unlimited amounts of capital from an unlimited number of accredited

---

[6] In 1953, the U.S. Supreme Court issued a ruling in the case of SEC v. Ralston Purina Co., that established basic criteria for determining the availability of Section 4(a)(2). Under the ruling, investors could qualify for this exemption and invest in the offering only if such investor could be shown (1) able to fend for themselves and, accordingly, not requiring the protection afforded by the Securities Act; and (2) have access to the type of information normally provided in a prospectus for a registered securities offering.

[7] Because the precise limits of the statutory private placement exemption remained undefined, however, in the wake of the Supreme Court's ruling in Ralston Purina Co., the question of whether or not a transaction is one not involving any public offering remained "essentially a question of fact and necessitates a consideration of all surrounding circumstances, including such factors as the relationship between the offerees and the issuer, and the nature, scope, size, type, and manner of the offering." Reg. D was an effort to deal with this issue. (See Non-Public Offering Exemption, Release No. 33-4552 (Nov. 6, 1962) [27 FR 11316 (Nov. 16, 1962])
Section 4(a)(2) was traditionally viewed as a way to provide "an exemption from registration for bank loans, private placements of securities with institutions, and the promotion of a business venture by a few closely related persons." In 1962, prompted by increased use of the exemption or speculative offerings to unrelated and uninformed persons, the Commission clarified limitations on the exemption's availability.
https://www.sec.gov/files/litigation/litreleases/2019/33-10649.pdf (P. 61)

investors.[8] Further, issuers conducting offerings on the basis of either exemption are not required to provide any substantive disclosure. Further, securities offered or sold pursuant to both exemptions are "covered securities" and therefore exempt from registration requirement imposed by state "Blue Sky" laws. Rule 506(c) allows issuers to conduct unlimited general solicitation.

Given the extent to which the features of Rule 506 are designed to meet the needs 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.[9]

Any changes to the accredited investor definition stand to impact the public securities markets at least as significantly as the already ballooning private securities markets.

The conversation about the accredited investor definition and the conversation about the decline in the number of publicly listed companies and IPOs have always been the same conversation – but with the 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 at the SEC relating to modernization of the accredited investor definition.[10] That debate is unfolding against the backdrop of explosive growth in the private placement markets. This debate and the policy decision that flow from it are thus poised to have lasting implications for the future of the *public* markets in addition to the private offering regime.

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

Public markets and private markets are not homologous; they are *not* merely different flavors of the same creature. Rather, they are entirely different beasts, with diametrically opposed priorities, assumptions and goals. What's more, while acknowledging and understanding the profound differences between the public and private markets is necessary, it is not sufficient.

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.[11] 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.[12]

---

[8] https://www.sec.gov/oiea/investor-alerts-and-bulletins/private-placements-under-regulation-d-investor-bulletin

[9] https://www.sec.gov/files/litigation/litreleases/2019/33-10649.pdf (P. 63)

[10] 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.

[11] *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.");

[12] 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

However, as the SEC's most important advisory committee, and the advisory committee that is 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. 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 to policies that will check the growth of private markets, which over the long term will undermine the interests of ordinary investors.

IV. Additional Observations Relevant to Today's IAC Discussion

Private Markets and Underserved Communities.

The IAC should be skeptical of arguments that suggest that relaxation of consumer protections or investor protection rules will benefit communities of color or other historically underserved communities. While there is no question that appalling disparities exist between white communities and black and brown communities, there is little evidence to support the view that this situation can be alleviated or addressed by rolling back or watering down rules intended to protect investors. Often, underserved communities benefit significantly and even disproportionately from the protections afforded by regulation.

In all likelihood the single most important thing that the IAC can do to support communities of color or other disadvantaged groups of investors is to stand firm against efforts to expand the private markets at the expense of the public markets. As already discussed, the public securities markets were designed to ensure that less sophisticated or less wealthy investors can access the capital markets freely and fairly, and on roughly the same terms as wealthy investors.

In addressing this point at a House Financial Services subcommittee hearing earlier this year, Duke Law Professor Gina-Gail S. Fletcher echoed this view and explained her thinking.

> Some have boldly suggested that the limitations on private offerings to investors who meet the "accredited investor" or "qualified institutional buyer" definitions is somehow discriminating against those who do not meet those definitions. Some have argued that the SEC should further expand these definitions to provide greater access to these markets by more potential investors. This is perverse logic, at best. There already are markets where all investors participate on a level playing field—the public markets. Expanding the definition of "accredited investor" is not going to result in more investors becoming millionaires. Rather, it is going to cause the very opposite result. If the scope of the accredited investor definition is broadened, this will expand the opportunities for wealth extraction and amplify wealth inequality in the country.[13]

---

investors front and center." Accessible at https://www.sec.gov/news/public-statement/lee-statement-investor-advisory-committee-nominating-process

[13] Testimony of Professor Gina-Gail S. Fletcher Before the House Committee on Financial Services, Subcommittee on Capital Markets. "Sophistication or Discrimination? How the Accredited Investor Definition Unfairly Limits Investment Access for the Non-wealthy and the Need for Reform." February 8, 2023. Accessible at https://democrats-financialservices.house.gov/uploadedfiles/hhrg-118-ba16-wstate-fletcherg-20230208.pdf

Private Markets and Geographic Proximity.

The idea that geographic proximity to an issuer can tangibly reduce the risks associated with investing in private offerings is often correct. In fact, one of the most compelling arguments in favor of federal and state registration exemptions is that they can make it much easier for investors to purchase the issues of local businesses about which they have particular knowledge, and conversely, that they enable issuers to raise capital from those who know them the best.

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

On October 9, 2014, the Investor Advisory Committee (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 recommendation 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. To be sure, from a purely quantitative standpoint, some of the 2014 recommendations would shift policies in a direction that would have modestly shrunk the private markets, whereas others might have modestly increased them. Yet the policies recommended in 2014 were perfectly consistent in that each stood to qualitatively improve the pool of accredited investors, better aligning it with requisite 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 terms. You're either for private markets or you're against them, and there is not a lot of time for details or 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.

The IAC's 2014 strategy of producing an expansive and balanced package of recommendations seemed reasonable at the time the recommendations were approved by the IAC. However, it is evident that the IAC's 2014 approach did not have the desired effect in 2014. In retrospect, it seems that by producing an inclusive package of recommendations that sought to balance the top priorities of issuer advocates and investor advocates, the IAC produced a package of recommendations that failed to excite or satisfy anyone. Whereas the authors of the 2014 recommendation presumably hoped that their ability to forge consensus on the IAC regarding a balanced approach to comprehensive modernization of the definition would inspire policymakers to a similar consensus, that did not happen, and the fact that it did not happen should inform the 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, I suggest it address only those issues where it can speak clearly, and loudly, and that it approaches the issue from a perspective that consistently and unabashedly prioritizes reforms favored by investors and investor protection advocates.

VI. Recommendations.

1. The IAC must use its considerable platform to-go-bat for the public securities markets. The IAC must not be timid or silent in the face of an unprecedented legislative effort to continue to expand the private offering regime at the expense of the public securities 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. Foremost among these specific steps should be recommendations that the SEC amend the definition to: (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 vote to propose reforms to 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 and unequivocally to avoid any confusion about its perspective and forestall any mischaracterization or "cherry picking" of its recommendations.

###

Written Statement of Michael J. Canning

SEC Investor Advisory Committee

September 21, 2023

ADDENDUM 1

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 basi3s. 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.