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Re: United States Congress
“Responsibly Funding our Priorities” Legislation (“RFOP”)

American Association of Private Lenders (“AAPL”) is a national trade association representing over 400 active members who make over \$100 billion in mortgage loans annually. The California Mortgage Association represents private lenders throughout California and the nation, who fund the building of additional housing units, as well as rehabilitate existing residential inventory.

On September 15, 2021, the House Ways and Means Committee approved a comprehensive tax bill that includes numerous restrictions on individual retirement account (IRA) investments, among other tax generating proposals.

We believe the proposed legislation has far-ranging unintended and materially adverse consequences for the private lending industry and for many other industries that rely on private investment. In addition, we feel strongly that the costs, benefits, risks and returns of this legislation are not currently understood by policymakers.

The purpose of this letter is to provide you information to make an informed decision regarding specific sections of the proposed legislation.

Self-Directed Individual Retirement Account Investments Used as a Tool to Fund Small Businesses and Enterprises

In 1982, Congress adopted Regulation D (“Reg D”) with the stated purpose “to simplify existing rules and regulations to facilitate capital formation, particularly for small businesses, consistent with the protection of investors.”

Reg D is a Securities and Exchange Commission (“SEC”) regulation governing the issuance of non-public securities which are typically used as investment capital in the form of debt or equity provided to small businesses.

These securities are typically provided to Accredited Investors, typically meaning a married couple with greater than \$300,000 of annual income or an excess of \$1,000,000 in net worth exclusive of their primary residence and other personal belongings. The issuance of a non-public security typically requires an investor to be an Accredited Investor as private offerings are not subject to the expensive and cumbersome process of issuing a public security permitting small business to capitalize more easily. These investors are assumed to have certain financial sophistication permitting them to understand the relevant risks of a private investment.

Reg D has been a smashing success. From 2009 - 2019, the number of Reg D offerings dwarfed the number of IPOs 242,070 vs. 2,333 with \$13.576 billion raised. During the same period, the median size of Reg D offerings was \$2.25 million, the median years since corporate inception was 2 and the average number of investors in the offering was 10. These statistics speak to the success of supporting small, entrepreneurial businesses, which of course, is the lifeblood of the U. S. economy.

Similarly, Reg D offerings consistently outpace public offerings in terms of dollars raised. For example, in 2019 Reg D offerings raised \$1.56 trillion in 41,196 offerings whereas IPOs accounted for \$1.2 trillion in 2,413 public ventures.

According to a 2020 SEC report on Reg D to Congress, small businesses have limited access to securities markets and commonly rely on personal savings, business profits, outside debt, and friends and family. The report also found that 64% of small businesses rely on private placements to raise capital, that a significant share has unmet credit needs and underrepresented minorities faced significantly higher hurdles in obtaining external financing.



Similarly, an estimated 5.9 million investors participated in Reg D offerings from 2009 – 2019 and only 221 SEC related civil complaints were filed. That works out to a complaint rate of 0.001243% or 99.88% of the time there is no complaint.

Currently, many individuals choose to use the funds in their self-directed IRAs to invest in these private securities offerings. The offerings may involve greater risk with an opportunity for greater return on investment.

In summary, Regulation D has been a bipartisan success and its implementation has spurred innovation, and opportunity for small businesses nationally. Many investors currently choose to use their IRA to choose to fund small businesses through the use of a Reg D offering, rather than invest in massive publicly traded companies in the public debt and equity markets such as banks, large technology companies, etc.

PROPOSED LEGISLATION

Section 138312 of the proposed legislation states:

Prohibition of IRA Investments Conditioned on Account Holder's Status. The bill prohibits an IRA from holding any security **if the issuer of the security requires the IRA owner to have certain minimum level of assets or income**, or have completed a minimum level of education or obtained a specific license or credential. For example, **the legislation prohibits IRAs from holding investments which are offered to accredited investors because those investments are securities that have not been registered under federal securities laws. IRAs holding such investments would lose their IRA status. This section generally takes effect for tax years beginning after December 31, 2021, but there is a 2-year transition period for IRAs already holding these investments.**

The motivation for precluding the use of IRA assets appears grounded in the highly publicized story about Peter Theil by *Publica* where the PayPal founder and early Facebook investor "turned a retirement account worth less than \$2,000 in 1999 into a \$5 billion tax-exempt piggy bank."

IMPACTS OF THE LEGISLATION TO SMALL BUSINESSES, PARTICULARLY MORTGAGE RELATED INDUSTRIES

The private lending industry revolves around non-bank mortgage companies making loans to small businesses who build additional housing units in needed areas, as well as who rehabilitate and return older residential housing stock to productive use. New units and improvements are typically financed either by loans to real estate investors who make the improvements or through direct investment.

Banks and other large financial institutions are reticent to make these loans because the properties are often dilapidated and require substantial improvements before they can be used as properties habitable by homeowners and/or tenants. Unlike banks and other depository institutions who use deposits to fund loans, private lenders receive investments from individual investors, many of whom choose to use their self-directed IRAs to make an investment in the private lending company, typically referred to as a mortgage fund ("Mortgage Fund"). The Mortgage Fund then makes loans directly to the borrowers providing consistent returns to the individual investors.



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Should this legislation pass, no IRA investment could be made into these Mortgage Funds dramatically reducing capital available to local developers, contractors and others who rely on private lenders to provide capital for these transitional real estate projects. These projects (1) add desperately needed additional housing units in underserved areas and (2) take properties which are neglected, vandalized and otherwise abandoned and turn them into productive real estate where families can occupy.

IRA investors also utilize their retirement funds to purchase private real estate assets and hold it similar to any other investment.

Further, and more problematically, not only does this legislation prohibit future investment in private investments such as private mortgage companies, the legislation as written would require a divestment of funds by the IRA accounts within two years. The forced withdrawals would trigger financial calamity and chaos to small businesses who rely upon these funds. Most private investments are illiquid in nature meaning there are no clear mechanisms for a governmentally forced withdrawal other than a potential liquidation of the entire business.

SECTION 138312 DOES NOT CREATE ANY NEW REVENUE AND INSTEAD FORCES IRAS TO INVEST IN LARGE PUBLICLY TRADED COMPANIES

Further, the proposed tax bill's function is to raise revenues to offset any financial impact of the investment bills Congress currently desires. **Section 138312 raises no new revenue.**

IRA Investors would simply divest from private offerings and move to public equity markets or other publicly available investment opportunities rather than in private real estate debt and equity. The invested funds would remain in tax-deferred traditional IRAs until withdrawal or never taxed if a Roth IRA resulting in no new tax revenue.

If the intended goal was to raise revenues or otherwise stop the "Peter Thiel" effect, Congress should seek limitations on ROTH IRAs which permit the gain on investments to ultimately never be taxed. However, Section 138312 simply forces the investors to move away from main street small businesses and instead forces them to invest in wall street publicly traded investments with no actual revenue gain.

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