Division of Economic and Risk Analysis

U.S. Securities and Exchange Commission
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Accredited Investors

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Accredited Investors

- Lengthy staff review of the definition of an “accredited investor” within U.S. securities markets

- December 18, 2015, available at SEC.GOV

- Pursuant to the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act
Background

- The SEC operates with three main goals:
  - to protect investors;
  - to maintain fair and orderly markets; and
  - to encourage capital formation

- What level of disclosure – and how tightly pre-specified – is appropriate for the Commission’s charge to protect investors

- This depends on the sophistication of potential investors. One investor’s “protection” is another investor’s “exclusion from attractive market opportunities”
The SEC has long sought to reduce the fixed costs of issuing securities, to afford smaller companies better access to financial markets.

Since 1982, Regulation D does not specify information that needs to be furnished to investors if the issuer sells only to “accredited investors.”

Concept of an accredited investor:

- Some element(s) of financial sophistication
- Ability to bear losses
- Supreme Court (In *S.E.C. v. Ralston Purina Co.*, 1953): can “fend for themselves” in the markets
Table 4.1: Inflation Adjustments

<table>
<thead>
<tr>
<th></th>
<th>Current Standard</th>
<th>Current Standard Adjusted for Inflation (CPI)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual Income</td>
<td>$200,000</td>
<td>$490,819</td>
</tr>
<tr>
<td>Joint Income</td>
<td>$300,000</td>
<td>$600,558</td>
</tr>
<tr>
<td>Net Worth</td>
<td>$1,000,000</td>
<td>$2,454,093</td>
</tr>
</tbody>
</table>

- Later removed house value...
<table>
<thead>
<tr>
<th>Standard</th>
<th>Financial Threshold for Natural Persons</th>
<th>Regulatory Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>Qualified Client</td>
<td>$1 million in assets under management; $2 million in net worth</td>
<td>Adviser may charge performance fees</td>
</tr>
<tr>
<td>Qualified Purchaser</td>
<td>$5 million in investments</td>
<td>Exemption from Investment Company Act registration for sales to qualified purchasers</td>
</tr>
<tr>
<td>Eligible Contract</td>
<td>$10 million in investments ($5 million if hedging)</td>
<td>Engage in certain derivatives and swaps transactions</td>
</tr>
<tr>
<td>Participant</td>
<td></td>
<td>Franchising</td>
</tr>
<tr>
<td>Sophisticated Investor</td>
<td>Initial investment ≥ $1.08 million 5 years’ experience and net worth ≥ $5.42 million</td>
<td></td>
</tr>
</tbody>
</table>
Over time, inflation has increased the number/proportion of households that qualify as accredited investors.

<table>
<thead>
<tr>
<th>Basis for Qualifying as an Accredited Investor</th>
<th>Percentage of Qualifying Households</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>In 1983</td>
</tr>
<tr>
<td>Individual Income</td>
<td>0.5%</td>
</tr>
<tr>
<td>Net Worth</td>
<td>1.7%</td>
</tr>
<tr>
<td>Individual Income or Net worth</td>
<td>1.8%</td>
</tr>
</tbody>
</table>

Have investors gotten (that much) smarter?
Alternative indicators worth considering?

- Inflation adjustments? (Were the initial boundaries right, and do they remain so?)

- Ownership of sufficient “investments”

- Sufficient education
  - Pass a test
  - Have a degree or certificate? Series 7, CPA, CFA, CFP, etc. If you can sell it, should you be able to buy it?
  - Use of professional advisers
  - Affiliated persons (expand current set)
Staff recommendations (p. 90)

- Leave $ limits in place, but limit size of permitted investments (as in Crowdfunding limits...)

- Inflation-adjusted limits, no limit on amount invested

- Permit qualification based on other criteria than income and net worth
  - Minimum amount of investments
  - Professional credentials
  - Pass an “accredited investor” exam
What’s Next?

- The public can comment on the Report through the SEC’s website

- Policy actions? Congress? Other?

- Implications for capital raising and for investor protection