Division of Economic and Risk Analysis

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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

	Current Standard	Current Standard Adjusted for Inflation (CPI)
Individual Income	$200,000	$490,819
Joint Income	$300,000	$600,558
Net Worth	$1,000,000	$2,454,093

- Later removed house value…

Standard	Financial Threshold for Natural Persons	Regulatory Purpose
Qualified Client	$1 million in assets under management; $2 million in net worth	Adviser may charge performance fees
Qualified Purchaser	$5 million in investments	Exemption from Investment Company Act registration for sales to qualified purchasers
Eligible Contract Participant	$10 million in investments ($5 million if hedging)	Engage in certain derivatives and swaps transactions
Sophisticated Investor (FTC)	Initial investment $\geq$ $1.08 million 5 years' experience and net worth $\geq$ $5.42 million	Franchising

- Over time, inflation has increased the number/proportion of households that qualify as accredited investors

Basis for Qualifying as an Accredited Investor	Percentage of Qualifying Households	
	In 1983	In 2013
Individual Income	0.5%	6.6%
Net Worth	1.7%	7.5%
Individual Income or Net worth	1.8%	10.1%

- 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