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One Step Closer to a Revised “Accredited Investor” Definition

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The rationale behind such change is that the current thresholds serve as imperfect proxies for access to information, financial sophistication and the ability to withstand losses typically seen as the markers of individuals who are not in need of the protections of the Securities Act. Current accredited investors that meet one of the applicable thresholds may not have sufficient liquidity or may be basing their net worth on retirement funds, resulting in limited ability to withstand losses.

As an alternative, should the SEC elect to retain an approach that relies principally on financial thresholds, the committee recommended limiting investments in private offerings to a percentage of an accredited investor’s assets or income with the goal of protecting investors without shrinking the pool of potential accredited investors. As one approach, the committee suggested an initial investment threshold based on income or assets, with restrictions being reduced or eliminated as income or assets increase, which should reduce the risk of unsophisticated investors suffering losses they cannot afford.

Hester Peirce, a financial markets researcher and the sole dissenting member of the committee, found these recommendations to be an encroachment on investors’ ability to think for themselves. She suggests that investors should have the autonomy to invest in both public and private offerings, even if that means some investors will lose money. Such changes may require legislative action, but, she notes, the committee is not restricted from making such recommendations. Ms. Peirce did not carry the day, but it will be worth following whether the committee heeds any of her advice in future reviews.

In its report, the committee acknowledged that the consequences of any changes to the accredited-investor definition are unclear and that the SEC would be well-advised to collect investor information in private offerings so that it could better assess its policy options and their effects going forward.

Especially if the SEC were to adopt its principal recommendation, the committee also recommended the development of an alternative means of verifying accredited-investor status that would shift the burden away from issuers to third parties. Such third parties would be expected to be subject to some regulatory oversight or at least be accountable to certain appropriate standards. The goals of any such transition would be to reduce the compliance burden on issuers and limit the need for investors to share potentially sensitive information.

A review of the committee's recommendations is currently under way by the SEC, but no deadline has been set for making any determination as to whether any of the recommendations will find their way into an upcoming proposed rule.

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