Debate Over Accredited Investor Definition Gaining Momentum

Discussions surrounding the accredited investor definition have crescendoed of late, demonstrating a sharp divide in opinion among regulators. On one side lies the North American Securities Administrators Association ("NASAA"), the lobbying group that represents the state securities administrators. The NASAA published a comment letter on the definition on May 25, 2016, evidencing a highly conservative approach. The group relies on investor protection concerns in calling for higher financial thresholds and rejecting calls to incorporate a test of sophistication. A more progressive approach was espoused at a recent meeting of the SEC Advisory Committee on Small and Emerging Companies ("ACSEC") and is further discussed below.

The NASAA Approach

Under the NASAA's approach, current quantitative thresholds would be increased to fully account for the impact of inflation since 1982. The NASAA further recommends that these financial thresholds be indexed for inflation on a going-forward basis. This approach would significantly erode the number of investors qualifying as accredited investors and permitted to participate in the private offering marketplace. Acknowledging this consequence, the NASAA notes that "[m]aintaining an adequate pool of investors is important to capital formation in the private marketplace and the businesses that use Rule 506. However, a pool consisting of a large number of investors lacking in sophistication or adequate financial resources serves no legitimate capital raising or investor protection purpose … [and] may further incentive violative conduct by promoters of private offerings."

The NASAA was equally conservative in its stance on a potential accreditation exam. While both the House of Representatives and the SEC have offered support for expanding non-quantitative avenues for accreditation, the NASAA did not share this optimism. In its comment letter, the NASAA expresses that "[q]ualification as an accredited investor absent any sort of experiential requirement does not objectively satisfy the sophistication requirement. The Commission should require a minimum of five years of experience in the field corresponding to the professional designation or credential to ensure an individual has obtained sufficient industry experience to demonstrate financial sophistication."

The ACSEC's More Inclusive Perspective

The ACSEC hinted at a more inclusive approach during a May 18th meeting. ACSEC opinions were more closely aligned with the SEC staff's December 18, 2015 suggestions, found in its review and report on the accredited investor definition. Chair Mary Jo White opined that the SEC's primary goal in reconsidering the definition should be to "do no harm to the private offering ecosystem." Chair White supports the inclusion of a sophistication test, which would naturally expand the pool of accredited investors.

SEC Commissioner Michael S. Piwowar provided many of the meeting's most poignant remarks, going so far as to ponder whether the accredited investor standard should be eliminated entirely. Commissioner Piwowar focused on the disenfranchising impact of the standard, which bars 90% of Americans from investing in potentially high-return securities in the name of "protection." He believes that increasing the definition's financial thresholds would serve to shrink the "privileged class" of accredited investors, and therefore "exacerbate wealth inequality and hinder job creation and economic growth."

While it's fair to question the likelihood that the accredited investor definition will be eliminated entirely, Commissioner Piwowar's comments highlight the divide between the SEC's perspective and that of the NASAA. The ACSEC meeting was intended to catalyze discussion of and potential change to the accredited investor definition. While pressure mounts on the SEC to revise the definition – including a bill passed by the House of Representatives in February that mandates the SEC widen the category to include investment advisers and other experts – the agency is yet to take affirmative initiative on the matter. The SEC must balance its investor protection responsibilities against rising pressure to ease capital formation rules. Chair White and Commissioner Piwowar's remarks indicate that investor protection concerns may be waning, thereby hinting at a potentially expanded definition.