MarketWatch

Opinion: Let’s not backtrack on loosening ‘accredited investor’ rules

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Jan. 29, 2021

This rule already makes it harder to get rich unless you already are rich

Last month, the exclusive “accredited investor” club cracked open its doors to the public. But don’t celebrate yet. Chances are you still didn’t receive an invitation to join.

Members in this exclusive club can legally invest in certain private offerings, like hedge funds and start-up companies. Until the SEC’s recent revision, entry was limited to people who earn at least $200,000 a year ($300,000 with a spouse) or have a net worth of at least $1 million. About 13% of U.S. households qualified under those rules.

The new SEC rule lowers that high threshold a bit, but only for people who hold certain securities licenses or work at private funds. So unless you are comparatively well-to-do or part of this group of financial industry insiders, most private securities offerings are still off limits to you.

Even this modest loosening of the restrictions has come under fire. House Financial Services Chairwoman Maxine Waters urges the Biden administration to rescind the revised definition. SEC commissioners Allison Herren Lee and Caroline Crenshaw suggest the wealth thresholds be indexed to inflation to ensure that the club remains limited.

The Biden administration should not heed these calls. Narrowing the accredited investor definition may be good news for the wealthy few because it concentrates investment opportunities in the hands of those who are already advantaged. Breaking down society’s wealth divides requires removing such barriers to opportunities for investors and entrepreneurs to make financial gains.

Broadening access to private offerings, rather than further restricting it, is a better solution.

The securities most people think of, like stocks sold on a public exchange, are registered under the Securities Act of 1933. A company registration statement must provide detailed disclosures about its business operations, financial condition, risk factors and management. But far more capital is raised through offerings exempt from registration, including through Regulation D offerings that are largely limited to accredited investors.

Broadening access to private offerings, rather than further restricting it, is a better solution.

In 2019, for example, registered offerings raised $1.2 trillion, while Regulation D offerings raised $1.5 trillion (of the $2.7 trillion total raised by exempt offerings).

The SEC reasons that less well-to-do investors are protected by limiting riskier investments to the financially sophisticated and those who can absorb losses.

But being wealthy is no proxy for financial sophistication. This line drawing lumps the elderly with substantial retirement savings and lottery winners with windfall profits in with people whose earnings depend on some financial know-how. It also excludes those who don't have a substantial nest egg but have a great deal of general investment knowledge or have experience with the industry in which they seek to invest.

MarketWatch and Barron's editors will convene top experts to discuss what is happening in the world, and how it may affect your personal finances. This series will help beginner investors understand and navigate the current landscape. Find out what has worked well, what to avoid, and ask questions.

The wealth test clearly misses the mark.

SEC Commissioner Hester Peirce has observed that the this limitation on investors "offends the principles of personal liberty, which allow people both to earn and spend money as they see fit." This interference is not harmless.

For investors, the accredited investor definition makes it harder to get rich unless you already are rich. It takes about 11 years for a company to go public today, meaning that it is likely past its high growth phase by the time most people can invest in it. There are also fewer public companies today than there were 20 years ago. So people have fewer choices in the public markets and those choices may offer lower potential returns.

Private offerings also provide different opportunities than those in the public markets, including diversification options and the ability to support a compelling idea or local entrepreneur.

And for investors and entrepreneurs alike, the accredited investor definition deprives many communities of capital needed to grow. Accredited investors aren't representative of the U.S. population: white families, on the whole, are considerably wealthier than others, and wealth is concentrated on the U.S. coasts. Would-be entrepreneurs in less-wealthy communities are thus limited in their ability to turn to those they know best in building their businesses.

Instead, 74% of aspiring entrepreneurs cite networks and connections as barriers to accessing capital, and too few can rely on angel investors, who tend to invest in nearby businesses. That's why the SEC recognized that minority-owned businesses, in particular, may benefit from increased access to accredited investors. Where proportionally more minority-owned businesses have closed in 2020 due to the pandemic, expanded access to capital is even more crucial.

To argue that more investors should be allowed to take part in these offerings isn't to recommend that they do so. Just because someone is permitted to buy into a hedge fund or invest in a start-up is no reason that they should. Indeed, there are plenty of risks to investing in the public securities markets, even apart from the soaring stock prices of GameStop **GME, +69.69%** and others.

But these investment risks do not justify reserving certain investments for the wealthy and disadvantaging others in the process. If limitations on investments in private offerings are to

persist, the accredited investor club should, at the very least, open its doors to more investors who are financially experienced or can obtain sophisticated advice from regulated financial advisers.

By no means should the club be narrowed even further.

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