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An Update to Reg D, Including Definition of an Accredited Investor, is a Top Priority for the SEC: How Could This Impact Private Markets?

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The **Securities and Exchange Commission's** regulatory agenda during the current leadership has changed little since it was first revealed in 2021. One item that has been near the top of the list is **Reg D "improvements,"** including an update to the **Accredited Investor** definition.

Regulation D or Reg D, both 505b and 506c, is an enormously important securities exemption facilitating over $1+ trillion in capital each year. Reg D is far larger than the initial public offering (IPO) market, providing growth capital for emerging and innovative firms while fueling entrepreneurship. It is probably the most successful path for capital formation in the securities ecosystem, supporting key policy goals of job creation, economic growth, and prosperity. Yet expectations are for the current Commission to change the exemption – including making it more difficult to qualify as an Accredited Investor.

The current **definition of an accredited investor** determines who may participate in Reg D offerings. As it stands today, an individual must earn $200,000 or more a year, or have a net worth of over $1 million – not counting a primary residence. If married, the salary hurdle rises to $300,000. If an individual holds a securities license like a Series 7, they are also considered accredited. While estimates vary, there are probably around 15 million accredited investors in the United States. Yet while the number of accredited individuals numbers in the millions, most likely a small percentage participate in Reg D securities offerings, but their participation is important for the economy.

> *While the first rule of regulation should be do no harm, a change to the Accredited Investor definition could have a negative impact on the economy*

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While the first rule of regulation should be "*do no harm*," a change to the Accredited Investor definition could have a negative impact on the economy. It will also impact online capital formation as many securities crowdfunding platforms list securities under Reg D 506c – the exemption that allows for the promotion of a securities offering to the public.

At the same time, most observers believe that a financial hurdle is a poor metric for qualifying as accredited. Experts understand that sophistication or financial acumen is not measured by salary or net worth but by experience or education.

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Additionally, excluding segments of society based on a theory that investor protection concerns outweigh the benefits of allowing knowledgeable investors to participate in these markets disenfranchises the vast majority of the population. In brief, it excludes most of the population to the benefit of the very wealthy.

Not too long ago, **Rodney Sampson**, General Partner, **100 Black Angels & Allies Fund I**; Executive Chairman, **Opportunity Hub**; Vice Chairman, **Piksel Technology Corporation**, **called on the SEC to update the definition of an Accredited Investor to expand access for more Americans.** Sampson has long advocated on behalf of underserved communities, and if the SEC makes it more difficult to become accredited, this will restrict further access for the non-wealthy population.

Sampson commented:

> "Some of us have worked a very long time to reach the current income and wealth minimums to be accredited investors. If we're not in the game, it's going to cut out a lot of early-stage capital that's funding the funds and founders who are not accessing capital today because of systemic and ongoing bias, along with limited network access in the ecosystem."

Last year, CI connected with securities law expert **David Burton** who told us that **Reg D is central to the economy.**

> "It is the source of initial funding for most of our successful, dynamic entrepreneurial ventures. Regulation D is the most important means of raising private capital amounting to approximately $1.7 trillion annually, and private offerings account for nearly twice as much capital as public offerings," Burton said. He added that the number of public companies continues to decline, and when they do go public, it tends to be much later in their life cycle. "This is primarily because of the ever-increasing regulatory burden imposed by the SEC on public companies and ever-increasing regulatory and litigation risks," Burton added.

Investor Choice Advocate Network (ICAN) is a nonprofit public interest law firm representing parties who cannot afford counsel regarding SEC matters. ICAN has been championing the cause of enabling more individuals to gain accredited investor status. The group is planning to file a petition for rulemaking to "remove the diversity, equity, and inclusion barriers" created by the Accredited Investor financial requirements.

ICAN has posted a video that shares commentary on the shortcomings of the current definition. **Brittany Davis** of **Backstage Capital** criticizes the definition as it makes it more difficult to pursue a "friends and family" raise, but they cannot tap into their community because they do not qualify as accredited.

Ryo Ishida, of **Rainbow Capital Partners**, predicts a change to the accredited investor definition will have adverse effects. They typically raise up to $25 million in a round and they try and save a portion for smaller investors. Rainbow Capital Partners mostly funds commercial real estate projects. As they invest in a new generation of operators, they have ended up funding primarily people of color, LGBTQ+, and women-led firms. About 95% of their investors are part of this underserved community.

Ramona Ortega of **My Money My Future**, says:

> "As someone who is dedicated to ensuring equity and financial inclusion–particularly communities of color—with a special focus on closing the racial wealth gap, I think the rules as they are now have a disproportionate, negative impact on communities of color."

CI connected with **Nick Morgan**, co-founder of ICAN, we asked him why would SEC Chairman **Gary Gensler** want to undermine such a successful exemption by limiting participation in Reg D offerings further.

Morgan explained that some regulators mistakenly believe that the best way to protect investors is to prohibit them from investing.

> "The "accredited investor" financial restrictions effectively prohibit ordinary investors from participating Reg D private offerings. This misguided attempt at protection harms the very people it is meant to protect," Morgan said.

As most everyone acknowledges the current definition is fundamentally flawed as it does not recognize acumen, we asked Morgan if the financial hurdle should simply be removed.

> **"Yes!** But unfortunately, the "protection through prohibition" advocates may currently be inclined to thwart meaningful reform in this direction. We'll see what reaction ICAN's petition receives in response to the diversity, equity, and inclusion objections to the current financial requirements."

Morgan believes the Commission should be working towards a definition that is more inclusive, but the current goal appears to be intent on exacerbating the wealth gap, where only the affluent can participate. Morgan notes that, "in the US, most wealth has been created through investing in or building businesses."

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Many policymakers believe qualification for Accredited Status should take a more common sense approach. ICAN's proposal is to continue down the path begun in recent years by adding to the list of certifications or licenses that would qualify someone to be an "accredited investor." This includes non-financial metrics like education or professional certifications, such as those required for certified public accountants, attorneys, chartered financial analysts, certified financial planners, securities brokers, or registered investment advisors.

> *Evidence that an investor is working with a registered investment advisor would better empower currently non-accredited investors than current prohibitions*

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> "Regarding the idea of a test, it's interesting to note that Singapore is considering requiring retail investors to take a test before trading crypto. ICAN doesn't favor restrictions on investors' ability to choose how to invest their own money, but certainly, a test along these lines would be an improvement over the current "accredited investor" financial restrictions," stated Morgan.

Morgan added that regulators tend to live on a spectrum between two poles; capital formation and investor protection. The current Commission appears to want to err on the side of investor protection even if it comes at the expense of capital formation.

> "Unfortunately, the financial restrictions in the "accredited investor" definition harm investors and harm capital formation," said Morgan. "We hope ICAN's rule petition will help make that point to the Commissioners. To paraphrase Benjamin Franklin's old quote, those who would sacrifice capital formation in the hope of protecting investors may get neither."

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