SEC advisory panel recommends new approach to accredited investor label

Group suggests gauging sophistication of individuals based on knowledge, or limiting the portion of a portfolio that can be invested in private placements

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The Securities and Exchange Commission should revise rules for designating someone a sophisticated investor who can participate in private securities offerings, according to recommendations that will be put before the agency next month.

The SEC Investor Advisory Committee is scheduled to vote on a reform plan from a subcommittee at its Oct. 9 meeting that calls for the SEC to rethink the income and net-worth minimums used to deem accredited investors.

Under current rules, an investor is accredited if he or she has a net worth of more than $1 million, excluding a primary residence, or an income of $200,000 or more. About 8.5 million people fit this category, according to various estimates.

"While reliance on income and net worth thresholds results in a definition that is clear and relatively simple to implement, this approach over-simplifies the factors that determine whether an individual truly has the wealth and liquidity to shoulder the potential risks of private offers," the **IAC subcommittee recommendation** states.

The accredited investor standard was designed to limit investments in risky private offerings to people who could “fend for themselves,” as outlined in a 1953 Supreme Court ruling, according to the recommendation.

“We don't think the current definition satisfies the Supreme Court standard,” said Barbara Roper, director of consumer protection at the Consumer Federation of America and chair of the IAC subcommittee. “There are a variety of approaches that are better than the current approach.”

Under the Dodd-Frank financial reform law, the **SEC must review the accredited-investor standard every four years**. This year marks the first time since the measure was enacted in 2010 for such an assessment. The standard has not been changed since 1982.

Among the IAC subcommittee's recommendations are scrapping income and net-worth thresholds and basing accredited investor status on financial sophistication that could be determined by professional credentials, investment experience, financial knowledge or a financial skills test.

If the SEC maintains the income and net-worth parameters, the IAC subcommittee recommends limiting the percentage of net worth that someone can invest in private placements.

“Leaving aside the question of whether the financial thresholds are currently set at an appropriate level, the basic 'on/off switch' approach seems illogical,” the recommendation states. “A more sensible approach might be to allow some investments in private securities once a person reaches an initial threshold, based on percentage of income or assets, with restrictions being reduced and then eliminated as income or assets rise.”

Such limits don't sit well with David Benway, chairman and chief executive of VerInvest Corp., an accredited-investor verification firm.

“The accredited investor embodies a standard that is supposed to confer a level of understanding about risk-taking,” Mr. Benway said. “I don't think you need to protect accredited investors from themselves.”

The IAC subcommittee also encouraged the SEC to consider using third parties to verify accredited investor status.

“Securities professionals, such as brokers and investment advisers, accountants and attorneys would all appear to be well situated to provide such services,” the recommendation states.

With the ubiquity of market information and the increase in market participation, the number of people who can be considered savvy has expanded, according to Mr. Benway. “Investors have become much smarter,” he said. “There's a dramatic increase in understanding and knowledge of investment products over the last 30 years.”