Anchin Alert

Anchin, Block & Anchin LLP
Accountants and Advisors

July 11, 2019

SEC Explores Softening Accredited Investor Standards

On June 18th, the SEC issued a comment release for feedback on possibly loosening the accredited investor definition. This would potentially allow more investors to contribute to private funds and other restricted investments. Here's what they're considering and what could happen next.

Accredited Investor Definition

Under federal securities law, someone must meet the accredited investor standards to participate in more sophisticated investments like private markets, hedge funds and equity crowdfunding. The idea is that these investments are more complicated and potentially riskier so an investor must have a certain level of knowledge to use them properly. As a result, the government believes they are not appropriate for the general public.

The SEC currently defines an individual as an accredited investor if their annual income has exceeded $200,000 in each of the last two years ($300,000 , when combined with their spouse, if married) and they reasonably expect that level of income to continue for the current year, or they have a net worth, excluding the value of their primary residence, over $1 million.

SEC Considerations

While the accredited investor protections may make sense in theory, a consequence is they also block many investors from potentially profitable investments. For example, they are not allowed to buy into an early-stage startup and must wait until it launches an IPO. The SEC wants to investigate whether they should loosen the rules to open markets.

Some of the possible changes they are considering include adjusting the accredited investor definition to lower the threshold for investing in private funds. They are also reconsidering the restrictions on retail funds related to investing in hedge funds and private equity funds. They could open up these funds to more investors or make them available through retirement plans like 401(k)s.

Hedge Fund Restrictions

Even with the possible change to the accredited investor definition, there will still be some restrictions for investing in hedge funds because many hedge funds have even stricter standards for who they accept. Hedge funds that rely on the exemptions under Section 3(c)(7) of the Investment Company Act can only take on qualified purchasers, who are individuals with at least $5 million in investments and institutions with at least $25 million in investments.

While hedge funds relying on Section 3(c)(1) exemptions can accept accredited investors, those that are operated by registered investment advisors typically only accept qualified clients, those with a net worth of at least $2.1 million or at least $1 million in assets with the advisor.

What Happens Next

With their comment release, the SEC has opened the floor for 90 days to collect feedback from the industry and the public. In particular, SEC Chairman Jay Clayton has said ""Input from startups, entrepreneurs and investors who have first-hand experience with our framework will be key to our efforts to analyze and improve the complex system we have today."

There is no guarantee that they will make changes based on the feedback received but if they do, they could then write a regulatory proposal issuing the new guidance. We will be sure to update you about any changes to the accredited investor rules and capital requirements based on this potential SEC decision.

ANCHIN®
Your Expert Partner
Accountants and Advisors

Anchin, Block & Anchin LLP
Accountants and Advisors
1375 Broadway, New York, NY 10018
212.840.3456 • www.anchin.com

Anchin Alert, Copyright © 2019 Anchin Block & Anchin LLP The Anchin Alert is published periodically by Anchin, Block & Anchin LLP, Accountants & Advisors. The Alert contains articles which are general in nature and based on sources which are believed to be authoritative. Specific applications would require consideration of all facts and circumstances by qualified professionals familiar with a taxpayer and therefore we are not liable for the application of any information contained herein. No part of this correspondence may be reproduced or utilized in any form or by any means without written permission from Anchin, Block & Anchin LLP.