MEMORANDUM

To: Members of the Committee on Financial Services

From: Committee Majority Staff

Date: February 3, 2023

Re: Subcommittee on Capital Markets Hearing Entitled: "Sophistication or Discrimination? How the Accredited Investor Definition Unfairly Limits Investment Access for the Non-wealthy and the Need for Reform"

On Wednesday, February 8, 2023, at 10:00 a.m., the Subcommittee on Capital Markets will hold a hearing, entitled: "Sophistication or Discrimination? How the Accredited Investor Definition Unfairly Limits Investment Access for the Non-wealthy and the Need for Reform." The purpose of this hearing is to examine policies designed to expand investor access to our private markets.

This will be a one-panel hearing with the following witnesses:

Witnesses

- Eli Velasquez, Founder & Managing Partner, Investors of Color Network
- Omi Bell, Founder, Black Girl Ventures
- David Olivencia, CEO & Co-Founder, Angeles Investors
- Jennifer Schulp, Director of Financial Regulation Studies, Center for Monetary and Financial Alternatives, Cato Institute
- Additional witnesses to be added

Expanding Opportunities for Underrepresented Investors and Entrepreneurs

Companies have two ways of accessing capital in the securities markets to fund their operations: an initial public offering (IPO) where they sell securities publicly through a registered offering with the SEC or a private offering under an exemption from registration. Accessing capital through an IPO is a significant step for a company because there are considerable upfront costs as well as increased costs associated with the company's ongoing reporting requirements as a public company. Before an IPO, companies often spend tens of millions of dollars gathering and compiling mandatory information to submit to the SEC and make available to the public for the sale of its securities.[1] After an IPO, companies must continue to comply with SEC regulatory requirements, such as audit and disclosure requirements intended

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[1] *See* Thaya Brook Knight, *A Walk Through the JOBS Act of 2012: Deregulation in the Wake of Financial Crisis*, Cato Institute (May 3, 2016), at 9, *available at* https://www.cato.org/policy-analysis/walk-through-jobs-act-2012-deregulation-wake-financial-crisis.

to provide shareholders and potential investors information necessary to make informed investment and voting decisions.

Many companies want to avoid the costs associated with being publicly traded, particularly smaller companies. However, raising capital privately can be challenging for these companies as the pool of potential investors is largely determined and restricted by the accredited investor definition. This definition uses criteria such as wealth and other limited qualitative professional criteria to determine sophistication, which limits access to private offerings and makes it harder for companies to secure funding.[2] Underrepresented entrepreneurs are particularly impacted because their potential investor pool is often limited to others within their personal network or community who do not qualify as accredited investors due to historical wealth disparities.[3]

The gap in capital raised in private versus public markets is significant, with private offerings raising $4.45 trillion from July 1, 2021 to June 30, 2022, compared to $126 billion raised in IPOs during the same period.[4] This gap highlights the investment opportunities primarily accessible to wealthy accredited investors. To increase investment opportunities for everyday Americans and help entrepreneurs raise more funds, Congress should consider policy changes that broaden the pool of investors in our private markets.

Legislative Proposals

- **H.R. ___**, **the "Fair Investment Opportunities for Professional Experts Act",** to expand the definition of "accredited investor" to include individuals with certain licenses and qualifying education or job experience.

- **H.R. ___**, **the "Equal Opportunity for All Investors Act of 2023"**, to expand the definition of "accredited investor" to include individuals that are certified through an examination established by the SEC.

- **H.R. ___**, **the "Accredited Investor Definition Review Act"**, to require the SEC to review the list of certifications, designations, and credentials for individuals to qualify as an accredited investor and add additional certifications, designations, and credentials to such list which the SEC determines are substantially similar to the existing ones within 18 months and every five years thereafter.

- **H.R. ___**, **the "Accredited Investor Self-Certification Act",** to require the SEC to create a form that would allow individuals qualify as an "accredited investor" by self-certifying that they understand the risks of investment in private issuers.

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[2] *See e.g*., "What is the Role of Accredited Investors?" *available at* https://www.sec.gov/education/capitalraising/building-blocks/accredited-investor.
[3] *See* Office of the Advocate for Small Business Capital Formation Annual Report for Fiscal Year 2022 (Dec. 2022), *available at FY22 OASB Annual Report (sec.gov)*
[4] *Id.*

- **H.R. ___**, **the "Investment Opportunity Expansion Act",** to expand the definition of "accredited investor" to include individuals who invest 10% or less of the greater of their net assets or annual income in a private offering.

- **H.R. ___,** to expand the definition of "accredited investor" to include individuals receiving individualized investment advice or individualized investment recommendations with respect to a private offering from a professional who qualifies as an accredited investor.

- **H.R. ___**, **the "Increasing Investor Opportunities Act"**, to amend the Investment Act of 1940 to allow a closed-end fund to invest up to all its assets in private funds.

- **H.R. ___**, **the "Gig Worker Equity Compensation Act"**, to expand Securities Act Rule 701 to include gig workers and preempt state laws that mischaracterize gig workers as employees.