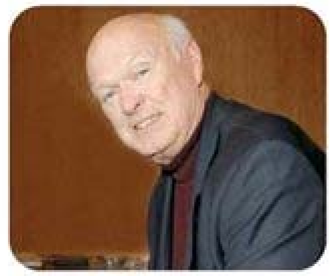
Flynn's Harp

Notes on people and issues
composed from business, politics and life.



Dear Villette,

Angel-investor group fears SEC will change accreditation rules and shrink angel ranks

Although the Securities and Exchange Commission (SEC) hasn't yet proposed an increase in the financial resources required for an individual investor to be accredited, the Angel Capital Association (ACA) fears such a move may loom ahead and has been pressing its members to collectively protest such a step.

The ACA sees the issue as having the potential to dramatically deplete the ranks of what are officially called accredited investors, individuals who are free to make the kind of high-risk investments that fuel the funding of financially risky early stage companies that are key contributors to job creation. All angels are accredited investors

Dan Rosen

The issue is front and center right now because when Congress passed the Dodd-Frank Act four years ago, it retained the long-time "accredited investor" threshold of $1 million net worth and $200,000 of annual income but ordered the SEC to do a quadrennial review of the qualifications. The first of those four-year reviews is to be due to conclude next month.

Angel-investor groups successfully overcame an attempt to include in Dodd-Frank a change that would have basically disqualified what by some estimates would have been up to 50 percent of angel investors by boosting the accredited minimums to $2.5 million net worth and annual individual income of $400,000.

But Congress did include in what is officially the Dodd-Frank Wall Street Reform and Consumer Protection Act a change to preclude primary residences from the $1 million-net-worth calculation.

The ACA website plays the job-creation card in preparing for a possible campaign by urging members: "Do you believe in preserving the health of early stage companies and their role in job creation? Then join the Angel Capital Association campaign to 'protect angel funding.'"

Dan Rosen, chairman of the Seattle-based Alliance of Angels and a longtime leader in ACA, says "a change to make the accredited investor definition more restrictive is exceedingly bad public policy."

"This is a time when America needs to unleash innovation and create exactly the kind of jobs that high-growth startups provide," argues Rosen, who until a few months ago chaired the ACA public policy committtee . "Angels fund most of these high-growth startups, investing well over $20-billion per year."

"We are not financial institutions in New York or Boston, we are individuals in every major city and town in the U.S. who invest not only our money, but also our knowledge and experience, to help these high-growth startups get off the ground and flourish," wrote Rosen, **who** is CEO and president of Dan Rosen & Associates, a technology investment and advisory firm

Although the multi-part mission of the SEC includes helping facilitate capital formation, the agency makes clear its "investor protection mission" has become most compelling, particularly after the excesses that led up to the "Great Recession."

Thus there is an amusing bit of irony as the SEC may move to "protect" a major segment of the high-net-worth angel-investor category by removing their "accredited" status while preparing to remove protections for scores or "unaccredited" investors by opening the door for them to do crowd-funding investment in startups.

Crowd funding is a concept spawned by legislation known as the JOBS Act, passed by Congress four years ago to permit entrepreneurs or a start-up business to raise up to a $1million a year by selling equity on the internet to up to 500 "unaccredited" investors. Some described passage of the bill and its signing by the president as a "democratization of investments." In essence, Congress felt those across the financial spectrum should all have a chance to own a piece of a company.

The ACA says a survey of its 12,000 members, who are the most active angel investors in the country, found that if the definition of accredited investor was changed to add an inflation factor, which is the standard being urged by those pressing for a change, more than 25 percent of its members would fall below the new threshold. The inflation factor would relate to the inflation that has occurred since 1972, when the accredited regulation first came about.

ACA, whose campaign to bring pressure against the change includes form letter and email template on its website, says such a change would be "devastating," particularly outside the angel-heavy population centers of New York, California and Boston. It claims the number of angel investors across the country outside those three areas would fall by one third.

Even so, not all angels oppose raising the bar for individuals to quality as accredited investors.

Steven J. Schueth, president of First Affirmative Financial Network in Colorado Springs, who has been a leader in the sustainable and responsible investment industry for more than 20 years and created the prominent SRI Conference that rotates annually around the West, is one who isn't sure a change would be bad.

"With my fiduciary duty hat on, I could make the argument that an investor with only $1 million in liquid, investable net worth is probably too small to be investing in private deals," Scheuth said in an email exchange. "I don't think someone with only $1 million has any business playing in this game."

I have assumed that increasing the qualification for accredited investor might have a large impact on sustainable and renewable startups seeking investment and asked Schueth if there might be less S-R investing.

"Perhaps there would be, but would that be bad? Maybe for entrepreneurs who are looking for capital from less-than-the-most savvy investors," he said. "But would it be bad for investors who now only meet the minimum accredited investor threshold? Not in most cases. There's a reason those rules were promulgated in 1972-to protect some people from themselves."

There are some investors who with some portion of their portfolio seek higher positive impact and care less about risk adjusted returns," Schueth added. "When I talk with these people, I try to help them think about making these kinds of investments out of their philanthropy budget; or at least know that the likelihood of making little or no financial return is a high probability."

I asked Schueth, whom I had quoted in previous columns because of his reputation in the sustainable and renewable investments arena, whether he thought it was interesting that while Congressional direction may guide a boost in what it takes to be qualified investor, crowd-funding is opening the door, also at congressional direction, to let everyone in.

"I don't believe I have ever heard anyone claim that Congress is a rational beast," he replied.

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