DOI: 10.1111/acfi.13366

ACCOUNTING & FINANCE afaanz

TECHNICAL NOTE

Accredited investor tests: How to balance, access, entrepreneurial funding, and investor protection?

Mark Humphery-Jenner

UNSW Business School and Otso Capital, Sydney, NSW, Australia

Correspondence
Mark Humphery-Jenner, UNSW Business School and Otso Capital, Sydney, NSW, Australia.
Email: mlhj@unsw.edu.au

Abstract
Regulators seek to balance investor protection with the costs of that protection. This often leads to a distinction between "accredited" and "retail" investors. Only "accredited" investors can invest in certain "risky" or "illiquid" assets, including start-ups and wholesale funds. But what should be the "bar" to be classified as "accredited"? Should people be able to qualify via income, wealth, or education? Should they be able to self-certify? Thus, this article considers the situation in the US, UK, and Australia and argues in favour of letting people qualify via wealth, income, and education and being able to self-certify.

KEYWORDS
accredited investor, regulation, startups, venture capital, wholesale investor

JEL CLASSIFICATION
G11, G24, G28

1 | INTRODUCTION

Who should be able to invest in startups? Or access nascent fund managers? Or subscribe to private placements or capital raises? Regulators often strive to balance investor protection, compliance costs, investor choice, and capital access. To this end, regulators often grapple with who should qualify as a "sophisticated", "experienced", or "wholesale" investor so as to be able to invest in such assets. This article argues that regulators should focus on investor education, rather than investor wealth, when making such decisions.

Regulators often gatekeep investments, restricting "complex" or "low disclosure" or "risky" investments to so-called sophisticated, or accredited investors. Gatekept investments typically

The author is on the management committee of Sydney Angels, which is directly affected by Australia's wholesale investor rules. Similarly, Otso Capital is a wholesale only fund. This article is based on the author's submission to the inquiry into "Wholesale investor and wholesale client tests" conducted by the Parliamentary Joint Committee on Corporations and Financial Services. To this end, the author thanks the committee panel members (Deborah O'Neill, Alex Hawke, and Paul Scarr) at the public hearing on 3 October 2024.

include startups, lower-disclosure funds, and private placements. For example, in the US, only "accredited" investors can be "angel investors" and invest in startups. In Australia, only "wholesale" investors can be angel investors, invest in "wholesale" funds or participate in private placements. The argued reasoning is that those investment-classes often have less regulation, or provide less disclosure; and thus, must be gate-restricted.

Why then do regulators even allow investments in these assets if they are "risky"? The answer is that it is necessary to foster innovation. Startups often cannot afford expensive disclosure and compliance processes. Similarly for nascent fund managers. Such expenses also addd to fees. Regulators do not want to foreclose whole asset classes: they acknowledge that startups require capital, nascent funds cannot afford complex disclosure beyond that necessary to ensure they are acting honestly. Investors also want choice. They are loathe to leave lucrative assets to a set group of investment managers who would then repackage investments while adding fees. Thus, enabling such investments can help to foster innovation.

The distinction between "retail" and "accredited" investors is an attempt to balance competing priorities. Regulators want to protect lay-investors from being misled or induced into investing in high-risk or illiquid products. However, regulators also realise that some of those investments – such as startups – benefit from a vibrant investor community. For example, angel investors contribute not just money, but skills and expertise, to their portfolio companies. Regulators also realise that the regulatory burden is costly. These costs might be so high as to prevent entrepreneurial and motivated fund managers from establishing funds. This deprives the fund manager from being able to start a business, resulting in the same issue as limiting startups' access to capital. Furthermore, high regulatory costs result in high fees. Regulators are mindful of the need to provide access to investment products.

Regulators often distinguish between investors based on either wealth and income, or on education and experience. The assumption is that if a person earns more money, then they are either financially literate or they can afford losses. Thus, whereas "retail" investors require protection, "sophisticated" or "accredited" investors do not. Alternatively, regulators might allow people to be "accredited" if they have satisfied professional exams, invested already in unlisted investments, worked in financial services, or can otherwise demonstrate knowledge and expertise.

The debate is thus about where to draw the line: what hurdle must an investor clear to be classified as "accredited"? Politicians and regulators have often considered whether to *raise* the threshold requirements in order to be considered an "accredited" or "sophisticated" or "wholesale" investor in order to protect investors from risky investments, or unscrupulous managers.[1] Typically, the discussion involves whether to raise the wealth or income requirement necessary to be considered "sophisticated" or "accredited". For example, the US increased the wealth threshold in 2011 by excluding individuals' primary residence from their wealth-level. Australia has considered raising the "accredited" investor hurdle (Parliamentary Joint Committee on Corporations and Financial Services, 2024), with the Australian Securities and Investment Commission recommending a significant increase in the level of assets and income so required (Australian Securities and Investment Commission, 2024).

The UK offers a cautionary tale about changing the "accredited" investor threshold. The UK aimed to do so in 2024. The UK moved to increase the income threshold to qualify as an accredited investor from GBP 100,000 to GBP 170,000 and increase the net assets threshold from GBP 250,000 to GBP 430,000.[2] However, there was significant backlash: nearly 3000 signatories signed an open letter under the banner of the "Startup Coalition" to resist the changes

[1]See for example the documented changes in the US in Ivanov (2023).

[2]See The Financial Services and Markets Act 2000 (Financial Promotion) (Amendment) (No. 2) Order 2023.

(Startup Coalition, 2024). Key concerns included that it would reduce the number of angel investors, thereby reducing startups' access to funding. Concerns also mounted that the increased income and wealth requirements would disproportionately impact part time workers, carers, and women (Prevett, 2024). Indeed, it quickly emerged that the costs of the changes outweighed the purported benefits and the government reversed the increases 2 months after they came into force.[3] The reason for the reversal being that investors disliked the reduction in choice, investees suffered a reduction in funding, and the alleged benefits to investor protection were not made out.

The empirical evidence suggests that there is little benefit to restricting raising the "accredited investor" wealth or income requirement. Xu (2023) examined such moves in the US in 2011. The empirical evidence in Xu (2023) suggests that such moves could be counter-productive, especially in regional areas. Raising the "accredited" investor bar, would reduce the number of potential startup investors, thereby creating capital rationing. This is especially harmful in areas that already had difficulty attracting investors, which includes regional and rural locations.

This article considers the extant "accredited" investor thresholds and analyses whether the thresholds should be changed. The article focuses on three main economies: the US, UK, and Australia. These countries have similar legal systems and similar investment and innovation objectives. The article analyses whether moves to alter the thresholds could be beneficial given the need to balance investor protection with investor choice and capital availability.

The article highlights that the financial thresholds are a blunt instrument and should be amended, and that education or experience thresholds could be beneficial. The article highlights that financial thresholds deprive knowledge-rich, but cash-poor, investors the ability to invest. This especially impacts early career investors. It also harms relationship-partners who might have skills, knowledge, and expertise, but have elected to reduce their work-hours for family reasons, inter alia. Given that women statistically are more likely to sacrifice career for family, the financial thresholds can exacerbate gender inequality. The article further highlights that satisfying a wealth or income threshold need not connote financial knowledge, rendering it a poor mechanism through which to protect investors.

This article also argues that there should be multiple ways of proving that an individual satisfies the criteria to be an accredited investor and that self-certification should be considered. Accountants are reportedly reticent to bear the legal liability of certifying an individual's wealth or income, lest it be inferred they are certifying that an investment-type is suitable for an investor, which could entail additional legal risk (Chartered Accountants Australia and New Zealand et al, 2024). Similarly, financial services firms are reluctant to certify that investors are experienced, or knowledgeable, enough for an investment as it exposes them to legal and reputational risk (Australian Law Reform Commission, 2024). Thus, from a practical standpoint, self-certification warrants consideration. Further, certain qualifications or experience types should be per se evidence of knowledge so as to quickly qualify an investor and avoid the need for subjective value-judgements.

The remainder of this article proceeds as follows. Section 2 outlines the "accredited" investor tests in the US, Australia and the UK. The article next covers the policy purpose behind the tests in Section 3. Section 4 then discusses the two limbs of a potential test: (a) income and assets, and (b) knowledge and experience. Section 6 discusses the issue of who decides or determines whether an investor is "accredited", "sophisticated" or "wholesale". Section 7 concludes.

[3]See: The Financial Services and Markets Act 2000 (Financial Promotion) (Amendment and Transitional Provision) Order 2024.

2 | THE "ACCREDITED" INVESTOR TESTS

Myriad countries restrict specific investments to so-called "accredited" investors. The thresholds differ across countries. To become an "accredited" investor, investors typically must meet income, wealth, or education thresholds. The precise level varies across country. Similarly, there is variance in whether jointly held assets can satisfy the test and whether education or experience can qualify an investor as accredited. Typically, investors must meet one of the income, wealth, or experience criteria. They need not meet all of them to be classified as an accredited investor. For example, in the US, an investor can be "accredited" if he/she earns more than USD 200,000 even if his/her net wealth is below USD 1 million.

The jurisdictions have different proof-requirements. In Australia, the burden of proving that an investor is sophisticated typically lies with the investment entity rather than with the investor should the entity be questioned. Thus, in Australia, entities typically require investors to obtain an accountant's certification that they meet the income or wealth thresholds. Neither the US nor UK require accountant certificates and both permit self-certification. However, in all cases, the investment vehicle would be prudent to verify the information provided in order to reduce their legal risk.

The thresholds have changed over time. In 2011, the US changed the wealth requirements so the family home was excluded from the investor's net worth. In 2024, the UK moved to increase the income and net worth requirements. The changes would have increased the income requirement from GBP 100,000 to GBP 170,000 and the wealth requirement from GBP 250,000 to GBP 430,000. However, as indicated, the UK reversed the changes 2 months after they came into force. The current sophisticated or accredited investor tests are in Table 1.

3 | THE POLICY PURPOSE: BALANCING ACCESS, PROTECTION, AND ENTREPRENEURSHIP

The "accredited" and "wholesale" investor tests attempt to balance several policy goals. In most jurisdictions, only "accredited" investors can invest in startups as angel investors or in "wholesale" or "accredited investor" funds. In all cases, "accredited" investors typically receive less voluminous disclosure, and "accredited" investments typically have lower regulatory burdens. There are several competing policy goals.

The tests and restrictions aim to protect investors from risky or illiquid investments. The tests aim to ensure that investors have the necessary skills, experience, or knowledge to make fully involved investment decisions. This is important because the "wholesale" style investments that are open to accredited investors might be risker, or more difficult to liquidate, as is the case with startup investments. The policy assumption is that wealthier investors can bear the loss or illiquidity from such investments.

The tests aim to balance investor protection against investor access. This itself is due to the fact that not all investments, or fund managers, can afford to meet onerous disclosure requirements. Focusing on startups, if a startup must go through a public offering process, as opposed to raising from angels, it bears onerous costs.[4] These costs include the costs associated with creating a form of prospectus, marketing, and distribution fees. The platform fees are also unattractive to investors, who realise that their investment dollars will not all go to the startup and who must often also bear annual fees and/or performance fees. Thus, given startups' scarce resources, a public offering to all investors (cf. accredited investors) is sub-optimal.

[4]For an analysis of equity crowdfunding see: Mochkabadi and Volkmann (2020), Blaseg et al. (2020), Johan and Reardon (2024).

TABLE 1 Sophisticated and Accredited Investor Tests.

	USA[a]	Australia[b]	UK[c]
Wealth and income thresholds			
Income	USD 200,000	AUD 250,000	GBP 100,000
Joint income (with spouse)	USD 300,000	N/A	N/A
Net Worth	USD 1,000,000, excluding primary residence	AUD 2,500,000	GBP 250,000, excluding primary residence and pension
Net Worth (with spouse)	USD 1,000,000	N/A	N/A
Experience and education thresholds			
Company directorships	Director or officer of the issuer of the securities in question.	Not explicitly noted. But, they can be an evidentiary basis for being able to invest.	Director of a company with at least GBP 1,000,000 turnover over the past two years
Investor networks	N/A	Can invest if an Australian Financial Services Licensee is satisfied "on reasonable grounds" that the investor is able to evaluate the merits of the offer, value of the securities, risks involved, their own information requirements, and the sufficiency of the information provided.	Been a member of an angel network or syndicate for at least six months
Prior unlisted investment	N/A		Made at least two investments in unlisted entities in the past two years.
Finance employees and workers	Knowledgeable employees of the issuer private fund		Have worked in a financial services company for the past two years.
Licences and education	Applies for people who have passed some exams/obtained certifications, such as Series 7, Series 65, and Series 82.		N/A

[a]See Securities Act of 1933, Title 17, Chapter II, Part 230, § 230.501, available here: https://www.ecfr.gov/current/title-17/chapter-II/part-230#230.501. The US rules have changed over time. For example, amendments in 2011 excluded the family home from the net assets test. Conversely, amendments in 2020 allowed people who had passed exams to qualify as sufficiently knowledgeable. A useful discussion of the history of US rules is here: Ivanov (2023, n 2).

[b]Corporations Act 2001 (Cth) Section 708 (for offers of securities), and Sections 761G, 761GA (for financial products and services).

[c]See The Financial Services and Markets Act 2000 (Financial Promotion) (Amendment and Transitional Provision) Order 2024, available here: https://www.legislation.gov.uk/uksi/2024/301/pdfs/uksi_20240301_en.pdf.

The "accredited" investor tests also aim to balance restrictions with the benefits startups might get from "accredited" or "angel" investor. Angel investors include industry experts with knowledge and experience in startups' specific industry, business operations, fund raising, law/intellectual property, and capital management. These investors aim to contribute this knowledge and expertise to the startup, sometimes doing so altruistically and in a manner disproportionate to their actual investment amount (cf. passive investors).[5] This knowledge and expertise can help startups develop, thereby generating innovation and new business creation.

[5]See for example the discussion in Green (2024).

The "accredited" investor category also enables access to fund managers and fosters a thriving fund management ecosystem. Many funds start as startups and fund managers start as entrepreneurs. In the initial years, funds typically do not generate significant cash flow until they amass sufficient funds under management. Thus, increasing regulatory costs raises the hurdle to commencing a nascent fund. This is a problem as it locks fund managers into a smaller pool of entrenched corporations and prevents them establishing their own fund management entity. That outcome would undermine competition, resulting in higher fees and worse performance. Thus, to enable talented managers to establish funds and foster competition, regulators also allow funds to satisfy less onerous disclosure requirements if they only raise funds from "accredited" investors. The policy purpose here is to both increase competition in the financial services sector and to enable entrepreneurs in the sector to establish new businesses.

The "accredited" investor should also be mindful of startups' need to access expertise. The tests come in two major forms: income and net worth, and experience and education. The assumption is that people who satisfy these criteria can either evaluate for themselves whether an investment is worthwhile, can hire someone to do so, or are wealthy enough to withstand illiquidity and losses.

4 | INCOME AND ASSETS TESTS

The "accredited" and "sophisticated" investor tests contain an income, or net worth, threshold. The precise level of the threshold varies across jurisdiction. Similarly, there are variations in whether the threshold includes the family home and whether partners can pool their assets for the purpose of the test. However, the income test is most frequently used. In some jurisdictions, such as Australia, a super-majority of investors qualify as "accredited" via their income rather than then net worth.[6] Further, where the financial position must be verified, it is typically easier to certify income from a tax return than to value the investors' entire unlisted portfolio.

There have been some changes over time in these thresholds. For example, the UK first increased the income requirement to GBP 170,000 from GBP 100,000 in 2023[7] before lowering it back to GBP 100,000 in 2024.[8] Similarly, in 2011, the US imposed the requirement that accredited investors must have a net worth of at least USD 1,000,000.[9] Australia has considered whether to increase its income-threshold, undertaking a review in 2024.

The financial thresholds attempt to protect investors from unscrupulous financial products, or from taking excessive risks. The financial requirements are premised on several underlying assumptions. First, a wealthy individual can more "afford" to lose their capital. Thus, they do not need as much investor protection. Second, a wealthy individual might have amassed some level of investment or business experience; and thus, they can evaluate financial products and investments better. Therefore, they do not need the same depth of disclosure as to other investors.

There are some downsides associated with imposing such a wealth threshold. The empirical evidence shows that increasing the thresholds can have a negative impact. In 2011, the SEC in the United States tightened its equivalent of the "wholesale investor" test by removing the

[6]Aussie Angels – an Angel Investor platform – estimates that 70% of its 1500 Angel Investors qualify via the income test: Mack (2024).

[7]See The Financial Services and Markets Act 2000 (Financial Promotion) (Amendment) (No. 2) Order 2023, available here: https://www.legislation.gov.uk/uksi/2023/1411/pdfs/uksi_20231411_en.pdf.

[8]See The Financial Services and Markets Act 2000 (Financial Promotion) (Amendment and Transitional Provision) Order 2024, available here: https://www.legislation.gov.uk/uksi/2024/301/pdfs/uksi_20240301_en.pdf.

[9]See the rule here: https://www.sec.gov/files/rules/final/2011/33-9287.pdf.

family home when assessing the person's net worth. In so doing, it significantly reduced the number of potential angel investors.

After the regulation change, cities that were the most impacted exhibited a significant drop in angel investment, entrepreneurship, innovation, employment, and sales (Xu, 2023). Companies then started to rely on loans in lieu of angel investment. Given that loans are often not forthcoming, or rely on founders' own collateral, this worsens the capital gap that many nascent companies face. Further, there was a significant reduction in new business creation, startup formation, startup employment, and salaries in the startup and highly skilled sectors (Lindsey & Stein, 2019).

The relative impact was larger in regional areas, and areas that had the greatest relative impact from the law (Xu, 2023). This is because: (i) there were fewer potential angel investors in regional areas to begin with under the old rules; (ii) even fewer potential angels qualified under the new rules due to the property dynamics in regional areas; and (iii) reducing the number of potential angels caused regional areas to lack the critical mass to form investor groups.

The change's impact was thus greater in areas that already struggled to attract capital. In major cities, Venture Capital (VC) funds or a small pool of very high net worth individuals can still fund startups, albeit at a lower aggregate level. However, outside of those hubs, capital rationing ensues given the low number of sufficiently wealthy individuals with expertise. In Australia, for example, this would especially impact regional areas, which in turn could harm Australia's AgTech sector.

Startups also face indirect costs from curtailing investor access. Angel investors bring skills, expertise, and advice.[10] This is especially so for early stage companies. Angel investors are not simply "passive" or "stupid" money. Rather, angels often are successful in business, law, finance, or science. Thus, they can help companies succeed. Gatekeeping angel investing risks denying startups access to that expertise.

The focus on "wealth" can be misleading. Myriad wealthy people have inherited money, or profited from property.[11] This might mean that they can "afford" to lose money. But, we should not encourage people to fritter away money merely because they can "afford" to. Conversely, myriad early career people have vital skills and expertise but relatively little wealth. We should not deny startups that knowledge base.

The income and assets tests also exacerbate inequalities. For example, in Australia, an income level of AUD 250,000 places an individual's earnings in the top 20% of Australians, according to the Australian Bureau of Statistics. The test also does not consider the investor's free cash flow or disposable income. It does not consider cash remaining after satisfying debts and necessary obligations. Rather, it considers gross income. Similarly, an assets level of AUD 2.5 million is in the top 20%. These are aspirational income and assets levels towards which people could strive. However, if some of the higher quality investments are "gate kept" from people in the bottom 80% of the wealth pool, it can exacerbate inequality. This issue magnifies if the threshold increases.

The income and assets tests can also penalise people who are returning to work, who work part time, or who have assumed caring responsibilities. Such individuals can have skills and expertise to contribute. Such investors might also have the necessary acumen and knowledge to analyse investments. Therefore, the income and assets test is a blunt tool to

[10] There is anecdotal, and empirical, evidence that angel investors aim to contribute to their startups: Madill (2005). However, despite contributing to startups, there is still a high failure rate in angel-backed companies. Angel investors often back companies at an earlier stage than VC funds. Angel investors might also be less skilled at, or discerning when, selecting startups. Thus, angel-backed companies need not have a higher success rate than non-angel VC-backed companies: Cumming and Zhang (2019).

[11] See for example the note on the role of growing property prices in Bunter (2024).

achieve the investor protection policy threshold in these circumstances. Some policy solutions to such an issue include allowing domestic partners to pool income of assets towards meeting the threshold, allowing people to meet the threshold over a proportion of recent years (rather than all of them),[12] or allowing lower income thresholds for part time workers.

The policy purpose of investor protection is thus not well served by imposing such high thresholds. Indeed, income thresholds need not properly protect investors. Further, they also deny startups access to valuable expertise and capital. This is especially the case for startups in areas that already face capital rationing. Thus, a low-bar income threshold can be beneficial.

5 | EXPERIENCED AND KNOWLEDGE INVESTOR TESTS

The “wholesale”, “accredited” and “sophisticated” investor tests also enable investors to qualify if they meet certain education requirements. The thresholds differ across country and have changed over time. For example, in 2020, the SEC amended rule 501 to enable people with certain qualifications to qualify as accredited investors.[13] The “experience” and “knowledge” pathways are important but involve challenges.

Individuals who have undertaken these qualifications are well placed to both evaluate investments and contribute to the investment, where appropriate. Degrees and courses can provide the necessary background to understand the risks associated with products. Similarly, an individual with a deep business knowledge can impart that knowledge to portfolio companies if they are angel investors and can help to support a more vibrant and innovative finance and startup ecosystem. Therefore, if the policy purpose behind the wholesale investor test is to protect investors, then an educational pathway towards being recognised as a wholesale investor is appropriate.

The main challenge to satisfying the education or experience requirement is being able to *prove* the requisite education. The UK permits self-certification.[14] This can enable individuals to lie about their level of experience in order to access investments. The concern is that an individual might be presented with a superficially attractive opportunity for which there is limited information or disclosure, and which presents significant risk. The individual, who might in reality lack financial education or experience, could then be induced to pretend that they have it. However, self-certification does open investments to people who have significant experience, but who might not have formal education, or who might not have undertaken time-consuming licensing examinations.

The US only permits education and experience to satisfy the test in limited circumstances. In this context, it has largely limited the education pathway to people who have passed specific regulated exams or who hold specific regulated licences. Specifically, the US Securities and Exchange Commission (SEC) has the power to designate specific qualifications or licences as satisfying the accredited investor test. For example, the SEC has so approved specific regulated exams, such as having a Series 7, Series 65, or Series 82 licence. While the SEC *could* expand the set of licences or certifications it recognises for these purposes, it has stopped

[12]See the proposal to allow people to meet the threshold in two of the prior 4 years in Mack (2024, n 18).

[13]The amendment is available here: https://www.sec.gov/files/rules/final/2020/33-10824.pdf. The final rule is available here: See Securities Act of 1933, Title 17, Chapter II, Part 230, § 230.501, available here: https://www.ecfr.gov/current/title-17/chapter-II/part-230#230.501.

[14]See for example Schedules 1 and 2 of The Financial Services and Markets Act 2000 (Financial Promotion) (Amendment and Transitional Provision) Order 2024, available here: https://www.legislation.gov.uk/uksi/2024/301/pdfs/uksi_20240301_en.pdf.

short of recognising university qualifications, for example. Further, the US does not permit self-certification.

Australia does not permit self-certification and leaves it to the relevant Financial Services Licensee to determine whether the person satisfies the experience or education tests. Here, the licensee must be "satisfied on reasonable grounds" that the individual has sufficient "previous experience" to enable them to understand the merits of the offer, the value of the securities, the risks of the offer, their own information needs, and whether the information provided is sufficient.[15] In practice, this can be challenging. It shifts the risk of certifying whether an individual is "experienced" onto the financial services licensee. Thus, it exposes the licensee to the risk that investors with buyer's remorse might seek recompense should an investment underperform by claiming that the licensee should not have originally certified them as "experienced". Thus, it raises the concern that genuinely experienced investors might nevertheless be denied access to investments because licensees do not want to take the risk of certifying them.

The issue is then how to enable investors to access "sophisticated" offerings while ensuring investors are aware of the risks involved. The goal is to reduce the risk that people invest in products or securities when they should not, while also reducing the concern that people cannot invest in products or securities when they should be able to do so. Logically, the approach should: (i) have at least clear metrics or criteria that can be satisfied without further assessment or a value-judgement; (ii) not shift the risk to the financial service provider (lest it simply refuse to take that risk and the system becomes ineffective); and (iii) reduce the risk that inexperienced or unknowledgeable people invest in inappropriate securities.

Accredited education programs could be one way to verify an investor as suitably knowledgeable or experienced. However, not all jurisdictions recognise educational qualifications. The US recognises the passing of specific exams. But, it does not recognise completing specific degrees, micro-credentials, or qualifications. The UK does not directly recognise educational qualifications, only indirectly doing so via peoples' subsequent work experience. Australia does provide an educational pathway. However, it requires that the relevant financial services licensee determine, on reasonable grounds, that the investor is able to evaluate the merits of the offer, value of the securities, risks involved, their own information requirements, and the sufficiency of the information provided.

Educational programs create some challenges when used to classify investors as "sophisticated" or "accredited". The key issues are which programs, and providers, would enable investors to satisfy the education requirement. One option is to require investors to pass professional exams, such as the US Series 7, 65, or 82 exams, as is the case under the SEC rules. However, such an approach ignores the role of other educational programs in upskilling investors and is prescriptive. Therefore, regulators could also approve additional courses that they deem to provide an adequate educational background. However, this would not fully capture ad hoc, or experiential, learning.

Educational pathways could be both formal and informal. These include both university programs and non-university programs, and they include degrees and non-degree offerings. University programs, such as finance degrees, or angel investor courses, can upskill individuals. Similarly, Chartered Financial Analyst (CFA), Chartered Accounting (CA) and Chartered Alternative Investment Analyst (CAIA) involve investment-related education and exams. Some investor groups have also created investor-education programs. Examples include the AirTree Explorer program (2024), Startmate First Believers Program (2024), and Sydney Angels (2024) educational program.

The wholesale investor test could be refined to systematise educational approvals. This can include continuing professional education (CPE) and course registers. It can involve course accreditation. It can involve a recognised way to approve individuals as relevantly experienced

[15]Corporations Act 2001 (Cth) Section 708 (10).

and knowledgeable. This both enables prospective investors to know the types of fundamental skills they should amass and enables investment administrators to allow "experienced" investors with safety and without the litigation or administrative risk that is inherent in the current system where the vagueness allows an investor with buyers' remorse to disingenuously claim that they were wrongly permitted to invest.

Individuals with significant investment experience should presumably be more able to qualify as "accredited" investors. However, experience is not always recognised. The UK permits investors to qualify as "accredited" through a broad range of experience types. These include membership of an angel investor group, making investments in unlisted entities, or being a director of a company with at least GBP 1 million turnover. The UK allows people to self-certify. The US has limited such pathways. Australia does allow financial services providers to consider an investor's experience when determining whether they are sufficiently "sophisticated". However, the Australian test places the risk and liability of making the determination on to the financial services providers, which deters them from doing so.

6 | WHO DECIDES?

Underlying all discretionary investor tests is the question of who determines whether an investor is "accredited". If investors self-certify, are there any checks? In which case, are financial service providers still expected to verify the person's income and experience? Or, if third parties check income, net worth, and experience, where does the liability fall?

Certification is possible, albeit fraught, when it relates to income and net worth. For the income and assets tests, regulators could either allow people to self-certify (as in the UK) or could require a third-party certificate (as in Australia, where people must adduce a certificate from an accountant verifying their income or assets). The issue with self-certification is that people could lie. The issue with accountant-certification is that either: (i) unscrupulous accountants might be induced to provide certificates that falsely certify a person's income: or (ii) it places additional obligations and liabilities onto accountants that do not want them. Indeed, there are concerns that accountants might be perceived as making a value judgement about whether wholesale (i.e., unlisted) investments are suitable for a client even if they are just certifying their income. Thus, the Chartered Accountants of Australia and New Zealand and CPA Australia (2024) have pushed to *not* be involved in certifying income and assets.

Certification in relation to education and experience is more challenging. The UK allows people to self-certify their educational experience. The US requires people to pass exams. Australia allows the licensee to determine whether they are satisfied "on reasonable grounds" that the investor is able to evaluate the merits of the offer, value of the securities, risks involved, their own information requirements, and the sufficiency of the information provided. Self-certification faces the risk that people who are eager to invest in a product, or who have been induced to do so, might falsely claim to be experienced. However, Australia's approach shifts the risk to the licensee. Reportedly, in practice, this leads to the fear that a disgruntled investor might allege the licensee inappropriately certified them. The licensee would then feel pressured to settle with the investor in order to avoid bad publicity, even if the licensee had not otherwise erred. Thus, the Australian Law Reform Commission (2024,) asserts that, in practice, licensees are reticent to certify investors.

7 | CONCLUSION

Regulators often try to balance the competing priorities of investor protection, investor access, and costs. The "accredited investor" threshold is one attempt to do so. In most jurisdictions, certain financial products, or investments, are only available to "accredited investors". Typically, those investment-categories fall into two categories. First, they include investments that are seen as higher risk or illiquid, including investments in startups. Second, they include financial products for which disclosure is more parsimonious. This latter category is attractive to fund managers as the streamlined disclosure and regulation significantly reduces costs. In so doing, it enables the fund manager to startup a company, charge lower fees, and attract capital from more risk tolerant or experienced investors.

This article outlines the two main avenues to differentiate "accredited" investors from ordinary or "retail" investors. First, regulators might screen people based on their income or net worth. There are various versions of such a screen, including whether to allow family income or asset pooling and whether to include (or exclude) the primary residence from the asset pool. Second, regulators might allow people to qualify via education or experience. Such qualification pathways can include professional exams, clearly demonstrated work experience, or experience investing.

The regulations also have several ways of verifying whether an individual satisfies the requirements to be "accredited". The UK allows people to self-certify their income and/or assets. By contrast, Australia requires people to obtain a certificate from a licensed accountant. In relation to education, the US requires people to pass professional exams. The UK allows self-certification. Australia requires the financial services provider to determine "on reasonable grounds" whether a person has the relevant experience and knowledge.

This article outlines the arguments for and against various models. Regulators must balance the tradeoffs between permissive and restrictive policy approaches. This article argues that the emphasis should be on education and experience. This is because knowledge-rich, but asset-poor, people might still be able to evaluate opportunities and contribute their skills and expertise to startups, in which only "accredited" investors can invest. The article suggests that self-certification can be an efficient approach, especially given that accountants and financial services providers are reportedly reticent to assume the liability of such certification. Additionally, it is advisable to provide clear objective guidelines in relation to the types of education and experience that could qualify people. This includes university study, continuing education, and work experience. But, in so doing, regulators should avoid being unduly prescriptive.

DATA AVAILABILITY STATEMENT

There is no data in the article.

ORCID

Mark Humphery-Jenner https://orcid.org/0000-0002-0541-1541

REFERENCES

Airtree. (2024) Explorer program. Available from: https://www.airtree.vc/explorer-program [Accessed 17th September 2024].

Australian Law Reform Commission. (2024) Inquiry into wholesale investor and wholesale client tests. Available from: Submission to the Parliamentary Joint Committee on Corporations and Financial Services https://www.aph.gov.au/DocumentStore.ashx?id=bd8b7ec4-6749-41db-8b0d-7a7eb75acc4b&subId=756462 [Accessed 6th October 2024].

Australian Securities and Investment Commission. (2024) Submission to the wholesale investor and wholesale client tests inquiry. Available from: https://www.aph.gov.au/DocumentStore.ashx?id=2a67ee35-69d6-433d-85a8-61ad90638fe4&subId=756943 [Accessed 8th October 2024].

Blaseg, D., Cumming, D. & Koetter, M. (2020) Equity crowdfunding: high-quality or low-quality entrepreneurs? *Entrepreneurship Theory and Practice*, 45, 505.

Bunter, A. (2024) Submission to the wholesale investor and wholesale client tests inquiry. Available from: https://www.aph.gov.au/DocumentStore.ashx?id=bc27da87-b8ae-4689-ad15-9ac526883f5f&subId=756502 [Accessed 10th October 2024].

Chartered Accountants Australia and New Zealand, CPA Australia, Institute of Public Accountants, and SMSF Association. (2024) Wholesale investor and wholesale client tests. Submission to the Parliamentary Joint

Committee on Corporations and Financial Services. Available from: https://www.aph.gov.au/DocumentStore.ashx?id=44448215-30e4-4e28-b65d-2f0835893596&subId=756929 [Accessed 6th October 2024].

Cumming, D. & Zhang, M. (2019) Angel investors around the world. *Journal of International Business Studies*, 50, 692.

Green, J. (2024) Submission to the Wholesale Investor and Wholesale Client Tests Inquiry. Available from: https://www.aph.gov.au/DocumentStore.ashx?id=a18a4e7c-3564-4340-9e82-55bb46f993e3&subId=756524 [Accessed 10th October 2024].

Ivanov, V.I. (2023) Recent changes to the regulatory framework for the private capital market. *Journal of Corporate Finance*, 81, 102427.

Johan, S. & Reardon, R.S. (2024) The role of platform stakes in equity crowdfunding success. *Finance Research Letters*, 69, 106097.

Lindsey, L.A. & Stein, L.C. (2019) Angels, entrepreneurship, and employment dynamics: evidence from investor accreditation rules. Working Paper. Available from: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2939994 [Accessed 8th October 2024].

Mack, C. (2024) *Submission to the wholesale investor and wholesale client tests inquiry*. Aussie Angels. Available from: https://www.aph.gov.au/DocumentStore.ashx?id=380a6eaa-3ba3-46b3-ae13-213d3a3c6f61&subId=756491 [Accessed 10th October 2024].

Madill, J.J. (2005) The role of angels in technology SMEs: a link to venture capital. *Venture Capital*, 7, 107.

Mochkabadi, K. & Volkmann, C.K. (2020) Equity crowdfunding: a systematic review of the literature. *Small Business Economics*, 54, 75.

cParliamentary Joint Committee on Corporations and Financial Services. (2024) Wholesale investor and wholesale client tests inquiry: terms of reference. Available from: https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Wholesaleinvestor/Terms_of_Reference [Accessed 8th October 2024].

Prevett, H. (2024) Female "angels" have their wings clipped. *The Times*. Available from: https://www.thetimes.com/business-money/entrepreneurs/article/female-angels-investors-have-wings-clipped-enterprise-network-2rcvfq0kb [Accessed 14th October 2024].

Startmate. (2024) First believers. Available from: https://www.startmate.com/c9-first-believers [Accessed 17th September 2024].

Startup Coalition. (2024) An open letter to the chancellor. Available from: https://www.angels-letter.com/ [Accessed 14th October 2024].

Sydney Angels. (2024) Submission to: review of the regulatory framework for managed investment schemes. Treasury Submission. Available from: https://treasury.gov.au/sites/default/files/2024-02/c2023-404702-sydney-angels.pdf [Accessed 17th September 2024].

Xu, J. (2023) Is there a trade-off between protecting investors and promoting entrepreneurial activity? Evidence from angel financing. *Journal of Financial and Quantitative Analysis*, 58, 3305.

How to cite this article: Humphery-Jenner, M. (2024) Accredited investor tests: How to balance, access, entrepreneurial funding, and investor protection? *Accounting & Finance*, 00, 1–12. Available from: https://doi.org/10.1111/acfi.13366