The Perfect Union: An Expansion of the Accredited Investor Definition and Potential Impacts on the Emergent Tokenized Real Estate Market

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ABSTRACT: While investment opportunities in publicly offered and traded companies continue to present great access to the financial markets for a wide array of investors, private, exempt offerings increasingly play a greater role in the overall investing landscape. These private offerings, however, are typically only available to a select group of individuals and investment firms known as "accredited investors." In August of 2020, the SEC adopted changes to the accredited investor definition in an attempt to modernize the definition and present occasion for greater capital formation. The basis for creating a distinction between accredited and unaccredited investors is rooted in a regulatory tradition that seeks to protect some investors from potentially dangerous investment vehicles, in the hope that such an oversight scheme can lead to more efficient and stable markets. In doing so, however, large portions of Americans are prevented from investing in a growing number of offerings that often represent dramatically positive asymmetric return opportunities. The newly revised definition indicates a positive step in the right direction but does not go far enough to achieve its goals, ultimately continuing to disallow many adequately sophisticated individual investors from a chance at participation in the exempt offering market. This Note offers several reasons the newly amended definition falls short and presents several additional means by which an individual investor can attain accredited status. This Note emphasizes that such changes would have the greatest impact in geographic areas with less available capital, particularly in product markets that are niche or growing. This Note closes by examining a burgeoning market, tokenized real estate, as a proxy for explaining some of the economic and financial benefits of an expanded "accredited" definition for both offerors and potential investors.

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I. Introduction

The American financial system has a long track record of being a bedrock of the international economy. Indeed, the early twentieth century saw the United States successfully leverage a multitude of factors—including the physical resources of the nation, the role of the country as an underwriter for war debts accrued by European factions involved in World War I, and lax regulatory regimes that encouraged rapid and efficient capital accumulation—to become the world's preeminent global financial power. Although this financial power has ebbed and flowed over time, bureaucrats and administrative leaders in Washington, D.C. continue to be critical players in most international financial decisions.

In large part, the American government controls domestic—and, through the strength of the U.S. dollar and the importance of American stock markets abroad, international—financial decisions through statutorily created and administratively configured bodies, namely the Federal Reserve and the Securities and Exchange Commission ("SEC"). The government has granted these administrative bodies broad oversight to respond to changing ideological, economic, and technological standards within financial markets.

In particular, this Note focuses on the ability of the SEC to control how potential investment opportunities are marketed to the public and who may invest in these opportunities. Companies, intermediaries, or individuals may offer securities in either public or private offerings depending on how the securities are registered with the SEC, who the target of the offering is, and how the offering is advertised.[1] Historically, both courts and the SEC struggled to provide offerors and offerees bright-line rules by which all parties involved in any given offering could make practical and informed decisions about the

1. *See infra* Section II.B.

kind of investments they wished to partake in.[2] The introduction of the "accredited investor" helped elucidate many of the questions that courts, offerors, and offerees had regarding what constituted a private offering and who was allowed to participate in one.[3]

The definition of the accredited investor remained largely unchanged for forty years. However, in August 2020, the SEC formally adopted amendments to the definition in an attempt "to update and improve the definition to identify more effectively investors that have sufficient knowledge and expertise to participate in [qualifying] investment opportunities."[4] The new accredited investor definition remedies many of the issues that the previous definition had.[5] Specifically, the new definition seeks to create a broader pool of potential accredited investors, establish more efficient means to achieve capital formation, and encourage more liquidity for qualified exempt offerings.[6] That said, there still remains more that the SEC can do to the definition to achieve these stated goals.

In addition to the change in the accredited investor definition, the SEC has found itself deeply preoccupied with a new form of technology. Blockchain services and platforms—which for all intents and purposes still remain on the periphery of everyday financial life—have found a footing in a variety of markets. Blockchains, first conceptualized in the 1980s and 1990s,[7] offer the possibility of trustless, distributed, and verifiable networks that are applicable over a large range of different domains. Of particular importance, the use of blockchains is slowly entering sectors that previously operated without them.[8] These sectors—including tokenized real estate, one of the focuses of this Note—offer fantastic investment opportunities as they grow and rapidly evolve, but initial participation in them is often limited to the accredited investor class.[9]

This Note argues that the SEC did not go far enough in implementing changes to the accredited investor definition, especially as to the individual

2. *See infra* Sections II.A–.B.

3. *See infra* Section II.B.

4. Accredited Investor Definition, Securities Act Release No. 33-10824, Exchange Act Release No. 34-89669, 85 Fed. Reg. 64,234, 64,234 (Oct. 9, 2020) (codified at 17 C.F.R. 230, 240) [hereinafter Final Rule].

5. *See infra* Section II.B.

6. Final Rule, *supra* note 4, at 64, 264–66.

7. *See generally* David Lee Chaum, Computer Systems Established, Maintained and Trusted by Mutually Suspicious Groups (1982) (Ph.D. dissertation, University of California, Berkeley), https://nakamotoinstitute.org/static/docs/computer-systems-by-mutually-suspicious-groups.pdf [https://perma.cc/J94A-6RT6] (arguing the need for a cryptographic system that could work to be trustable through trustless verification protocols); Stuart Haber & W. Scott Stornetta, *How to Time-Stamp a Digital Document*, 3 J. CRYPTOLOGY 99 (1991) (discussing the usage of interdependently verified time-stamps to confirm electronic transactions).

8. *See infra* notes 232–43 and accompanying text.

9. *See infra* Section IV.B.2.

investor. It provides a modified test for determining individual accreditation, as well as an example of a particular market in which a further expanded definition could drastically help both offerors and offerees in the capital formation process. The amended definition would include a downward adjustment to the current wealth and income thresholds for attaining accreditation. This adjustment would be based on the geography of the investor, a change that would hopefully qualify investors—and thereby encourage broader capital formation—in areas of the country that have relatively lower capital participation.[10] The amended definition would also expand the newly added sophistication requirements, as investor sophistication would be expanded to include investors that pass a centralized SEC aptitude examination in lieu of receiving FINRA certification.[11] Lastly, this Note argues that such changes would have their most drastic impacts on niche and emerging markets, allowing both investors and offerors in these sectors alike to gain and prosper.[12]

Part II offers background information regarding the role of the SEC in regulating public and private offerings, specifically through its accredited investor definition. In addition, Part II offers insight into the changes of that definition over time and the goals that the SEC sought to achieve by having a definition in the first place. Finally, Part II briefly explains the rise of crowdfunding as a vehicle for encouraging capital formation in private offerings, noting that such processes reflect how a further expanded accredited investor definition might operate.

Part III explains the amended SEC accredited investor definition and the reasoning behind the amendment. Part III emphasizes that, while the new definition is constructively expansive, it still does not go far enough in encouraging capital formation and broader investment participation.

Part IV argues several changes to the recently adopted accredited investor definition. Part IV concedes that such changes might result in some negative externalities and would almost certainly be slow to be adopted by the SEC. However, Part IV explains that expanding the accredited investor definition more could augment the stated desires of the SEC in its Final Ruling and that the risk of such expansions could be offset by other regulatory safeguards. Part IV next explains the impact that a further definitional change can have in niche or undercapitalized markets. Part IV concludes by using the tokenized real estate market as a proxy for supplementing the argument for further definitional expansion and identifies some economic feedback loops that would substantially magnify the positive impacts of the definitional expansion.

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10. *See infra* Section III.B.3.

11. *See infra* Sections IV.A.1–.3.

12. *See infra* Section IV.B.

II. HISTORICAL UNDERPINNINGS: TRADITIONAL CONCEPTUALIZATIONS OF INVESTOR PROTECTION, SOPHISTICATION, AND ADAPTIVE MODERN APPROACHES

To understand the recent changes to the accredited investor definition, it is important to review the accredited investor's historical definition and usage. Further, understanding how an expansion of the accredited investor definition could most positively impact niche, emerging markets—like the tokenized real estate market—is critical. Section II.A discusses the ambiguity in original investor protection case law and the need for an updated standard following several court cases. Section II.B explains the adoption of the accredited investor standard for exempt private offerings. Section II.C concludes by analyzing the relaxation on some of the previously strict standards related to private offering opportunities in the wake of the 2008–09 financial crisis.

A. *THE NEED FOR AN "ACCREDITED INVESTOR" DEFINITION*

Today's regulatory framework for both offerors and investors in the private markets has extensive historical antecedents deeply rooted in protectionism through disclosure. However, this was not always the case. In the United States, regulatory measures aimed at businesses and capital formation usually take time. In our capitalist society, debate continues as to the efficiency and effectiveness of government regulation of private enterprise.[13] Indeed, oftentimes truly impactful legislative and administrative measures are taken only after national crises expose issues rampant in the previous existent regulatory status quo.[14]

The "Roaring Twenties," and their 1929 denouement of catastrophic stock market and economy failure, represent one of these crises perfectly. The 1920s marked a decade of technological advancement, laissez-faire economics, and American geopolitical protectionism that allowed the U.S. stock market to rapidly expand. By September of 1929, the Dow Jones Industrial Average ("DJI") reached 381 points, a high watermark at the time and a figure that indicated a ten-fold return over the previous nine years.[15] However, like many historical "bubbles," the stock market soon outran economic realities. On October 24, 1929, infamously referred to as "Black Thursday," the DJI fell sharply, spooking institutional investors and banks.[16] Although the market stabilized for a short period, the weekend saw an immense amount of liquidations on overleveraged positions.[17] By the next week, a wave of margin

13. Harry M. Trebing, *Government Regulation and Modern Capitalism*, J. ECON. ISSUES, Mar. 1969, at 87, 89–91.

14. *See* Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1591–94 (2005).

15. BARRIE A. WIGMORE, THE CRASH AND ITS AFTERMATH: A HISTORY OF SECURITIES MARKETS IN THE UNITED STATES, 1929–1933, at 3–4 (1985).

16. *Id.* at 6–11.

17. *Id.* at 13.

calls created a cascade of panic that resulted in the DJI dropping nearly 20 percent in two days.[18] Unfortunately, such volatility also existed outside Wall Street. In fact, because of the ease by which small investors were able to participate in the stock market—and the fact they were able to use complicated instruments like margin accounts—millions felt the cataclysmic impact.[19]

In response to the crash, Congress passed the 1933 Securities Act ("1933 Act").[20] In a speech before the Bond Club of Philadelphia, Baldwin Bane, Chief of the Securities Division of the Federal Trade Commission, bluntly stated that the 1933 Act was "a program designed to eradicate some of the more apparent causes of [the] present [financial] conditions," and that the 1993 Act would aim to "2317acilit[e] disclosure to the investor of the elements necessary to insure an informed judgment by which he may be guided in deciding whether he will purchase a security."[21] The 1933 Act made sweeping changes, enabling the federal government to oversee the clearance and initial sale of publicly traded securities. It also granted them broad oversight into the public markets of most securities. Beyond the scope of the government's ability to oversee different kinds of securities offerings, the government also supplied an equally vast definition of what constituted a security in the first place.[22] In addition, firms of all kinds that wished to trade publicly had to provide information to both the government and potential investors in the forms of registration statements and prospectuses.[23]

However, in limited circumstances, the government allowed registration exemptions to securities offered in situations "where 'there [was] no practical need for [the 1933 Act's] application or where the public benefits [were] too remote.'"[24] When first passed, these exempted transactions included exemptions

18. *Id.* at 15.

19. *See* Richard Lambert, *Crashes, Bangs & Wallops*, FIN. TIMES (July 19, 2008, 3:00 PM), https://www.ft.com/content/3cc7b1b2-52f2-11dd-9ba7-000077b07658 [https://perma.cc/2W3B-6NVX] (stating that nearly two-thirds of the values of stocks owned by small investors were bought through loans, and that most of these stocks were already purchased on margin; these loans created extremely levered positions, positions not advisable, nor typical, to average retail investors).

20. *See* Baldwin B. Bane, Chief, Sec. Div. of the Fed. Trade Comm'n, Address of Baldwin B. Bane on the Securities Act of 1933 Before the Bond Club of Philadelphia 1 (Dec. 21, 1933), https://www.sec.gov/news/speech/1933/122133bane.pdf [https://perma.cc/7YV2-SEDK].

21. *Id.*

22. Securities Act of 1933, 15 U.S.C. § 77b(a)(1) (2018) (enumerating what is a security under the 1933 Act). The list includes over 20 kinds of financial instruments, essentially making the 1933 Act applicable to all financial strategies and instruments at the time. *Id.*

23. *Id.* §§ 77e–77f (explaining who could be contacted about a potential security buying opportunity and how they could be contacted, how a company goes about registering its offerings with the SEC, and what important information needs to be disclosed to the public and to the SEC before any offering is completed).

24. Syed Haq, *Revisiting the Accredited Investor Standard*, 5 MICH. BUS. & ENTREPRENEURIAL L. REV. 59, 61 (2016) (first alteration in original) (quoting H. R. REP. NO. 73–85, at 5 (1933)).

for "transactions by an issuer not involving any public offering."[25] The exact definition of these transactions was unclear on its face but indicated some kind of "private" offerings might be exempted from strict regulatory oversight.

The Supreme Court finally attempted to clarify the scope of private offerings nearly 20 years after the 1933 Act's passage in the seminal case *Securities and Exchange Commission v. Ralston Purina Co.*[26] Ralston Purina was a large Missouri-based animal feed and cereal company.[27] With facilities and distribution centers scattered across the United States and Canada, it boasted over 7,000 employees that were actively encouraged throughout the firm's history to purchase common shares of stock in the company.[28] The issue before the court was the fact that "[b]etween 1947 and 1951 . . . Ralston Purina sold nearly $2,000,000 of stock to employees without registration . . . ."[29] Before sale, Ralston Purina sent a memo to employees that stated " '[t]he only employees to whom this stock will be available will be those who take the initiative and are interested in buying stock at present market prices.' "[30] The firm sent the memo to numerous individuals, including a bakeshop foreman, a copywriter, a stenographer, and a veterinarian—hardly professionals who required advanced understandings of finance or securities, but whom the firm deemed "key employees."[31] Ralston Purina conceded that a security offering to employees outside this "key" demographic would be considered a public sale, but maintained that the offering was private due to the company's "key" classification and therefore exempt from registration requirements.[32]

Given the statutory ambiguity inherent in the exemption clause of the 1933 Act, the Court considered Ralston Purina's sale of securities in light of "the particular class of persons [that] need[ed] the protection of the Act."[33] The Court stated that to pass this test, Ralston Purina needed to show that the offering was intended for individuals "able to fend for themselves" and that, if the individuals involved indeed passed this test, the offering could be considered exempt.[34] The Court ultimately held that Ralston Purina's employees did not fit this mold[35]; however, the Court left the question open as

25. 15 U.S.C. § 77d(a)(2) (originally enacted as Securities Act of 1933, ch. 38, § 4, 48 Stat. 74, 77).

26. *See generally* Sec. & Exch. Comm'n v. Ralston Purina Co., 346 U.S. 119 (1953) (clarifying the scope of private offerings).

27. *Id.* at 120; *see also Ralston Purina Company*, BRITANNICA, https://www.britannica.com/topic/Ralston-Purina-Company [https://perma.cc/QU3B-AMLS] (identifying Ralston Purina as a Missouri-based company).

28. *Ralston Purina Co.*, 346 U.S. at 120–21.

29. *Id.* at 121.

30. *Id.*

31. *Id.*

32. *Id.* at 121–22.

33. *Id.* at 125.

34. *Id.*

35. *Id.* at 125–26

to whether or not offerings to certain employees with advanced, sophisticated knowledge, or the ability to withstand serious capital loss, could be exempt going forward.[36]

Multiple courts tried clarifying the questions left by *Ralston* in subsequent years, but ambiguity remained. One commentator stated that, following *Ralston*, "the trickle of judicial decisions [relating to private and exempt offerings] ha[d] expanded to a moderately heavy stream, particularly [in the] federal district courts."[37] Although tests and rulings varied, most courts agreed generally with the statement that "evidence of a high degree of business or legal sophistication on the part of all offerees" is a crucial question, though not the only one, to be asked in light of an alleged private offering.[38] However, because the classification of an exempt or nonexempt private offering largely hinged on the amorphous definition of "sophistication," there existed no bright-line rule regarding what constituted an exempt private offering. Despite the judicial gloss on the regulatory rule that had been passed two decades before, ambiguity remained in the wake of *Ralston*.

B. Regulatory Clarity: Regulation D Defines "Accredited Investor"

Uncertainty and doubt due to different jurisdictional rulings on exempt offerings continued clogging court dockets by forcing case-by-case scrutinization of both facts and court precedent.[39] However, as the American economic and financial systems continued to grow, and as exempt private offerings constituted some of the best opportunities to raise seed capital in the initial stages of business development (as long as they were not eventually mired in litigation), private offerings under the exemption in the 1933 Act continued to expand into the 1970s.[40] The SEC saw the need to remedy the ambiguities

36. *Id.* at 127.

37. Julian M. Meer, *The Private Offering Exemption Under the Federal Securities Act—A Study in Administrative and Judicial Contraction*, 20 SW. L.J. 503, 512 (1966).

38. Doran v. Petroleum Mgmt. Corp., 545 F.2d 893, 902 (5th Cir. 1977) (explaining that investor sophistication was certainly a large portion of the test to see whether an offer could be exempted or not). The Fifth Circuit also articulated that, tangential to investor sophistication, it was also necessary to investigate "the number of offerees and their relationship to each other and the issuer, the number of units offered, the size of the offering, and the manner of the offering." *Id.* at 900. *Doran* represented one of the earliest decided, and subsequently most cited, securities regulations cases before the passage of Regulation D.

39. *See* Meer, *supra* note 37, at 512–13 (explaining that absent any directive from administrative authorities, "[s]ome of the [court] decisions have held [perceived private and exempt] offerings [under *Ralston*'s reading] . . . to be non-exempt making reliance on the private-offering exemption in any transaction a calculated business risk at best").

40. *See* Mark A. Sargent, *The New Regulation D: Deregulation, Federalism and the Dynamics of Regulatory Reform*, 68 WASH. U. L.Q. 225, 274 (1990) (discussing how "[a] complex body of law and lore crystallized around investor suitability as financing," which in turn created an inherently difficult area of law to manage, one that was enticing to those wishing engage in capital formation precisely for the reason that it was so difficult to manage).

of *Ralston* and its progeny by attempting to define "sophistication" throughout the 1970s and 1980s.

In 1974 the SEC implemented Rule 146.[41] This Rule set out several steps to determine whether an offering was exempt. The SEC's main avenue to achieve this involved developing a (vague) formula with which to test investor sophistication in the context of the offering itself. First, the issuer of the offering needed to reasonably believe that the individual, or group of individuals, engaged in the offering was a "sophisticated" investor.[42] Such sophistication could be shown through "[e]ither wealth or knowledge."[43] Next, the issuer needed to maintain a reasonable belief that an investor could properly determine the risk of the offer at hand, or was capable of ascertaining the risks through a financial advisor.[44] Lastly, the investor needed to be given the kind of information that would normally be given in a registration statement or prospectus as proscribed in a public offering under the 1933 Act.[45]

On its face, these changes reinforced the general holding in *Ralston* and at least afforded some sort of regulatory clarity on what parameters constituted a private exempt offering. However, the same issues as before Rule 146's adoption persisted in the ongoing subjectivity regarding "sophistication." This continued to impose capital frictions on smaller offerors, discouraging them from attempting such offers in the first place.[46]

In 1980, the SEC put forth Rule 242, which attempted to clarify Rule 146. This rule acted as a precursor to the modern Regulation D and identified "specific classes of investors [who] were designated as accredited investors based on their ability to obtain information upon which to make an informed investment decision."[47] The new rule expanded the accredited investor

41. For a full reading of Rule 146, see Transactions by an Issuer Deemed Not to Involve Any Public Offering, Securities Act Release No. 33-5487, 39 Fed. Reg. 15,261, 15, 266–68 (May 2, 1974).

42. C. Edward Fletcher III, *Sophisticated Investors Under the Federal Securities Laws,* 1988 DUKE L.J. 1081, 1122.

43. *Id.* (emphasis omitted) (citing 17 C.F.R. § 230.146(d)(1) (1976), which was repealed and replaced by 17 C.F.R. § 230.506 (1988) and most recently codified, generally, in 17 C.F.R. § 230.500 (2021)).

44. *Id.* at 1122–23.

45. *Id.* at 1123. For a more complete overview of requirements of a registration statement and prospectus, see 17 C.F.R. §§ 230.400–.419 (2021).

46. Small businesses did not want to risk the possibility of financial penalty in the off chance they privately offered. This came about in large part due to the lack of a clear dollar demarcation or any licensing requirement for the wealth and knowledge required for financial "sophistication." *See* Wallis K. Finger, Note, *Unsophisticated Wealth: Reconsidering the SEC's "Accredited Investor" Definition Under the 1933 Act*, 86 WASH. U. L. REV. 733, 740 (2009) (citing concerns raised by an association of small businesses in a 1980 SEC docket on the matter regarding their inability to raise capital under the previous regulatory regime).

47. Defining the Term "Qualified Purchaser" Under the Securities Act of 1933, Securities Act Release No. 33-8041, 66 Fed. Reg. 66,839, 66,841 (Dec. 27, 2001).

definition, and Congress eventually codified it in 1980 through the Small Business Investment Incentive Act.[48]

Two years later, in an attempt "to 'simplify and clarify existing exemptions [that were contained in the Small Business Investment Incentive Act], to expand their availability, and . . . to facilitate capital formation consistent with the protection of investors,'"[49] the SEC implemented Regulation D. Most importantly, Regulation D formally and clearly stipulated the kind of Investor who contained the sophistication necessary for investment in a private exempt offering, calling such an investor an "accredited investor."[50] Regulation D defined accredited investors—both individuals and investment firms—nearly solely in terms of income or wealth, with a rare caveat for some types of private investments companies. For individuals, one needed a net worth, when combined with one's spouse, of more than $1 million dollars for accredited investor status.[51] Alternatively, an individual could become accredited by showing a yearly income in excess of two hundred thousand dollars (or when combined with a spouse, three hundred thousand) that was expected to continue during the year of accreditation.[52] While strictly monetary on their face, these requirements attempted to show that individuals meeting either of these criteria contained: (1) enough financial sophistication to get them to a point in life with income or wealth at those levels; or (2) that they had attained

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48. Small Business Investment Incentive Act of 1980, Pub. L. No. 96-477, 94 Stat. 2275, 2294 (1980).

49. Finger, *supra* note 46, at 741 (quoting Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers and Sales, Securities Act Release No. 33-6389, 47 Fed. Reg. 11,251, 11,251 (Mar. 16, 1982)) (explaining the reasoning behind expounding further on Rule 242's scope and applicability).

50. The definition was as follows:

> (1) Any bank [or other likewise enumerated financial institution or financial fund with assets at or above $5,000,000] . . . ; (2) [a]ny private business development company . . . ; (3) [a]ny [501(c)(3)] organization [like a nonprofit or public charity] . . . with total assets in excess of $5,000,000; (4) [a]ny director, executive officer, or general partner of the issuer of the securities being offered or sold, or any director, executive officer, or general partner of a general partner of that issuer; (5) [a]ny natural person whose individual net worth, or joint net worth with that person's spouse . . . exceeds $1,000,000 . . . ; (6) [a]ny natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year; (7) [a]ny trust, with total assets in excess of $5,000,000 . . . ; and (8) [a]ny entity in which all of the equity owners are accredited investors.

17 C.F.R. § 230.501(a)(1)–(8) (2019).

51. *Id.* § 230.501(a)(5). The initial rule allowed an individual to use their primary residence in their net worth calculation. This rule was also rescinded following the financial crisis of 2008–2009. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1577–78 (2010).

52. 17 C.F.R. § 230.501(a)(6) (2021).

an economic position capable of withstanding substantial losses from an exempt investment.[53]

The initial implementation of Regulation D also included the adoption of Rules 504,[54] 505,[55] and 506.[56] These rules actually enumerated the various conditions under which exempted offerings could occur. In other words, whereas Rule 501(a) defined who could invest in exempt offerings, Rules 504 and 506 (Rule 505 is repealed) defined the parameters to consider when determining what an exempt offering was and how one could be marketed.[57]

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53. *See* Felicia Smith, *Madoff Ponzi Scheme Exposes "The Myth of the Sophisticated Investor,"* 40 BALT. L. REV. 215, 250–53 (2010) (explaining the essentially circular logic of wealth indicating sophistication and vice versa). Ultimately this author, as many others have, argues that sophistication based solely on wealth is a poor indicator of true sophistication, and that such individuals might not actually be able to "fend for themselves" in the traditional *Ralston* sense. *See id.* at 252 (arguing accredited investors often still do not ask the right questions about those offerings they invest in, and, thus, they still have a "practical need" for protection by American regulatory bodies). *See generally* Finger, *supra* note 46 (arguing that under the pre-2020 accredited investor definition made little sense). In his introduction, Finger explains the nonsensical nature of the definition by explaining the absurd outcome of how someone with no financial experience and an abundance of wealth, like Paris Hilton, could invest in exempt offerings, while someone with advanced degrees in financial and statistical analysis conceivably could not. *See id.* at 733–34.

54. Rule 504, 17 C.F.R. § 230.504 (2017). Rule 504 has been amended to reflect a change in aggregate price, which now shall not exceed $10,000,000. All other language remains the same. *See* 17 C.F.R. § 230.504 (2021).

55. Rule 505 was repealed by the SEC in 2017 and replaced with 17 C.F.R. § 230.504 (2021).

56. Rule 506, 17 C.F.R. § 230.506 (2021).

57. This Note routinely focuses on section (c) of Rule 506, which absolutely requires accreditation to participate in offerings under the exemption. *See infra* Section III.A. However, becoming accredited is also extremely important for Rule 506(b) offerings as well, even though up to 35 unaccredited investors are technically legally allowed to participate. *See* Final Rule, *supra* note 4, at 64,259 (explaining that while unaccredited investors can participate in 506(b) offerings, they almost never are allowed to do so, with "only between 3.4% and 6.9% of" all 506(b) offerings between 2009 and 2019 actually including any unaccredited investors); *see also* Jacob Preiserowicz, Note, *The New Regulatory Regime for Hedge Funds: Has the SEC Gone Down the Wrong Path?*, 11 FORDHAM J. CORP. & FIN. L. 807, 815 (2006) ("Thus, from a practical standpoint, while funds can accept some unaccredited investors, very few do so. . . . [T]he expense and time that is required to generate the additional material required essentially makes it highly unlikely that the fund will accept these investors."). Rule 504 allows offerings that are totally open to an unlimited number of accredited investors (like 506(c) offerings), but offerings cannot exceed a numerical dollar value threshold. Rule 504, 17 C.F.R. § 230.504 (2021). Additionally, Rule 504 disallows the use of general solicitation, making it a difficult rule to comply with for large-scale firms that use very active marketing tools. *Id.* § 230.504(b)(1)(iii) (2021). It is rarely used, making up only two percent of all offerings that rely on Regulation D. Laura Anthony, *SEC Final Rule Changes for Exempt Offerings – Part 3*, ANTHONY L.G., PLLC: SEC. L. BLOG (Feb. 16, 2021), https://securities-law-blog.com/2021/02/16/sec-final-rule-changes-for-exempt-offerings-part-3/#:~:text=Even%20with%20the%20increased%20offering,in%20any%2012%2Dmonth%20period [https://perma.cc/HZ9E-FZPQ]. The definition of solicitation itself can also be tricky, and most companies that use a general and publicly available website cannot register under either Rule 504 or 506(b). *See Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings*, U.S. SEC. & EXCH. COMM'N (Sept. 20, 2013), https://www.sec.gov/info/smallbus/secg/general-solicitation-small-entity-compliance-guide.htm [https://perma.cc/Y66V-NRBT].

The newly adopted accredited investor definition clarified previous court tests and gave a clear, bright-line approach to answering the question of investor sophistication (which, in turn, made it immensely easier to classify private exempt offerings). However, the sagacious nature of this definition—and its use for participation in exempt investment opportunities—proved perhaps less advisable and equitable in practice than was expected, producing years of critical analysis.[58] These negative outcomes led to an amendment to the accredited investor definition in August of 2020, the focal point of this Note.[59]

C. *REGULATION A AND THE RISE OF CROWDFUNDING*

Regulation D arguably achieved what it set out to do; that is, it provided investors and offerors alike with bright-line rules, which allowed for more efficient capital allocation. Just seven years after its implementation, the amount of capital raised in private exempt offerings increased more than ten-fold, from just shy of 20 billion dollars to slightly over two hundred billion.[60] By 2006 and 2007, that number had eclipsed more than one trillion dollars a year.[61] This staggering growth came to an abrupt halt with the onset of the 2008–09 financial crisis. Following the collapse of the U.S. housing market—due to years of large financial institutions making leveraged trades on largely unregulated credit default swaps—Congress bailed out banks and other private institutions to the tune of several trillion dollars.[62] Economic growth was drastically stymied as millions of Americans lost their jobs, including thousands more who became homeless or saw their pension plans melt away.[63]

Much as with the 1933 Act, a moment of economic turmoil provided Congress with an opportunity. And, just like the 1933 Act, Congress passed sweeping legislation five years after the 2008 crash in the form of the

58. *See generally* So-Yeon Lee, Note, *Why the "Accredited Investor" Standard Fails the Average Investor*, 31 REV. BANKING & FIN. L. 987 (2012) (arguing that disallowing retail participation in private investment opportunities enhances wealth inequality by allowing only the wealthy the chance to invest in high upside opportunities); Haq, *supra* note 24 (arguing that wealth serves as a poor proxy for investor sophistication, especially when considering differing methods for wealth accumulation); Finger, *supra* note 46 (explaining the shortcomings of wealth as a proxy for investor sophistication given changed market conditions from their inception); Smith, *supra* note 53 (arguing that wealth is a poor proxy for investor sophistication and that wealth itself does not mean an investor can fend for themselves or withstand serious financial consequences from bad investments).

59. *See infra* Section III.A.

60. Roberta S. Karmel, *Regulation by Exemption: The Changing Definition of an Accredited Investor*, 39 RUTGERS L.J. 681, 689 (2008).

61. *Id.*

62. *See* Austin Murphy, An Analysis of the Financial Crisis of 2008: Causes and Solutions 2 (Nov. 4, 2008) (unpublished manuscript), http://dx.doi.org/10.2139/ssrn.1295344 [https://perma.cc/6P7M-7WKW].

63. *See Chart Book: The Legacy of the Great Recession*, CTR. ON BUDGET & POL'Y PRIORITIES (June 6, 2019), https://www.cbpp.org/research/economy/the-legacy-of-the-great-recession [https://perma.cc/EFU7-EMP5].

Jumpstart Our Business Startups Act (JOBS Act).[64] The hallmark bill helped spark growth in smaller- and medium-sized market capitalization companies, helping accelerate a broader economic recovery. Perhaps most importantly, at least in the context of this Note, the JOBS Act encouraged wider adoption of the theretofore infrequently used Regulation A.[65]

"Regulation A ha[d] been recognized as a convenient vehicle for direct offerings over the internet" and was "particularly well suited for crowdfunding efforts."[66] "Crowdfunding is the use of small amounts of capital from a large number of individuals to finance a new business venture."[67] However, compliance costs associated with Regulation A filing, and the heavier burden of SEC filings, still made Regulation A an underutilized instrument for achieving exemption.[68] The JOBS Act aimed to lessen these burdens somewhat.[69] Importantly, Regulation A offerings allow investments by unaccredited investors, with the caveat that they may not invest more than ten percent of their annual income or net worth.[70]

Regulation A can be used both as a public and private equity tool. In essence, public exempt offerings made under Regulation A require less SEC oversight than other forms of public offerings, while private exempt offerings made under Regulation A require more oversight than other forms of private

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64. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012) (codified as amended at 15 U.S.C. §§ 77–78).

65. 17 C.F.R. §§ 230.251–.263 (2021). The adoption of Regulation A is important to this Note for two reasons. First, its passage showed that Congress saw a need for relaxed regulation due to an overextended demand for investors by offerors. The need for Regulation A closely mirrored the need for the Rules expounded by the SEC in the 1970s and 1980s. *See supra* notes 39–41 and accompanying text. Additionally, Regulation A's passage also closely mirrors the SEC's reasoning for amending the accredited investor definition in 2020. *See infra* Section III.A. Second, while Regulation A has not seen as much usage as anticipated, the fact that it has been used in offerings shows that such a scheme can work. *See* Final Rule, *supra* note 4, at 64, 264–65. This fact can be used to assuage fears that an expansion of the accredited investor definition, beyond the changes in 2020, would be unduly risky for offerors or offerees.

66. Thomas Lee Hazen, *Crowdfunding or Fraudfunding? Social Networks and the Securities Laws —Why the Specially Tailored Exemption Must Be Conditioned on Meaningful Disclosure*, 90 N.C. L. REV. 1735, 1746 (2012).

67. Tim Smith, *Crowdfunding*, INVESTOPEDIA (May 15, 2021), https://www.investopedia.com/terms/c/crowdfunding.asp [https://perma.cc/6SVE-BEBC].

68. Hazen, *supra* note 66, at 1746.

69. In relevant part, Regulation A states a private exempt offering may be made for:

> A public offer or sale of eligible securities, as defined in Rule 261 . . . , pursuant to Regulation A shall be exempt under section 3(b) from the registration requirements of the [1933 Act] . . . . Tier 1. Offerings pursuant to Regulation A in which the . . . "aggregate offering price" . . . plus the . . . "aggregate sales" . . . does not exceed $20,000,000 . . . .

17 C.F.R. § 230.251(a)–(a)(1) (2021). Regulation A further stipulates that "[e]xcept as allowed by Rule 255 . . . , no offer of securities may be made unless an offering statement has been filed with the [SEC]. . . . Solicitations of interest and other communications pursuant to Rule 255 . . . may be made." *Id.* § 230.251(d)(1)(i), (d)(1)(ii)(C).

70. *Id.* § 230.251(d)(2)(i)(C)(1). *See infra* Section IV.A.3.

exempt offerings. On its face, Regulation A appeared to be a fairly friendly regulatory regime for private offerors seeking capital from unaccredited investors.[71]

However, this has not been reality.[72] Although there are indeed growing instances of Regulation A being used for exempt offerings, they remain relatively underutilized.[73] This is primarily because of the more restrictive and time-intensive filing requirements for a Regulation A private offering,[74] the unwillingness for investment firms to allow unaccredited investors in their investing pools, the administrative capital cap imposed on Regulation A offerings,[75] and the costs associated with using a crowdfunding intermediary between investors and the offeror.[76] However, the Regulation A framework offers a great insight into how an expanded accredited investor regime might operate, especially if the lines between the accredited and unaccredited investor move closer together.[77]

71. As opposed to Rule 506(c), unaccredited investors can invest in Regulation A offerings. 17 C.F.R. § 230.251(d)(2)(i)(C) (2021). Further, as opposed to Rules 504 and 506(b), Regulation A offerings allow general solicitation for the offering. *Id.* § 230.251(d). It would appear that, given these facts, Regulation A offerings would provide both investors (accredited and unaccredited) and offerors some of the most favorable terms by which to engage in capital formation. The result of this framework, however, has not necessarily been borne out in reality, even though Regulation A offerings are essentially a hybrid of 506(b) and 506(c) offerings. *See* source cited *infra* note 72 (demonstrating disparities in the dollar amounts raised under each Regulation).

72. While Regulation D offerings raised around 1.5 trillion dollars of investment capital in 2019, Regulation A offerings raised just over 1 billion dollars. SEC. & EXCH. COMM'N, REPORT TO CONGRESS ON REGULATION A / REGULATION D PERFORMANCE 3 (2020), https://www.sec.gov/files/report-congress-regulation-a-d.pdf [https://perma.cc/U6N7-ZXH3]. The report also mentions that 1.2 trillion was raised through registered offerings, indicating exempt offerings now raise more capital than nonexempt ones. *Id.*

73. *See supra* notes 71–72 and accompanying text.

74. Quentin H., *Security Token Offering – All You Need to Know*, MARKCHAIN (Feb. 27, 2020), https://markchain.io/en/security-token-offering-all-you-need-to-know [https://perma.cc/ET7Z-3NAL].

75. Letter from David R. Burton, Senior Fellow in Econ. Pol'y, The Heritage Found., to Vanessa A. Countryman, Sec'y, U.S. Sec. & Exch. Comm'n 5 (May 1, 2020), https://www.sec.gov/comments/s7-25-19/s72519-7144449-216247.pdf [https://perma.cc/C9B6-TVCS] (stating that such capital caps "substantially reduce the attractiveness of this approach" by essentially "imposing portfolio limits" on interested investors). Additionally, Regulation A offerings only allow offerors to raise up to 50 million dollars, depending on the tier of the offer. Brooke Levin, Potential for Cryptocurrency to Fund Investment in Sustainable Real Assets 14 (Apr. 24, 2018) (Masters Project, Duke University), https://dukespace.lib.duke.edu/dspace/bitstream/handle/10161/16574/Levin_Brooke_MP_Final.pdf?sequence=1 [https://perma.cc/CN2V-M6SQ].

76. Alana Benson, *Real Estate Crowdfunding: What to Consider*, NERDWALLET (May 25, 2021), https://www.nerdwallet.com/blog/investing/real-estate-crowdfunding-worth [https://perma.cc/TY7R-4JE7].

77. *See infra* Section IV.A.3.

III. TAKING IT SLOW: THE NEW "ACCREDITED INVESTOR"

Markets ebb and flow, rising or falling steadily before shifting violently due to changed economic, technological, or geopolitical circumstances.[78] Yet regulatory authorities often are slow to react to change, either because remaining inert provides positive benefits that naturally occur from a stabilized status quo,[79] or because moving too quickly can result in negative downstream reverberations due to even minute errors in regulatory tailoring.[80] The long unchanged accredited investor definition fits into both molds. Money has continued to pour into private exempt offerings from the 1980s up until the present day and, outside of brief recessions, Regulation D's scheme has facially worked to encourage exempt investment opportunities.[81] Likewise, due to the SEC's stated goal of maintaining a "consistent, accessible, and effective [regulatory scheme] for both issuers and investors,"[82] any changes needed to be carefully "consider[ed] and analyze[d]" so as not to upset the financial apple cart, especially given the relatively risky nature some private offerings might entail.[83] However, calls for change finally resulted in the SEC issuing proposed amendments in both 2007[84] and 2015,[85] before formally adopting some of the measures in August of 2020.[86]

Section III.A opens by explaining some of the shortcomings of the accredited investor definition that prompted the SEC to take action in amending it. These shortcomings centered on complaints that the former definition lacked tailoring to the SEC's reasoning for adopting the definition in the first place, which focused on protecting retail investors while simultaneously facilitating a robust capital market for private offerors. The complaints also alleged that wealth actually is a poor proxy for accessing

78. James D. Hamilton & Gang Lin, *Stock Market Volatility and the Business Cycle*, 11 J. APPLIED ECONOMETRICS 573, 573 (1996).

79. *See generally* James A. Fanto, *Financial Regulation Reform: Maintaining the Status Quo*, 35 BROOK. J. INT'L L. 635 (2010) (arguing that, following the financial crisis of 2008–09, American regulatory authorities, in concert with the Obama administration, failed to voice and pass meaningful legislation because of reliance on the status quo and a captivation with financial authority).

80. MICHAEL MANDEL & DIANA G. CAREW, PROGRESSIVE POL'Y INST., REGULATORY IMPROVEMENT COMMISSION: A POLITICALLY-VIABLE APPROACH TO U.S. REGULATORY REFORM 4 (May 2013), https://www.progressivepolicy.org/wp-content/uploads/2013/05/05.2013-Mandel-Carew_Regulatory-Improvement-Commission_A-Politically-Viable-Approach-to-US-Regulatory-Reform.pdf [https://perma.cc/CAF4-UXSJ].

81. *See supra* notes 57–61 and accompanying text.

82. Final Rule, *supra* note 4, at 64,235.

83. *See id.* at 64,235, 64,260.

84. *See* Revisions of Limited Offering Exemptions in Regulation D, Securities Act Release No. 33-8828, 72 Fed. Reg. 45,116, 45,116 (Aug. 10, 2007).

85. *See* U.S. SEC. & EXCH. COMM'N, REPORT ON THE REVIEW OF THE DEFINITION OF "ACCREDITED INVESTOR" 1–8 (2015), https://www.sec.gov/files/review-definition-of-accredited-investor-12-18-2015.pdf [https://perma.cc/ZUA2-ZMUX].

86. *See generally* Final Rule, *supra* note 4 (amending the definition of "accredited investor").

investor sophistication.[87] Further, Section III.A reviews the newly adopted changes to the accredited investor definition, including the changes both for individual investors and accredited investment entities.

Section III.B next examines the challenges, some of which are outright admitted by the SEC, that the updated definition will face. The expected outcomes of the changed definition are fundamentally economic in nature, and Section III.B shows that the updated definition actually does not go very far in granting new parties (especially individual investors) accredited status. Section III.B uses these shortcomings as the basis for explaining the need of an even broader accredited investor definition.

A. The Need for Change and the SEC's Amendment to the "Accredited Investor" Definition

Accredited investor status remained a powerful demarcation for financial sophistication in private markets for years after its adoption. However, over time it began facing increasing criticism from legal scholars.[88] At the heart of most of the critiques lay the central premise that the accredited investor definition for individuals relied more on the ability of the investor to withstand financial hardship as opposed to accessing the individual's mental skills or attributes that would lead to sophistication. Thus, the standard before August of 2020 was firmly negative as opposed to positive.[89] A review of the literature indicates agreement on several key criticisms of the original accredited investor definition.

First, commentators pointed out that wealth is actually a poor indicator of investor sophistication.[90] A classification based solely on individual net worth is both overinclusive and underinclusive.[91] As an example, individual A may have ten million dollars of wealth recently inherited from her deceased

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87. These complaints center around the facts that the wealth requirements did not ask how an investor acquired their wealth, did not access the liquidity health of the investor, and perhaps overlooked perfectly capable investors who simply did not meet the wealth or income thresholds. *See infra* notes 90–103 and accompanying text.

88. *See* Finger, *supra* note 46, at 733–37; Karmel, *supra* note 60, at 681–85; Lee, *supra* note 58, at 988; Larissa Lee, Note, *The Ban Has Lifted: Now Is the Time to Change the Accredited-Investor Standard*, 2014 UTAH L. REV. 369, 369 (2014); Jeff Thomas, *Redefining Accredited Investor: That's One Small Step for the SEC, One Giant Leap for Our Economy*, 9 MICH. BUS. & ENTREPRENEURIAL L. REV. 175, 176–77 (2020).

89. Negative, in this context, means that the accredited definition essentially asked the question for attaining accreditation as: "If this investment goes wrong, will this individual be able to withstand the hardship of the poor investment?" Conversely, a positive question might be: "Given this individual's knowledge, might she be able to take advantage of this private market, while also being able to discern the risk factors associated with her investment?" The ideology behind the negative borders on outright paternalism by the SEC and arguably does not meet the spirit of the ruling from *Ralston*. *See supra* notes 26–36 and accompanying text.

90. *See* Stephen Choi, *Regulating Investors Not Issuers: A Market-Based Proposal*, 88 CALIF. L. REV. 279, 310–11 (2000).

91. *Id.*

parents. Individual A is able to partake in an unregistered private offering by the sole fact that she has such wealth, even though she has never taken a business, economics, finance, or accounting course. Conversely, Individual B might have an advanced statistical analysis degree from an Ivy League school. But because individual B was out of the job market while getting her degree, she has accumulated almost no wealth (indeed she may actually be in a large amount of debt), and it may still take her numerous years to reach the income threshold that would enable her to partake in the exempt market. If, at the core of *Ralston*—and especially in light of the legislative and administrative action taken in response to *Ralston*—a main policy concern is investor protection from potentially dangerous investment vehicles, it follows that wealth, by itself, is an inaccurate barometer for evaluating investor sophistication vis-á-vis prospective risk.[92]

Second, critics argued that the definition of wealth failed to account for the liquidity of one's assets and therefore was a poor measurement for evaluating an individual's actual ability to withstand immediate financial hardship.[93] Outside of removing one's primary residence from the wealth calculation, there was no other way with which the SEC took liquidity into consideration when determining one's wealth.[94] Wealthy individuals often have very balanced portfolios containing a mixture of liquid assets like cash, bonds, and stocks, as well as illiquid assets like real estate or art. However, this might not be the case in every situation, and, in fact, wealthy investors may have a higher portion of their wealth in illiquid assets when compared to less wealthy investors (at least with regard to the percentage of their wealth in illiquid markets).[95] Without any regard to liquidity, it is easy to envision a situation where one would be forced to sell a highly illiquid asset—often under duress and subsequently thus at a discount—to cover for their loses on an exempt investment.[96] Critics said the accredited investor definition did nearly nothing to account for this possibility, because the process for receiving accreditation contained only the primary residency analysis for determining wealth liquidity. No analysis went into where the wealth may have come from or where else it may be stored and accessed.

92. Finger, *supra* note 46, at 733.

93. Haq, *supra* note 24, at 72.

94. 17 C.F.R. § 230.501(a)(5)(i)(A) (2021). Liquidity essentially measures how quickly and easily an asset may be converted to cash. James Chen, *Liquid Asset*, INVESTOPEDIA (Mar. 28, 2021), https://www.investopedia.com/terms/l/liquidasset.asp [https://perma.cc/XHH5-3LBX].

95. This is particularly true when one considers that illiquid assets are oftentimes one of the best ways to grow and protect wealth in the first place, something highly wealthy individuals are keenly aware of. Illiquid assets are often less correlated to broader market conditions and can be more stable over time. They also often appreciate at a faster rate over time due to the premium paid for them. *See The Case for Illiquid Investments*, WTW (Dec. 5, 2019), https://www.wtwco.com/en-GB/Insights/2019/11/the-case-for-illiquid-investments [https://perma.cc/39P6-MU9Z] (discussing illiquidity risk premium).

96. *See* Haq, *supra* note 24, at 72.

Third, some critics have argued that income might actually be more indicative of investor sophistication but that income analysis still falls short in measuring actual sophistication.[97] Making $200,000 a year provides at least the outward indication that an individual has received some sort of educational or practical experience or savviness (instead of simply inheriting money), thus they should be able to navigate the private markets themselves. However, this argument is weak for two reasons. First, it presupposes incomes are comparative across geographic and racial classifications. In doing so, the definition could preclude individuals that might truly be sophisticated, but do not meet the definition because of lower salaries due to geographic location[98] or being a member of a minority group.[99] Second, income by itself cannot indicate the financial health of an individual. One might imagine a situation where a "sixth-year associate[] at [a] large law firm[] would be able to participate in the private market, even though [she could] be burdened with a high amount of [student] loan repayments."[100] This individual would thus be greatly at risk for financial hardship if a couple of her private investments went sour.

Fourth, critics contended that even if income or wealth were adequate measuring sticks for investor sophistication, the fact that the monetary thresholds for the income or wealth requirements had remained unchanged since adoption of Rule 501 undermined the argument that the SEC truly believed income or wealth were the best—indeed, by Rule 501's language, the only—way to determine such sophistication. In fact, if the threshold would have been adjusted yearly for inflation, the wealth one would need to gain

97. *See* sources cited *supra* note 58 and accompanying text.

98. The SEC impliedly admitted that the rigidity in the income requirement could not overcome this basic conundrum. *See* Amending the "Accredited Investor" Definition, Securities Act Release No. 33-10734, 85 Fed. Reg. 2,574, 2,594–95 (Jan. 15, 2020). The memorandum states:

> Further, raising the financial thresholds from current levels may have disparate impacts on certain investors. For example, certain geographic areas of the United States, such as the Midwest and South, have a lower cost of living compared to other geographic areas and employees in those areas may be earning lower wages relative to other areas and therefore be less likely to qualify as accredited investors under the current financial thresholds.

Id. at 2,594. Essentially this passage indicates that an immediate adjustment for inflation would render many investors in the South and Midwest unable to qualify as accredited. *See id.* Through inverting this analysis, one can draw the conclusion that more accredited investors are *currently* able to qualify in the East and West because of the salary disparity the SEC mentions. *See id.*

99. Black and brown individuals face salary gaps, even in careers that require advance degrees. Stephen Miller, *Black Workers Still Earn Less than Their White Counterparts*, SHRM (June 11, 2020), https://www.shrm.org/resourcesandtools/hr-topics/compensation/pages/racial-wage-gaps-persistence-poses-challenge.aspx [https://perma.cc/VGG7-SL7P]. The statistics are quite shocking. The median income for Black individuals with careers requiring advanced degrees (the very careers you might expect would be the perfect embodiment of "sophistication") make around $82,000 yearly compared to their white counterparts that make around $115,000. *Id.*

100. Haq, *supra* note 24, at 72.

accredited status in 2020 would be in excess of $2.7 million (instead of it still being at $1 million).[101] Additionally, the annual income requirement would no longer be $200,000 for a single individual, but would rather be adjusted upward to $538,000.[102] "Such inflation . . . result[ed] in more accredited investors, many of whom may not be able to appreciate the risks of investing in private offerings."[103]

After years of critical engagement and multiple internal discussions and proposals,[104] the SEC formally declared a Final Ruling to amend the definition for attaining accredited investor status in August of 2020.[105] The changes "add new categories of qualifying natural persons and entities and . . . make certain other modifications to the existing definition."[106] The SEC stated that "these amendments will provide a foundation for our ongoing efforts to assess whether the exempt offering framework, in its component parts and as a whole, is consistent, accessible, and effective for both issuers and investors."[107] The SEC explained that the goal of answering this question would allow them to "simplify, harmonize, and improve the" efficiency of, and ongoing expansion in, the private exempt offering market.[108]

The SEC worked with the guidance of a slew of interested parties including "the Small Business Capital Formation Advisory Committee, the former Advisory Committee on Small and Emerging Companies, the Investor Advisory Committee, and a wide array of public commenters."[109] Over 200 public commenters responded to the SEC's 2019 proposed release,[110] including

101. Final Rule, *supra* note 4, at 64,274.

102. *Id.*

103. Finger, *supra* note 46, at 748.

104. For examples of various discussions and proposals, see generally Revisions of Limited Offering Exemptions in Regulation D, Securities Act Release No. 33-8828, 72 Fed. Reg. 45,116 (Aug. 10, 2007); U.S. SEC. & EXCH. COMM'N, *supra* note 85; Amending the "Accredited Investor" Definition, Securities Act Release No. 33-10734, 85 Fed. Reg. 2,574 (Jan. 15, 2020).

105. *See generally* Final Rule, *supra* note 4 (describing the SEC's new ruling on accredited investor status).

106. *Id.* at 64,234.

107. *Id.* at 64,235.

108. *Id.*

109. *Id.* at 64,236.

110. *Id.*

U.S. senators,[111] state treasurers,[112] professors of finance[113] and law,[114] financial advisors,[115] and law school students.[116] The SEC further explained that the opinions of these public commenters represented drastically different viewpoints, and that some "supported expanding the accredited investor definition, while [other] commenters did not. Other commenters recommended eliminating the definition altogether so that anyone could invest in exempt offerings."[117] After considering all of the letters in conjunction with the changes previously proposed in 2019, the SEC adopted the following changes to the accredited investor definition, effective as of December 8, 2020, explained below.

1. Changes for Individuals

While not sweeping, this Note argues the SEC took a correct approach by expanding the individual accredited investor definition. Foremost, the amended definition now allows individuals to become accredited by showing that they have received licensure from passing any one of several financial advisor exams.[118] Additionally, an individual can become accredited by showing she meets a "knowledgeable employee" threshold, though more often than not, individuals working in these jobs would also be considered accredited through their licensure.[119]

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111. Letter from John Thune, John Barasso, M. Michael Rounds & Michael B. Enzi, U.S. Senators to Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n 2 (Oct. 23, 2019), https://www.sec.gov/comments/s7-25-19/s72519-6832400-208614.pdf [https://perma.cc/SRG6-HS78].

112. Letter from David C. Damschen, State Treasurer, State of Utah, to Vanessa A. Countryman, Sec'y, U.S. Sec. & Exch. Comm'n 3 (Feb. 26, 2020), https://www.sec.gov/comments/s7-25-19/s72519-6892314-210935.pdf [https://perma.cc/FZ8C-2C66].

113. Letter from Kenton V. McCarthy, Adjunct Professor of Fin., Arizona State Univ., to Vanessa A. Countryman, Sec'y, U.S. Sec. & Exch. Comm'n 1 (Feb. 17, 2020), https://www.sec.gov/comments/s7-25-19/s72519-6862739-210613.pdf [https://perma.cc/7GSG-GTVH]; Letter from James J. Angel, Professor of Fin., Georgetown Univ., to U.S. Sec. & Exch. Comm'n 1 (Mar. 3, 2020), https://www.sec.gov/comments/s7-25-19/s72519-6898005-211087.pdf [https://perma.cc/H3EW-MYNA].

114. Letter from Marc I. Steinberg, Professor of L., S. Methodist Univ., to Vanessa A. Countryman, Sec'y, U.S. Sec. & Exch. Comm'n 1 (Jan. 23, 2020), https://www.sec.gov/comments/s7-25-19/s72519-6684984-205887.pdf [https://perma.cc/QE36-6GHG].

115. Letter from Mark Headrick, Fin. Adviser, Dempsey Lord Smith, LLC, to Martha Legg Miller, Dir., Off. of the Advoc. for Small Bus. Formation, U.S. Sec. & Exch. Comm'n 1 (Feb. 7, 2020), https://www.sec.gov/comments/s7-25-19/s72519-208250.htm [https://perma.cc/RU5B-UZNZ].

116. Letter from Matthew J. Trudeau, L. Student, Maurice A. Deane Sch. of L. at Hofstra Univ., to Vanessa Countryman, Sec'y, U.S. Sec. & Exch. Comm'n 8 (Mar. 13, 2020), https://www.sec.gov/comments/s7-25-19/s72519-6952330-212566.pdf [https://perma.cc/54MN-RHAR].

117. Final Rule, *supra* note 4, at 64,236 (footnotes omitted) (citing around 20 letters supporting accredited investor expansion, eight letters rejecting changes to the definition, and ten letters arguing for the total abandonment of the accredited investor).

118. *See id.* at 64,241.

119. *Id.* at 64,243.

i. FINRA Certification

The largest change made by the SEC to allow individuals to attain accreditation comes from its adoption of accreditation through passage of any one of three financial certification examinations. Rule 501(a), as applied to individuals, now operates functionally as a wealth or sophistication test. Whereas before individual accreditation was based solely on income or wealth,[120] now individuals may qualify for accredited status by meeting the enumerated income or wealth thresholds,[121] *or* by showing that they have attained the "following certifications or designations administered by the Financial Industry Regulatory Authority, Inc. (FINRA): the Licensed General Securities Representative (Series 7), Licensed Investment Adviser Representative (Series 65), and Licensed Private Securities Offerings Representative (Series 82)."[122] The SEC declined to change its income and wealth parameters, stating that "adjusting the income and wealth thresholds may reduce private issuers' access to capital and would reduce investors' access to private investment opportunities."[123] The SEC's belief that data conflicted on the erosion of the income and wealth requirements augmented this decision. Given this inconsistency, the SEC did not wish to move the lower bounds of the threshold, when doing so may have eliminated a substantial portion of truly sophisticated investors.[124] Therefore, the new accredited investor test remained fixed as before in regard to the income or wealth of an individual[125] but added a second avenue for attaining accredited status through FINRA credentialing. The SEC proffered an explanation for the new credential and licensure-based approach, stating:

> While certain of these individuals may have fewer financial resources and, as a result, be less able to bear the financial risk of private investments, . . . we believe their professional credentials and experience should enable these investors to assess investment opportunities, appropriately allocate capital based on their individual circumstances, including whether to reallocate investment capital between private investments and other equivalent-sized investments, and otherwise make appropriately informed decisions regarding

120. *See* 17 C.F.R. § 230.501(a) (2019).

121. Final Rule, *supra* note 4, at 64,254 (explaining that the "wealth tests" as previously used by the SEC will continue to be used to review how exempt markets function).

122. *Id.* at 64,237.

123. *Id.* at 64,273.

124. *See id.* at 64,276. This essentially means that the SEC did not want to raise the income and wealth thresholds when doing so could have suddenly stripped previously accredited investors of their accreditation, even as these investors had proven through their previous accreditation they could hold their own in the private market. *Id.*

125. The SEC did slightly alter the calculation for joint income and wealth requirements, including language that allows the income or wealth of "spousal equivalent[s]" to be considered, instead of only calculating joint income based on a legal spouse. *See id.* at 64,251.

their financial interests, including their ability to bear the financial risk.[126]

The "professional credentials" come in the form of the Series 7, Series 65, and Series 82 licenses.[127] All cover roughly the same content—regulation regarding the purchase and sale of securities—though they differ in scope, prevalence, and intended candidacy pools. Crucially, however, the SEC admitted the fluidity with which additional certification requirements might be added, emphasizing that the list of three licenses was "non-exclusive"[128] and that taking "this approach will provide the Commission with flexibility to reevaluate . . . designations, or credentials if they change over time, and also to designate other certifications, designations, or credentials if [they] are consistent with the specified criteria . . . the Commission determines are appropriate."[129] For the time being, the Series 7, Series 65, and Series 82 are the licensing tools used to determine investor sophistication.

The Series 7 license approves an individual "to sell all types of securities products except commodities and futures."[130] The test "focuses on investment risk, taxation, equity, and debt instruments," as well as "packaged securities, options, retirement plans, and interactions with clients for prospective securities industry professionals," and is typically considered the most difficult of the FINRA exams due to its length and breadth.[131] The Series 65 license "covers laws, regulations, ethics, and various topics important to the role of a financial adviser" and is geared more toward the planning and practice of being a traditional financial advisor rather than knowing the ins and outs of intraday or swing trading.[132] The Series 82 license enables "financial

126. *Id.* at 64,241 (footnote omitted).

127. *Id.* at 64,242.

128. *Id.*

129. *Id.* at 64,241.

130. Julia Kagan, *Series 7*, INVESTOPEDIA (July 13, 2020), https://www.investopedia.com/terms/s/series7.asp [https://perma.cc/KSL7-4TL6].

131. *Id.*; Mark P. Cussen, *Breaking Down Financial Securities Licenses*, INVESTOPEDIA (July 30, 2021), https://www.investopedia.com/articles/financialcareers/07/securities_licenses.asp [https://perma.cc/H2E2-CUSN]. In addition, in order to take the Series 7 test, a "[c]andidate[] must be associated with and sponsored by a FINRA member firm or other applicable self-regulatory organization (SRO) member firm to be eligible . . . ." *Series 7 – General Securities Representative Exam*, FIN. INDUS. REGUL. AUTH., https://www.finra.org/registration-exams-ce/qualificationexams/series7 [https://perma.cc/Y294-GLCF]. Around 40,000 applicants take the exam each year "with only two-thirds passing." Dan Butcher & Beecher Tuttle, *Seven Things You May Not Know About the Series 7 that Can Help You Pass*, EFINANCIALCAREERS (Dec. 19, 2016), https://www.efinancialcareers.com/news/2016/12/five-things-may-know-series-7-can-help-pass [https://perma.cc/DMZ5-4B7K].

132. Julia Kagan, *Series 65*, INVESTOPEDIA (June 30, 2020), https://www.investopedia.com/terms/s/series65.asp [https://perma.cc/F8BE-D2DR]. Unlike the Series 7, for a Series 65 license "[a]n individual does not need to be sponsored by a member firm to take the exam[,] [but] [s]uccessful completion of the exam does not convey the right to transact business prior to being granted a license or registration by a state." Order Designating Certain Professional Licenses as

professionals representing a sponsor organization the ability to transact private securities for clients."[133]

In addition to the three licensure certifications, the SEC "adopt[ed] a good-standing requirement" that requires an investor to maintain certification, though it does not explicitly require the investor "to practice in the field[] related to the certification."[134] Moreover, the Final Rule noted that the certification needs to be independently verifiable.[135] Lastly, the Commission requires issuers of a private exempt offering to "take reasonable steps to verify whether an investor . . . is an accredited investor" and explains that a primary reason for using the three aforementioned licenses as a benchmark for accreditation stems from the ease with which they can be verified.[136]

The ability for an individual to gain accreditation through certification is a radical break from the previous process for accreditation. Sophistication is now determined with a balanced approach; instead of accredited status being based solely on the ability to withstand the hardship of an investment gone bad, the new test gives adequate weight to an individual's capacity to ascertain the hard facts about a prospective private investment opportunity. For this Note, the licensing change represents the single most important amendment to the accredited investor definition, though its shortcomings remain potentially onerous for large swaths of individuals.[137]

ii. "Knowledgeable Employee" Designation

In addition to allowing individuals with certain certifications to become accredited, the SEC also extended accreditation to a class of "knowledgeable employees."[138] This class of individuals includes private fund[139] employees, other than clerical or secretarial staff, that either oversee the investment

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Qualifying Natural Persons for Accredited Investor Status, Securities Act Release No. 33-10823, 85 Fed. Reg. 64234, 64234 n.4 (Oct. 9, 2020). Series 65 certification is required for all individuals wishing to "provide any kind of financial advice or service on a non-commission basis." *See* Cussen, *supra* note 131.

133. James Chen, *Series 82*, INVESTOPEDIA (Nov. 24, 2020), https://www.investopedia.com/terms/s/series-82.asp [https://perma.cc/Y22B-P47Y]. Like the Series 7 exam, a "[c]andidate[] must be associated with and sponsored by a FINRA member firm or other applicable self-regulatory organization (SRO) member firm to be eligible . . . ." *Series 82 – Private Securities Offerings Representative Exam*, FIN. INDUS. REGUL. AUTH., https://www.finra.org/registration-exams-ce/qualificationexams/series82 [https://perma.cc/7YXP-E4H4].

134. Final Rule, *supra* note 4, at 64,242. The SEC notes that it does not require an individual to be practicing in the field in which their certification is required but alludes to the fact that FINRA certification can lapse after leaving a sponsor organization for a period of two years. *Id.* at 64,242 n.96.

135. *Id.* at 64,242.

136. *Id.*

137. *See infra* Section III.B.

138. Final Rule, *supra* note 4, at 64,237.

139. The private fund employees covered under this amendment include employees working at Section 3(c)(1) or 3(c)(7) private funds. *Id.* at 64,244.

activities of the fund or who participate in the fund's investment activities as part of their regular duties as employees.[140] The reasoning behind the change mirrors that of the certification addition, in that the SEC believes these employees, "through their knowledge and active participation of the investment activities of the private fund," attain the requisite financial sophistication to qualify as accredited investors.[141] The SEC admits that adding this classification may have little impact on changing the capital formation landscape, as it is likely that many "knowledgeable employees" previously qualified for accredited status based on income and wealth requirements.[142] However, as with the addition of accreditation through FINRA certification, this change indicates a willingness by the SEC to open up individual accreditation based on actual financial sophistication rather than solely by wealth.

2. Changes for Investment Entities

In addition to amending the accreditation requirements for individuals, the SEC also expanded the opportunity for certain investment funds to attain accredited status.[143] This includes the addition of accredited status for "SEC- and state-registered investment advisers, rural business investment companies, limited liability companies, family offices, [and] family clients."[144] The SEC believed that these amendments were especially important to undertake, given how much the formation and use of investment entities had changed since Regulation D's adoption.[145] Additionally, the SEC recognized how vital investment entities are to the exempt offering market in particular, arguing that such entities "play a prominent role in Regulation D offerings [because they] have substantial capital."[146]

i. Registered Investment Advisors

Perhaps the largest change to the accreditation standards for investment entities was their expansion to who or what is considered a registered investment advisor under Rule 501(a)(1). The SEC "believe[d] it [was] appropriate to extend accredited investor status to all SEC- and state-registered investment advisers," including "exempt reporting advisers."[147] In doing so, the SEC opened

140. *Id.*

141. *Id.* Here, the SEC explicitly states that these employees can "fend[] for themselves," a direct homage to the spirit of *Ralston*. *See id.*

142. *Id.* at 64,260. In addition, the SEC's main reason for adopting this change is so that a fund enumerated in Rule 501(a)(1) does not lose its accredited status by sole virtue of it losing some assets and going under the $5 million threshold. *See* 17 C.F.R. § 230.501(a)(1) (2021). If all the equity owners of the fund are accredited, the fund can maintain accredited status by virtue of Rule 501(a)(8). *See id.* § 230.501(a)(8).

143. Final Rule, *supra* note 4, at 64,245.

144. *Id.*

145. *Id.* at 64,246.

146. *Id.* at 64,263.

147. *Id.* at 64,246.

the door for approximately 31,000 new institutional accredited investors.[148] The purpose for making this amendment was the SEC's belief that there was no reason to distinguish between an investment advisor institution operating as a sole proprietorship and other investment advisor institutions.[149] This change will likely, in practice, extend *individual* accreditation status, given the purpose was to include *sole* proprietorships as investment institutions capable of attaining accreditation status. The SEC reiterated that these investment advisors have the requisite knowledge for accredited status, regardless of whether they have the $5 million asset threshold that would have previously made them eligible for accreditation before the amendments.[150]

ii. Rural Business Investment Companies

The SEC also allowed Rural Business Investment Companies (RBICs) to become accredited.[151] The SEC reasoned that because RBICs and Small Business Investment Companies (SBICs) have a "common purpose and [experience] similar treatment under other federal securities laws . . . [they] should be treated similarly."[152] Given that SBICs were previously accredited under 17 CFR § 230.501(a)(1), the SEC determined it was appropriate for RBICs to be extended the privilege as well.[153]

iii. Limited Liability Companies

The SEC additionally amended 17 CFR § 230.501(a)(3) to include limited liability companies.[154] The SEC stated that 501(a)(3) previously did "not include limited liability companies, which have become a widely adopted corporate form since the Commission last updated the accredited investor rules."[155] As long as a limited liability company meets the asset threshold requirement in the rest of 501(a)(3), it can now attain accredited status.[156]

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148. *See id.* However, the SEC makes clear it cannot calculate how many of these investment advisors were not already qualified under the $5 million asset threshold in 17 CFR § 230.501(a)(3) (2011). *Id.*

149. *Id.* Indeed, the SEC estimated that nearly 1,800 investment advisors were sole proprietorships that heretofore may not have qualified as accredited because they did not meet the $5 million asset threshold, even though the entire reason for their existence is to invest and perform investment analysis. *Id.* at 64,246 n.139.

150. Previously, registered investment advisors could become accredited under Rule 501(a)(3). *See* Rule 501(a)(3), 17 C.F.R. § 230.501(a)(3) (2021).

151. Final Rule, *supra* note 4, at 64,246–47. "RBICs are [investment institutions] intended to promote economic development and the creation of wealth and job opportunities in rural areas and among individuals living in such areas." *Id.* at 64,246.

152. *Id.* at 64,247.

153. *Id.*

154. *Id.*

155. *Id.*

156. *Id.* The SEC notes that this change simply made formal the fact that LLCs could invest in private offerings. Although not on the books before, due to "a long standing staff interpretation

iv. Other Entities Meeting an Investments-Owned Test

The SEC also promulgated a non-exhaustive list of other financial "entities, such as Indian tribes, labor unions, governmental bodies and funds, and entities organized under the laws of a foreign country," which can now attain accredited status.[157] This change is meant to act as a "catch-all category" that remains broad and largely undefined.[158] The SEC left this section vague so that it may act as a flexible and adjustable standard for accreditation in the case that new entity types "may be created in the future."[159]

v. Family Offices and Family Clients

Lastly, the SEC allowed certain "family offices" to qualify for accreditation. They qualified as long as the office passes a three-part test: having "more than $5 million in assets under management," not being formed for the sole purpose of engaging in the particular exempt offering, and having an individual in charge of making the investment for the family office that has requisite "knowledge and experience in financial and business matters" that make that individual "capable of evaluating the merits and risks of the prospective investment."[160]

B. Shortcomings of the Definitional Change

Although the changes to the accreditation investor definition indicate the SEC's willingness to adapt to more modern investment trends, they ultimately come short of fundamentally benefiting the individual accredited investor and, in practice, may marginalize that investor even more. The SEC recognized that the process by which the new changes were accepted—and certain proposed changes that were not adopted—essentially came down to a cost-benefit analysis of the risks and rewards of the proposed amendments.[161] In its Final Ruling, the SEC devoted a little over a third of the entire discussion to the expected economic impacts of the amendments.[162] The SEC openly admitted some of the shortcomings of the amendments and noted that some further refining might be necessary going forth.[163] Additionally, however, the positive analysis for the changes that were made also indicated that the

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[which allowed LLCs to become accredited investors], [the SEC] do[es] not expect that the pool of accredited investors will change significantly as a result of this amendment." *Id.*

157. *Id.*
158. *Id.* at 64,249.
159. *Id.*
160. *Id.* at 64,250.
161. *Id.* at 64,272–75.
162. *See id.* at 64,259–75.
163. *See supra* notes 161–62 and accompanying text.

changes may not have as much of an effect as the SEC might have previously anticipated.[164]

The changes, while constructively expansive, especially for investment entities, continue to preclude large swathes of individual investors from partaking in exempt offerings. The new system doubles down on viewing sophistication largely in terms of withstanding a loss on an investment as opposed to accessing one's ability to fend for themselves in a competitive market environment. Additionally, because the amendments widely expand investment firm accreditation relative to individual accreditation, the amendments run the risk of widening financial opportunity gaps between individuals that remain just outside of the accredited definition and the newly incorporated investment entities that already have distinct advantages in the market.

The issue of the expanding opportunity gap becomes all the more prevalent as private exempt offerings continue to grow in pervasiveness[165] and asymmetric return probability.[166] The private market is typically considered riskier than the public market—especially as to expected returns—and therefore offers the best chance of higher potential upside gains. Even with the new changes, most individuals still remain "categorically excluded from a type of investment specifically because it presents a greater risk . . . [therefore] prevent[ing] [them] from realizing the potential upside."[167] The risk that may have initially existed for private offerings may be lesser with the advent of widespread internet usage—which helps bridge at least some information asymmetry—yet returns in the private market still remain higher given ongoing perceived risk.[168] Lastly, and perhaps most troubling, the "trend

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164. Although it is less so for investment entities, this is especially true for individual accreditation, for which the changes radically broke from previous standards. *See* Final Rule, *supra* note 4, at 64,243 ("[W]e do not expect that number of newly eligible individual accredited investors to be significant compared to the number of individual investors that currently are eligible to participate in private offerings, and . . . we expect the amount of capital invested by such newly eligible individual investors to have minimal effects on the private offering market generally.").

165. The SEC uses data in its Final Ruling to show that private investment offerings undertaken under Regulation D now exceed, in monetary scale, offerings that are registered publicly. *Id.* at 64,261–62.

166. *See infra* Section IV.B.3.ii. Although private offerings are now mainstream, they still offer better chances for asymmetrical returns compared to registered public offerings because of comparatively greater differences in information asymmetry and smaller relative market capitalization at the time the investment is made. *See* Claire Rohlfs, *Why Private Market Investing Means Higher Returns: The Upside to Inefficiency*, FUNDRISE (July 14, 2017), https://fundrise.com/education/why-private-market-investing-means-higher-returns-the-upside-to-inefficienc [https://perma.cc/NW3V-TFU9]. This is doubly true when such offerings occur in smaller, growing markets. *See infra* Section IV.B.3.ii.

167. Thaya Brook Knight, *Your Money's No Good Here: How Restrictions on Private Securities Offerings Harm Investors*, CATO INST. (Feb. 9, 2018), https://www.cato.org/publications/policy-analysis/moneys-no-good-here-how-restrictions-private-securities-offerings-harm [https://perma.cc/5XQG-WPZB].

168. *Id.*

toward companies deferring their IPOs [initial public offerings] in recent years means that the company's greatest growth—and greatest dynamism—has already passed by the time the company is public."[169] Given this fact, most of the growth and value that investment in a new company affords has already been extracted in the private market, by already advantaged individuals, before many in the public are offered the chance at the same opportunity.

1. Limited Expansion for Individual Investors

Although the changes to the individual accredited investor definition are marginally expansive, especially when considering the addition of sole proprietorship registered investment advisors in the investment entity category, the Final Rule does not offer a truly meaningful revision to individual accreditation. The SEC admits that there exists significant crossover between individuals that were already considered accredited under the income and wealth thresholds, and those now eligible for accreditation under the credentialling process.[170] Under the income and wealth thresholds, the SEC estimated that approximately 16 million households would qualify as accredited investors, while nearly 300,000 of these households participated annually in private exempt offerings.[171] When taking this data in concert with estimated numbers of FINRA-certified individuals and "knowledge employees"—the two classes of individuals who may now qualify for accreditation—the SEC contends that the upper bound of newly eligible individual investors would represent no more than a 4.2 percent increase in the individual accredited investor pool (and only an increase of 0.2 percent of the population in totality).[172]

This upper bound is highly unlikely to be a true indicator of how many individuals actually can now attain accredited status.[173] Instead, the number of individuals actually gaining the ability to receive accreditation is almost certainly (much) lower; thus, the changes to the individual accreditation standard barely moves the needle in allowing sophisticated investors more opportunity for investment in the private exempt markets, nor helps markedly increase the base for capital formation for offerors. Instead, many of the individuals now afforded the opportunity to attain accredited status already would have qualified under existing wealth and income requirements or are covered under the registered investment advisors section of the Final Ruling's changes for accredited investment entities. The SEC concedes these points,

169. *Id.*
170. *See supra* note 142 and accompanying text.
171. Final Rule, *supra* note 4, at 64,261.
172. *Id.* at 64,262.
173. *Id.*

stating its belief that "it is unlikely that these newly eligible investors will provide an additional, meaningful source of capital in most private offerings."[174]

Additionally, the costs associated with obtaining the required accreditation credentials, the Series 7, Series 65, and Series 82 licenses, can be burdensome both directly and indirectly.[175] Although one can appreciate the SEC taking a cautious approach to implementing new changes to individual accreditation,[176] its newly formed accredited investor definition—and by extension, its idea on what makes an investor sophisticated—still leans heavily toward outright protectionism based on one's ability to withstand financial hardship, opposed to a more free-market approach based on one's capability to outperform others in the market.[177] Although there exist difficulties with such a free-market approach,[178] and indeed such concerns were precisely the reasons for adopting the accredited investor concept in the first place, cutting regulatory constraints for some (institutional entities) while keeping them rigid for others (individuals) can lead to increased inequality and decreased economic participation.

174. *Id.*

175. It can cost between $60–$300 for these tests. *See Qualification Exams*, FIN. INDUS. REGUL. AUTH., https://www.finra.org/registration-exams-ce/qualification-exams [https://perma.cc/4SHE-ZV4M] (explaining the cost of the Series 7 exam is $300, the Series 65 exam is $187, and the Series 82 exam is $60). Moreover, the indirect costs, such as studying time, can be great, and, additionally, two out of three of these tests require an individual to have a FINRA sponsor organization, essentially limiting the choice of an individual to take employment elsewhere if they wish to invest in exempt private offerings. *See* Sarah Thompson, *The Series 7 Examination and Why You Need to Pass It*, EFINANCIALCAREERS (Apr. 20, 2020), https://news.efinancialcareers.com/us-en/153705/seven-tips-for-acing-the-series-7-and-other-financial-exams [https://perma.cc/7QND-HGCQ] (explaining the Series 7 test probably requires between 80-100 hours of studying to pass).

176. *See* Final Rule, *supra* note 4, at 64,235 ("[T]he accredited investor definition is 'intended to encompass those persons whose financial sophistication and ability to sustain the risk of loss of investment or fend for themselves render the protections of the Securities Act's registration process unnecessary.'" (quoting Regulation D Revisions; Exemption for Certain Employee Benefit Plans, Securities Act Release No. 33-6683, 52 Fed. Reg. 3,015, 3,017 (Jan. 30, 1987))). The SEC was quoting a 1987 press release when it stated this, and more than forty years later little had been done to update the accredited investor definition, indicating a reluctance to do so.

177. In the preceding footnote's quote, there is a duality in sophistication, one being "financial sophistication" and the other being the "ability to sustain the risk of loss." *See supra* note 176 and accompanying text. The "ability to sustain the risk of loss" has been, and continues after the amendment to be, the predominate factor between the two in deciding how to accredit individual investors. *See supra* note 176 and accompanying text; Final Rule, *supra* note 4, at 64,235.

178. These difficulties can involve many of the issues seen during both the Great Depression and Great Recession and can include individuals who cannot afford being overleveraged or being invested in questionable entities who have not gone through the rigorous regulatory oversight in their filings that would be mandatory had the entity undergone a public offering. *See supra* Section II.A.

2. Funnels Individual Investors into Investment Funds and Concentrates Market Power

A second issue with the SEC's Final Ruling is its disparate impact on individual accreditation vis-à-vis institutional investment firms. Given the limited impact of the changed definition on altering the base of newly eligible individual investors, in combination with the broadly expanded institutional definitions, it is possible that the updates may force individual investors to rely almost entirely on institutional intermediaries in order to invest in private offerings.[179] This funneling becomes increasingly more likely as private offerings continue to proliferate in number and asymmetric return profile.[180] This is hardly a strictly negative outcome; qualified professional investment services can offer investors more opportunity in finding and interpreting investment opportunities[181]; set short, medium, and long-term investment strategies and goals[182]; and take some of the burden off of actively managing investment portfolios.[183] Indeed, many individuals choose to forgo active participation in the markets entirely, instead delegating such investing activity to passive funds run by institutional entities.[184]

However, given the increasing prevalence of exempt offerings, it is likely that individuals—who otherwise might be considered sophisticated on slightly less restrictive means than certification on just three FINRA tests—will lose significant autonomy in the ability to choose what they invest in and how they do so. Limiting still-unaccredited individuals to investing in public offerings or forcing them to invest through investment entities in order to have access to the private market has several obvious consequences. There are often fees associated with using an investment entity's services, including initial sign-up

179. *See infra* notes 181–84 and accompanying text.

180. *See supra* notes 165–69 and accompanying text.

181. *See generally* Laura Casares Field & Michelle Lowry, *Institutional Versus Individual Investment in IPOs: The Importance of Firm Fundamentals*, 44 J. FIN. & QUANTITATIVE ANALYSIS 489 (2009) (arguing that the real benefit of using an investment firm, especially in initial public offerings, lies more in the fact that the investment firm is better able to act efficiently on public information opposed to simply gaining information privately before it is more publicly available).

182. Jason Fernando, *Investment Advisor*, INVESTOPEDIA (Jun. 25, 2020), https://www.investopedia.com/terms/i/investmentadvisor.asp [https://perma.cc/5ZEF-9JCV] (explaining that one of the main goals of a financial advisor at an investment firm is ascertaining an individual's personal risk tolerance, a concept heavily intertwined with an individual's investment time horizon).

183. This burden can be the time put into managing a portfolio, but even more important can be the returns from the portfolio. The rise of passively managed portfolios compared to actively managed portfolios doubles down on this point, that returns from investment have been shown to increase from individually managed to investment firm, actively managed, and finally to investment firm, passively managed. *See* Scott Vincent, *Is Portfolio Theory Harming Your Portfolio?*, 6 J. APPLIED RSCH. ACCT. & FIN. 2, 8 (2011).

184. This is exactly how many traditional 401(k) plans are structured. *See* Mark P. Cussen, *The Basics of a 401(k) Retirement Plan*, INVESTOPEDIA (Dec. 13, 2021), https://www.investopedia.com/articles/retirement/08/401k-info.asp [https://perma.cc/4PQ9-X66D].

fees, portfolio maintenance fees, and individual trade fees.[185] Additionally, attaining the services of an investment firm may allow an active individual investor to invest in certain exempt offerings through an accredited institutional investor, while that individual still invests in more accessible offerings on her own. Doing so can lead to scattered capital, poor tax outcomes, and increased monitoring costs.[186] Investing through an investment firm can also tie up capital and restrict an individual from quickly shifting capital from one opportunity to another without incurring fees or spending considerable time attempting to free up that capital, which can lead to slippage, especially in dynamic markets.[187] Additionally, conflicts of interests often arise between individuals and their investment firms due to, among other things, the latter's fee and commission structures.[188]

The process of using an institutional advisor itself may not be entirely without merit, and indeed using an investment firm as a means to invest is probably the right choice for most individuals. However, when duplicated over a large spectrum of society, the process can encourage overzealous belief and trust in investment firms, which can in turn invite risk-taking by those firms.[189]

185. Some investment firms essentially double tax investments. *See* Pam McCallum, *The Disadvantages of Financial Intermediaries*, SAPLING, https://www.sapling.com/8634380/disadvantages-financial-intermediaries [https://perma.cc/4GYK-EJRD] (explaining a structure common to many investment firms, in which a fee is charged for placing a trade, and then a portion of the gain of the investment is charged as a commission when the trade is closed). Adding in any capital gains tax on top of this can result in, effectively, a triple taxation.

186. Mark Henricks, *Having Multiple Advisors Could Increase Your Risk of Poor Returns*, CNBC (May 30, 2018, 9:00 AM), https://www.cnbc.com/2018/05/30/are-you-being-unfaithful-to-your-financial-advisor.html [https://perma.cc/8YS4-GX2N].

187. *Slippage*, CORP. FIN. INST., https://corporatefinanceinstitute.com/resources/knowledge/trading-investing/slippage [https://perma.cc/V3LE-7B8S].

188. *See* Todd E. Frank, *The Risks and Disadvantages of Large Brokerage Firms*, FRANK FIN. ADVISORS (Dec. 16, 2014), https://frankfinancialadvisors.com/risks-disadvantages-large-brokerage-firms [https://perma.cc/259T-T7N7] (explaining three types of conflicts of interests that arise in the investment setting, including different commission fees brokers earns for selling certain products, pressure from top-line management to influence investment choices of smaller brokers, and incentives to management provided by third-party sources such as specific companies that want their stock bought).

189. *See* Martin F. Hellwig, *Systemic Risk in the Financial Sector: An Analysis of the Subprime-Mortgage Financial Crisis*, 157 DE ECONOMIST 129, 134 (2009) ("Systemic interdependence has also played an important role. . . . [P]articipants did not know the extent to which systemic interdependence exposed them to risks. Risk taking that, with hindsight, must be considered excessive was not just a result of recklessness, but also a result of an insufficient understanding [by participants] and of insufficient information about systemic risk exposure."). Indeed, the financial crisis of 2008–09 perfectly exhibits how trust can breed trust, in turn, creating a financial system that becomes imbalanced without healthy skepticism. *See* Stephen C. Nelson & Peter J. Katzenstein, *Uncertainty, Risk, and the Financial Crisis of 2008*, 68 INT'L ORG. 361, 363 (2014) ("[The crisis resulted] from consumers' widely shared economic beliefs in the inevitabl[e] upward movement of prices in the housing market to bankers' unqualified trust in the quantitative models of market risk employed by financial institutions and credit rating agencies."). The end

3. Continues to Lack Geographic Differentiation

A third shortcoming of the amended accredited investor is that the SEC failed to revise the income and wealth requirements to better account for geographic disparities. By taking no action on the income and wealth thresholds, the SEC implicitly allowed an ever-expanding accredited individual pool.[190] However, the thresholds continue to lack geographic differentiation, and thus the definition maintains a bias toward geographic areas like the east and west coasts that have higher salaries.

The lack of differentiation is problematic in two ways, and it potentially undermines the actions of both investors and offerors. For investors, similarly situated individuals are treated differently due to where they live in the country. As an example, investors A and B might have the exact same job responsibilities at the exact same company. Both have no debt, attended the same university, and received the exact same degrees.[191] Yet investor A works at the company's New York office making over $200,000 a year, while investor B works out of the Sioux City, Iowa office and makes only $160,000. The New York investor would be able to gain accredited status due to his income level, while the Sioux City investor would not. Although the current income thresholds at least facially achieve one of the goals for having an accreditation standard in the first place,[192] the SEC has not offered any valid explanation for why otherwise identical investors should be treated so differently given their identical circumstances.

Perhaps more importantly across domestic financial markets as a whole—maintaining the previous thresholds can discourage offerors from initiating exempt offerings in certain areas of the country. Indeed, former SEC commissioner Hester Peirce admitted the shortcomings of the ongoing regime, stating "that the current thresholds work better in certain geographic areas, such as coastal cities and the Northeast than in . . . other regions

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result is risk and instability coming from the exact ways of investing that were meant to protect from risk in the first place.

190. This assumes ever-increasing inflation that, while not a guarantee, is likely given the fact that the Federal Reserve actively targets two percent (and in some cases more) inflation on a year-by-year basis. *See Why Does the Federal Reserve Aim for Inflation of 2 Percent Over the Longer Run?*, BD. OF GOVERNORS OF THE FED. RSRV. SYS. (Aug. 27, 2020), https://www.federalreserve.gov/faqs/economy_14400.htm [https://perma.cc/32Y9-5BYK]. Other goods and services, such as wages in this instance, also rise in tandem with inflation, meaning that over time more and more individuals will reach the income thresholds even in identical jobs in which their wages previously would not have qualified for them. *See* Juan M. Sánchez, *The Relationship Between Wage Growth and Inflation*, FED. RSRV. BANK OF ST. LOUIS (Nov. 9, 2015), https://www.stlouisfed.org/on-the-economy/2015/november/relationship-between-wage-growth-inflation [https://perma.cc/U2KH-WPFJ].

191. These extra factors are only added to further the explanation. In reality, even these very valid questions regarding individual circumstances and characteristics are not accounted for by the current individual accreditation standards. *See supra* Section III.A.

192. One of the goals of having an accredited investor standard is to protect the individual by ensuring they are able to withstand financial loss associated with the investment. *See supra* Section II.B.

throughout the Midwest, and the South."[193] This same line of thinking mirrors how poorly the thresholds work for investors themselves. But they also hurt offerors, preventing the "facilitat[ion] [of] capital formation, [which could] allow neighbors to invest in one another's futures, and breathe new economic life into these regions."[194] In its Final Ruling, the SEC further drove the point home, stating that "[r]ecent research has examined the importance of the pool of accredited investors for the entry of new businesses and employment and finds that geographic areas experiencing a larger reduction in the number of potential accredited investors experienced negative effects on new firm entry."[195] The willingness of an offeror to offer is predicated on an expectation that they will be able to raise the capital necessary to facilitate the project. And investors are more inclined to invest in projects with which they have social ties.[196] Social ties, however, are inextricably linked to geographic proximity. At least for smaller, but perhaps still accreditation-worthy investors, it is likely that such social ties rely even more on geographic proximity.[197]

Thus, as currently written, the thresholds continue to treat otherwise similarly situated individuals differently by sole virtue of the fact that they make different amounts of money, a factor inherently linked to geographic disparities. This discourages capital formation in relatively less wealthy regions and leads to decreased desire for offerors to offer in these regions in the first place.

IV. AN ANTICIPATED ENGAGEMENT: THE SYNERGETIC FUTURE OF AN EXPANDED "ACCREDITED INVESTOR" DEFINITION WITH TOKENIZED REAL ESTATE

The updated accredited investor definition contains some positive attributes. The changes broadly expand the ability of institutional firms to invest in private exempt offerings under Regulation D. The amendments also allow individual investors the opportunity to gain accreditation through a set of three FINRA certification tests that are meant to show that an individual is financially sophisticated. The changes have shifted the accreditation standard from the strict—and, due to inflation, rather arbitrary—income and wealth thresholds as the only ways for individual accreditation. These changes work

193. Hester M. Peirce, Comm'r, U.S. Sec. & Exch. Comm'n, Statement at Open Meeting on Amending the "Accredited Investor" Definition (Dec. 18, 2019), https://www.sec.gov/news/public-statement/statement-2019-12-18-peirce-accredited-investor [https://perma.cc/8FRA-ZP4N].

194. *Id.*

195. Final Rule, *supra* note 4, at 64,271.

196. *See* Colin Edwards, *Recent Research: Social Connections More Important than Geography in Accessing Investment Capital*, STATE SCI. & TECH. INST. (Oct. 8, 2020), https://ssti.org/blog/recent-research-social-connections-more-important-geography-accessing-investment-capital [https://perma.cc/A6VP-TTQ5].

197. Indeed, former Commissioner Hester Peirce's statement concedes such. Individuals wanting to invest in their neighbors would imply that social ties, and the trust that comes with such ties, are heavily related to geographic proximity. *See supra* text accompanying note 193.

well to begin encouraging broader capital formation in the private exempt marketplace. However, the updated definition skews heavily in favor of institutional investors and continues to curtail many individual investors, who might otherwise be sophisticated enough, from the possibility of investing in highly profitable private offerings. Although it can be argued that individuals still have a chance to participate in private offerings done under Regulation A, data shows that these offerings numerically pale in comparison to the Regulation D market.[198]

Section IV.A explains changes that could be made to the accredited investor definition for individual investors. The approach would be twofold, with one modification relating to the income and wealth thresholds, and the other relating to the SEC's determination of individual investor aptitude. First, the SEC could implement a downward adjustment to the income and wealth threshold across spatial bounds. Next, the SEC could utilize a two-tiered approach in ascertaining investor sophistication, tier-one being the current FINRA Series tests and tier-two requiring a prospective investor to pass a SEC certified aptitude test or show requisite financial knowledge through other professional certification. In order to offset offeror hesitancy and other potential negative externalities in the second tier, the SEC could adopt investment limits on investors qualifying under this category, mirroring the approach of Regulation A offerings.

Section IV.B moves to show how these extended changes offer fertile grounds for investment expansion in certain emerging markets, using tokenized real estate as a proxy. Section IV.B begins by offering a *very* brief overview of blockchain technology and its recent growing usage for more mainstream applications. Section IV.B then uses the tokenized real estate market as a singular emerging market that currently suffers—and likely will not receive much reprieve even after the SEC's recent amendments—under the accredited investor scheme. Section IV.B argues that without further expansion of the accreditation standard, it is unlikely that capable investors can take advantage of the aforementioned asymmetric return opportunities that niche and emergent markets offer, nor is it likely that offerors in such markets will be able to sustain meaningful growth.

A. Further Expansion to the "Accredited Investor" Definition

1. Downward Adjustment to Income and Wealth Thresholds Geographically

The first step in further amending the individual accredited investor definition would be implementing an econometric model for differentiating income and wealth thresholds across geographic boundaries. This kind of model was alluded to in the SEC's Final Ruling, and several commenters

198. *See supra* note 72 and accompanying text.

supported such an amendment.[199] However, the SEC ultimately ruled against it, arguing that "the complexities that geography-specific financial thresholds would create for issuers and investors do not weigh in favor of adding such geography-specific financial thresholds to the accredited investor definition at this time."[200]

However, it is likely the SEC overstates these issues. With a budget nearing $2 billion for the 2021 fiscal year,[201] the SEC has plenty of capital to create a small team of economists that could create a workable econometric model that could adequately ascertain equivalent wealth and income levels across spatial boundaries. Further, although the cost to offerors and investors is a valid concern, the SEC could internalize these costs somewhat by creating a centralized database that clearly delineates the varying wealth and income thresholds for any given geographic area. This would allow offerors and investors alike to find if they qualify on a single, centralized platform. Such investigation would be part of routine due diligence that is already required for 50I) offerings.[202]

Such a geographic-specific model would likely rely heavily on house prices, the cost of housing (rents as opposed to mortgages), the cost of living (groceries, travel, etc.), and, to a lesser extent, other factors like geographic "amenities."[203] The model would then isolate the relevant factors—relative salaries and wages of various regions—allowing the SEC to determine specified income and wealth thresholds across space. If, as the SEC has stated, a concern is that the changing income and wealth thresholds would possibly exclude accredited investors that were previously accredited, the SEC should adjust the thresholds downward.[204] That is, the income and wealth thresholds would not change (as they currently exist) for the most expensive regions of

199. *See* Letter from the Small Bus. Cap. Formation Advisory Comm., to Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n 1 (Dec. 11, 2019), https://www.sec.gov/spotlight/sbcfac/recommendation-accredited-investor.pdf [https://perma.cc/84LF-S764] (advising a model that "adjust[s] such [wealth and income] thresholds downwards for certain regions of the country"); Letter from Da Kui, to Vanessa A. Countryman, Sec'y, U.S. Sec. & Exch. Comm'n 5 (Jan. 10, 2020), https://www.sec.gov/comments/s7-25-19/s72519-6634586-203223.pdf [https://perma.cc/NK4S-FNMH] ("One possible approach is to design a mechanism based on the income levels, living costs and other relevant factors, without regard to the existing region categories, at least not completely and unconditionally restricted to them.").

200. Final Rule, *supra* note 4, at 64,254.

201. U.S. SEC. & EXCH. COMM'N, FISCAL YEAR 2021: CONGRESSIONAL BUDGET JUSTIFICATION ANNUAL PERFORMANCE PLAN 2 (2021), https://www.sec.gov/files/secfy21congbudgjust.pdf#page=21 [https://perma.cc/2JX6-F7ZJ].

202. While such investigation is not absolutely required by offerors under 506(b) offerings, it is likely that such due diligence occurs anyway. *See* Rule 506, 17 C.F.R. § 230.506 (2021).

203. COMM. ON GEOGRAPHIC ADJUSTMENT FACTORS IN MEDICARE PAYMENT, BD. ON HEALTH CARE SERVS. & INST. OF MED., GEOGRAPHIC ADJUSTMENT IN MEDICARE PAYMENT: PHASE I: IMPROVING ACCURACY 40 (Margaret Edmunds & Frank A. Sloan eds., 2nd ed. 2012), https://www.ncbi.nlm.nih.gov/books/NBK190065 [https://perma.cc/GE3U-RQP8].

204. *See supra* note 98 and accompanying text.

the country, while they would be lowered for regions that have lower relative costs.

To assuage concerns that this may burden the SEC with administrative costs,[205] the SEC could simply adopt a quadrennial adjustment, so that the adjustments are made once every four years.[206] Facially, asking this of an administrative body such as the SEC hardly seems radical. Once a model is formulated and approved, it would only take a small group of economists, every four years, to pull data from a data aggregator such as the Integrated Public Use Microdata Series (IPUMS) and enter these data points into the existing model. Further, if, as this Note argues, the calculations are done by the SEC itself, it is hard to see how costs would fall to offerors and investors. The SEC could simply announce the information as it calculates it and add this data to its centralized database. This would put both offerors and investors on notice of the new changes. Requiring an investor to show taxation data, or some other form of income and wealth indicator, either to the SEC, or directly to offerors, would not appear to be an overly burdensome way of affirming accredited status. Indeed, when weighing the possibility that potentially large swaths of investors are excluded from private offerings because of the current thresholds, the current regulatory regime hardly seems equitable.

By keeping the upper range of income and wealth thresholds constant for more expensive regions, it is likely that the various lower-priced geographic regions would, at some point, come into harmony with them. At this point, the SEC could shed this prong of the accredited investor test for previously inexpensive regions and adopt new inflationary standards—or stop adjusting for those regions entirely. Taking this approach helps alleviate the fears that inflation adjustment could have negative consequences for capital formation in expensive regions, while simultaneously allowing the potential for a larger pool of qualified investors in cheaper (and likely less capitally saturated) regions.

2. Two-Tiered Test Approach for Financial Sophistication

The second change to the accredited investor definition is somewhat less intuitive. It would require an either-or test for individual accreditation based on sophistication. The test would be broken into a tier-one investor and a tier-two investor. First, an investor could become accredited by showing FINRA certification under newly added Series 7, Series 65, or Series 82 licensure requirements. This tier reflects the SEC's recent adoptions for determining individual accreditation, which was well thought out and acts as an adequate adjustment in the short-term for determining the ability of some individuals

205. *See* Final Rule, *supra* note 4, at 64,274 ("[S]uch an approach could increase the costs of verifying the accredited investor status of those individuals. Given these complexities, we have determined not to adopt this approach at this time.").

206. The SEC meets to assess the accredited definition every four years. *See id.* at 64,243.

to prove their sophistication. The second way an individual, without holding FINRA certification, could become accredited would be by showing other professional certifications worthy of accreditation or by passing a standardized SEC financial aptitude test. Because professional certification and a uniformly administered and standardized test have the possibility of producing some negative externalities, the SEC could initially adopt an investment cap, much like the investment cap that bounds unaccredited investors in Regulation A offerings.

i. Tier-One: FINRA Certification

The SEC should continue using FINRA certification for individuals to become accredited. Additionally, these individuals should have access to the full array of benefits that come from the ability to invest in Rule 506(b) and Rule 506(c) offerings, including an unlimited investment cap. Although there may exist alternative forms of FINRA certification that could be less burdensome on an individual's ability to gain accreditation, the action taken by the SEC at least seems to be an adequate stimulus for capital formation and broadening the capital base in the short-term. However, there should also be a second tier to individual accreditation, as explained below.

ii. Tier-Two: Standardized SEC Test / Other Professional Certification

The SEC should also create a second tier of individual accreditation that would involve an individual either passing a standardized SEC financial aptitude test or showing sophistication by way of other professional certification. Several commentors to the Final Ruling indicated implementing a standardized test or other professional certification accreditation.[207] Further, several others commentors, in very brief letters, requested using a tiered system (though these tiers focused more on tiered income and wealth thresholds).[208] Opening up accreditation through these two qualification avenues could drastically expand individual accreditation.

Of the two accreditation qualification categories in tier-two, a standardized aptitude test would probably yield the most accurate results on whether an individual is financially sophisticated and has the lowest costs associated with it. Commentators of the Final Ruling found this proposal wildly popular,[209] yet the SEC chose not to adopt a test because it wished to "tak[e] a measured approach to the" initial amendments, and wanted to "first gain[] experience

207. *See id.* at 64,235–37 (discussing various proposals that the SEC received leading up to its new individual investor amendments, including a standardized test, other certification requirements, and professional experience).

208. *See id.* at 64,255 n.265 (citing three separate commentators who argued for a tiered system for determining individual accreditation status).

209. *See id.* at 64,240 nn.67–68 (showing over 15 commentors supportive of a standardized SEC accreditation test, with only two commentors directly opposed).

with the revised rules."[210] Though this approach is laudable in its own right, failing to introduce a standardized test—one likely to be more broadly available to potential individual investors—falls short of the overarching SEC objectives for adopting the amendments in the first place.[211] While other objectives of the SEC like maintaining adequate investor protections is also important, the SEC failed to state why adopting an objective and standardized test could not achieve this goal. Instead, it appears the SEC adopted the new amendments with incrementality and expediency in mind, rather than a truly new and robust accreditation system.[212]

The standardized test would be drafted and administered by the SEC. It would likely include similar questions as those contained in the FINRA exams now used to attain accreditation. Crucially, however, an individual would not need to be a member of a sponsor organization (like two of the FINRA tests require).[213] Likewise, the SEC could formally certify that individuals have passed such an exam by making a database with relevant information on individual passage, so that both offerors and investors alike are easily able to self-certify the accreditation. Lastly, the SEC could make the test free to take, so that there are no initial financial barriers to gaining accreditation. Again, outside some slight administrative costs, the upshots for adopting this vehicle, like expanding the breadth of the individual accredited investor pool, seem to outweigh the costs.[214]

The second category, expanded professional certification, may be harder to implement and track unlike a bright-line, standardized test. Indeed, the SEC recognized this, leaving open the possibility for adding a professional certification category to the individual investor, stating that "the [SEC] may designate qualifying professional certifications, designations, and other credentials by order," but choosing not to do so at the time.[215] Commentors of the Final Ruling expressed positive and negative attitudes toward adopting further professional certifications as vehicles for accreditation, unlike the more uniformly embraced positive sentiment toward a standardized SEC test.[216] Differentiating professional credentials could be difficult for the SEC. Indeed, the administrative costs associated with oversight seem most prevalent here.

210. *Id.* at 64,243.

211. A main argument for expansion of the accredited investor definition was to "expand investment opportunities." *Id.* at 64,235. However, without expanding the individual accreditation standards further, the SEC runs the risk of expanding these opportunities only to investment funds, not individuals that might, under a different test, be qualified. *See supra* Section III.B.2.

212. *See supra* notes 161–64 and accompanying text.

213. *See* Kagan, *supra* note 130; Kagan, *supra* note 132.

214. *See infra* notes 266–69 and accompanying text.

215. Final Rule, *supra* note 4, at 64,241.

216. *See id.* at 64,239–40 (explaining an essentially even split by commentators urging for professional certification or experience to be included as accredited investors against commentors arguing that such standards only add ambiguity to the definition).

However, there could also potentially be large benefits resulting from such a change, depending on which professional certifications are allowed.[217] Whereas allowing individuals with law degrees or business administrative degrees might prove more difficult and, indeed, potentially more dangerous for investors and offerors alike, allowing individuals who have passed the Certified Public Accountant (CPA) or Chartered Financial Analyst (CFA) exams to attain accreditation hardly seems a far extension from the current FINRA qualification requirements. Indeed, these tests are used to determine individual's financial sophistication, with the CFA being billed as "[a]chiev[ing] one of the highest distinctions in the investment management profession," which shows one has "the knowledge and the skills to thrive in the competitive investing industry."[218] This second tier could drastically widen the individual investment pool. If the SEC is wary in expanding the individual accreditation standards so broadly, it can use an investment cap on tier-two investors, as explained below.

3. Set Cap for Individuals Qualifying Under Tier-Two

If the SEC is worried that implementing a tiered system might allow some unsophisticated investors into the market, it could implement a cap on the dollar value or percentage of income or wealth that an individual could invest per year. Several commentors to the Final Ruling recommended using a system somewhat like this.[219] Adding caps would protect tier-two investors from overleveraging themselves, while still enabling them to enter the lucrative 506(b) and 506(c) offering markets.[220] This tier would operate similarly to how Regulation A offerings are currently conducted, allowing unaccredited investors to participate in those offerings but setting an investment cap at ten percent of the investor's income or net worth.[221] Such a system of investment limitation could be extended to 506(b) and 506(c) offerings, but would only be placed on tier-two accredited investors so as not to burden previously unburdened tier-one investors. Doing so would allow tier-two investors access to the private exempt market, and, because the tier-two investors are actually

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217. Just as one example, there are over 669,000 actively licensed Certified Public Accountants ("CPAs") in the United States. *How Many CPAs Are There?*, NAT'L ASS'N STATE BDS. OF ACCT. (Aug. 24, 2021), https://nasba.org/licensure/howmanycpas/#:~:text=As%20of%20September%202%2C%202020,the%2055%20CPA%20licensing%20jurisdictions [https://perma.cc/R83T-96Y4]. This number represents only slightly less individuals as those that have FINRA certification. *See* Final Rule, *supra* note 4, at 64,262 (estimating that a little over 690,000 individuals hold FINRA licensure to attain accredited status as of December 2018).

218. *CFA Program*, CFA INST., https://www.cfainstitute.org/en/programs/cfa [https://perma.cc/PGU9-S37E].

219. *See* Final Rule, *supra* note 4, at 64,240 (explaining an equal split between commentors on the pros and cons of investment limits).

220. Additionally, in practice, being accredited is almost always necessary to participate in 506(b) offerings as well. *See supra* note 57 and accompanying text.

221. *See supra* note 70 and accompanying text.

accredited (even if at a relatively lower status than their tier-one counterparts), offerors should feel more comfortable selling to them. This scheme thus takes the constructive attribute of Regulation A offerings (investor protection through investment limits), combined with the positives of Rule 506 offerings (unlimited fundraising and heightened investor scrutiny, which are both attractive for offerors), to make an intermediate category beneficial to all parties.

B. *Practical Application in Niche and Growing Sectors: Complementary Market Effects in the Tokenized Real Estate Market*

1. Initial Blockchain Conceptualizations and Recent Use Cases

Blockchain technologies and their usage in commercial real estate help explain how a change in the accredited investor definition can have fundamental and widespread financial impacts. Especially in emergent markets, blockchain is a fantastic proxy for wider implications in such rapidly growing markets. However, in order to see the compounding positive effects a changed definition can have on just this one particular market, some background information regarding blockchain adoption is necessary.

The financial woes of 2008 produced much more than just legislation. The crash also led to skepticism about how the American financial system fundamentally operated.[222] Such disenchantment led an unknown entity named Satoshi Nakamoto to create Bitcoin—a secured, private, and decentralized peer-to-peer cash system—in an attempt to hedge against loose central banking monetary policy.[223] In 2009, Nakamoto successfully created the first blockchain that was to act as the public ledger for the Bitcoin network.[224] Nakamoto's creation was revolutionary in that it introduced a system to earn, pay, accumulate, and distribute money, across the world, without the need for a centralized authority to confirm or deny the transaction.

222. *See generally* Timothy C. Earle, *Trust, Confidence, and the 2008 Global Financial Crisis*, 29 RISK ANALYSIS 785 (2009) (discussing skepticism following the 2008 Global Financial Crisis generally); Felix Roth, *The Effects of the Financial Crisis on Systemic Trust* (Ctr. for Eur. Pol'y Studs., Working Paper No. 316, 2009) (discussing skepticism following the 2008 Global Financial Crisis within Europe); Ben Rooney, *Consumer Confidence at All-Time Low*, CNNMONEY (Oct. 28, 2008, 5:05 PM), https://money.cnn.com/2008/10/28/news/economy/consumer_confidence [https://perma.cc/HGF8-DCWF] (discussing skepticism in the months following the start of the 2008 Global Financial Crisis).

223. *See* Jamie Redman, *A Deep Dive into Satoshi's 11-Year Old Bitcoin Genesis Block*, BITCOIN.COM (Jan. 3, 2020), https://news.bitcoin.com/a-deep-dive-into-satoshis-11-year-old-bitcoin-genesis-block [https://perma.cc/6JBM-G45D] (explaining the memo written into the genesis block of Bitcoin which contained a jab at central banks by quoting a 2009 headline from The London Times which read, "Chancellor on brink of second bailout for banks").

224. SATOSHI NAKAMOTO, BITCOIN: A PEER-TO-PEER ELECTRONIC CASH SYSTEM 1–2, https://bitcoin.org/bitcoin.pdf [https://perma.cc/A8HA-HR3Q].

Blockchain technology—essentially decentralized strings of cryptographic historical transaction information—undergird the entire Bitcoin system.[225] In plainer English, a blockchain is "a digital database containing information (such as records of financial transactions) that can be simultaneously used and shared within a large decentralized, publicly accessible network."[226] "Blocks" are verified by independent third parties that solve algorithmic equations to create a unique "hash" for the batched transactions.[227] The third parties, often called "miners," ensure that the network is secure and decentralized, and usually earn "block rewards," which are normally rewards distributed to the miner in the form of the blockchain's native token.[228] Although mining was initially the primary means for acquiring a given blockchain's native tokens, over the years most advanced blockchain systems have increased the algorithmic difficulty to such an extent that mining is nearly impossible for individuals outside complex mining pools.[229] Instead, individuals now typically use secondary markets called "cryptocurrency exchanges" to purchase the tokens nearly instantaneously.[230]

In totality, each transaction is earmarked by miners with three pieces of information which include: (1) the time, date, or monetary amount involved; (2) the parties involved in the transaction (usually represented by blockchain addresses rather than directly stated party names); and (3) the unique hash that memorializes the transaction and ensures it is distinguishable from every other transaction that has ever been performed on the blockchain.[231] All of this data is stored publicly, on the system's ledger, to ensure that all transactions can be independently verified by whatever party wishes to verify.

225. *Id.* at 3–4. The Bitcoin Whitepaper marks the first actual use case for blockchains, taking the technology from something conceptual, to something tangible (as much as cryptographic code can be considered tangible).

226. *Blockchain*, MERRIAM-WEBSTER DICTIONARY, https://www.merriam-webster.com/dictionary/blockchain [https://perma.cc/AJ2P-LVQ3].

227. Adam Hayes, *Blockchain Explained*, INVESTOPEDIA (Feb. 16, 2022), https://www.investopedia.com/terms/b/blockchain.asp [https://perma.cc/9486-TMK9].

228. JERRY BRITO & ANDREA CASTILLO, BITCOIN: A PRIMER FOR POLICYMAKERS 5–7 (2013), https://www.mercatus.org/system/files/Brito_BitcoinPrimer_v1.3.pdf [https://perma.cc/HQ8H-DJLC]. In the case of the Bitcoin network, the native token is Bitcoin itself. *Id.*

229. *See* Iskander Khasanov, *Cryptocurrency Mining Profitability in 2020: Is It Possible?*, COINTELEGRAPH (Aug. 9, 2020), https://cointelegraph.com/news/cryptocurrency-mining-profitability-in-2020-is-it-possible [https://perma.cc/SDP6-6B94].

230. Jake Frankenfield, *Bitcoin Exchange*, INVESTOPEDIA (Jan. 15, 2022), https://www.investopedia.com/terms/b/bitcoin-exchange.asp [https://perma.cc/A2HX-PEQT].

231. *See* Hayes, *supra* note 227. This analysis is valid for so-called "proof of work" blockchains. Proof of work blockchains remain the primary way of blockchain validation at the time of this writing. "Proof of stake" blockchains operate in a somewhat different manner, though an in-depth analysis of the differences is well beyond the scope of this paper. They remain slightly more theoretical, though recent blockchain adoption of this form of network validation has worked. *Id.*

The invention of the Bitcoin blockchain was revolutionary and led to a flurry of activity in the space in subsequent years. Building off Satoshi's blockchain conceptualization, Vitalik Buterin envisioned, and then created, the Ethereum blockchain in 2013 and 2015, respectively.[232] Ethereum created a distributed network that worked primarily as an open-sourced blockchain and acted as a base layer for smart contract operability.[233] Through the smart contract function, individuals looking to tokenize a wide variety of things —stock in crypto companies, property, and currencies (like stable coins)—could write to the smart contract with their proposal and receive a consensus approval through the network.[234] Ethereum rapidly grew in popularity, and currently sits second in the cryptocurrency asset class (behind Bitcoin) in market capitalization.[235]

Ethereum drastically broadened the reach of blockchains. Ethereum uses smart contracts to interact with applications that are built on the Ethereum network itself. In essence:

> These contracts create and track . . . token ownership. In particular, they map tokens to current owner addresses. Whenever someone wants to transfer a token, this person needs to interact with the contract and make a corresponding transfer call. If successful, i.e., if a person can provide cryptographic proof of ownership, the state of the contract gets adjusted accordingly.[236]

The Ethereum network itself has been billed as a "world computer" due to the ability of developers to develop a myriad of applications on the base layer.[237] In practice, Ethereum has proven useful in removing some of the barriers of entry into investment opportunities, including high transaction costs, low liquidity, and low information transparency.[238] The initial applications

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232. *See Ethereum Whitepaper*, ETHEREUM (Feb. 24, 2022), https://ethereum.org/en/white paper [https://perma.cc/HM7X-RQTN].

233. VITALIK BUTERIN, ETHEREUM WHITEPAPER 13 (2014), https://ethereum.org/669c9e2e 2027310b6b3cdce6e1c52962/Ethereum_White_Paper_-_Buterin_2014.pdf [https://perma.cc /9QD8-NVXU].

234. *Id.*

235. *Cryptocurrency Prices by Market Cap*, COINGEKCO, https://www.coingecko.com [https:// perma.cc/9Z9H-A3N3] (providing a regularly updated ranking of the top one hundred cryptocurrencies by market capitalization).

236. Jakob Roth, Fabian Schär & Aljoscha Schöpfer, *The Tokenization of Assets: Using Blockchains for Equity Crowdfunding*, *in* THEORIES OF CHANGE: CHANGE LEADERSHIP TOOLS, MODELS AND APPLICATIONS FOR INVESTING IN SUSTAINABLE DEVELOPMENT 329, 337 (Karen Wendt ed., 2021).

237. Chris Hoffman, *What Is Ethereum, and What Are Smart Contracts?*, HOW-TO GEEK (Jan. 25, 2022, 11:08 AM), https://www.howtogeek.com/350322/what-is-ethereum-and-what-are-smart contracts/#:~:text=Smart%20contracts%20are%20applications%20that,that%20resource%20i n%20Ether%20tokens [https://perma.cc/LQH6-MXVD].

238. *See* Levin, *supra* note 75, at 41–44 (describing the ways blockchain technology can reduce barriers to investment entry); *see also id.* at 24–25 (describing Ethereum's attributes, including its use of blockchain technology).

built through smart contracts on Ethereum following its release varied heavily, from collectibles,[239] to digital land,[240] and more recently have included insurance protocols,[241] decentralized exchanges,[242] and betting markets.[243] Initially, however, the height of usage came from the ICO (initial coin offering) craze during 2017.[244]

Bitcoin and Ether, Ethereum's native token, had skyrocketed in price into 2017, with Bitcoin's price per coin gaining over 1,800 percent,[245] while Ether increased in price nearly 200-fold from 2015 to 2017.[246] The intense gains in the market encouraged high speculation into the end of 2017, especially around ICOs that often billed themselves as alternative investment vehicles that offered solutions to real-world problems and potentially enormous upside financial gains.[247] Many involved tokens with nearly no utility or turned

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239. Fitz Tepper, *People Have Spent Over $1M Buying Virtual Cats on the Ethereum Blockchain*, TECHCRUNCH (Dec. 3, 2017, 5:48 PM), https://techcrunch.com/2017/12/03/people-have-spent-over-1m-buying-virtual-cats-on-the-ethereum-blockchain/?guccounter=1 [https://perma.cc/NAZ7-4F3V].

240. *See* ESTEBAN ORDANO, ARIEL MEILICH, YEMEL JARDI & MANUEL ARAOZ, DECENTRALAND: WHITE PAPER 5, https://decentraland.org/whitepaper.pdf [https://perma.cc/6628-HUV3] (stating the goal of the project "began as a proof of concept for allocating ownership of digital real estate to users on a blockchain"). Indeed, Decentraland was, and continues to be, a popular site for digital real estate, with its native token retaining a market capitalization of over five billion dollars at the time of publication, up from just one hundred million dollars at the time the author began this piece in fall of 2020. *See Cryptocurrency Prices by Market Cap*, *supra* note 235.

241. *See* HUGH KARP & REINIS MELBARDIS, NEXUS MUTUAL: A PEER-TO-PEER DISCRETIONARY MUTUAL ON THE ETHEREUM BLOCKCHAIN 1–2, https://nexusmutual.io/assets/docs/nmx_white_paperv2_3.pdf [https://perma.cc/D2KS-LX9T].

242. *See* HAYDEN ADAMS, NOAH ZINSMEISTER & DAN ROBINSON, UNISWAP V2 CORE 1–2 (2020), https://uniswap.org/whitepaper.pdf [https://perma.cc/Z8X5-QZB9].

243. JACK PETERSON, JOSEPH KRUG, MICAH ZOLTU, AUSTIN K. WILLIAMS & STEPHANIE ALEXANDER, AUGUR: A DECENTRALIZED ORACLE AND PREDICTION MARKET PLATFORM 1 (2018), https://whitepaper.io/document/29/augur-whitepaper [https://perma.cc/BR4A-LVNS].

244. Cole Petersen, *Data: ICO Bubble Bursts as Median Return Plummets to -87%*, ETHEREUM WORLD NEWS (Aug. 7, 2019), https://en.ethereumworldnews.com/data-ico-bubble-bursts-as-median-return-plummets-to-87 [https://perma.cc/L7ND-22J7]. This thrust the entire Ethereum network into the national spotlight, not necessarily in a good way. *See* Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n, Statement on Cryptocurrencies and Initial Coin Offerings (Dec. 11, 2017), https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11 [https://perma.cc/5KSB-7PAF]; Press Release, U.S. Sec. & Exch. Comm'n, SEC Issues Investigative Report Concluding DAO Tokens, A Digital Asset, Were Securities (July 25, 2017), https://www.sec.gov/news/press-release/2017-131 [https://perma.cc/5THW-UZER].

245. David Z. Morris, *Bitcoin Hits a New Record High, but Stops Short of $20,000*, FORTUNE (Dec. 17, 2017, 10:52 AM), https://fortune.com/2017/12/17/bitcoin-record-high-short-of-20000 [https://perma.cc/FN48-BEAA].

246. Timothy B. Lee, *Explaining the New Cryptocurrency Bubble—And Why It Might Not Be All Bad*, ARS TECHNICA (Oct. 5, 2017, 7:00 AM), https://arstechnica.com/tech-policy/2017/10/explaining-the-new-cryptocurrency-bubble-and-why-it-might-not-be-all-bad [https://perma.cc/H4U6-BXGF].

247. *Id.*

out to be blatant Ponzi schemes.[248] These tokens saw their prices run up massively into 2018 before having their value plummet as insiders dumped their vested tokens on unknowing retail investors.[249]

Billions of dollars were lost in the frenzy, which largely centered around companies releasing tokens (that essentially represented stock in the company) to the public, with almost no regulatory oversight whatsoever.[250] The median loss was around 87 percent for those who invested in the numerous ICO projects,[251] including countless small-time investors that ordinarily would not have been able to invest in such risky projects. The fallout of this debacle was a stricter approach to blockchain offerings by the SEC that has classified nearly every crypto asset, besides Bitcoin and Ether, as potentially representing securities.[252] However, such scrutiny has also allowed regulatory bodies to become more accustomed to blockchain systems generally. Doing so has allowed mainstream financial authorities to recognize the benefits of the technology[253] and, in turn, has compelled such authorities to allow at least some ability for investors to partake in crypto asset investments.[254]

Lost in the hype of stock-like blockchain tokens was the increased adoption of non-fungible tokens ("NFTs"). Technical differences aside, NFTs are smart contract tokens built on Ethereum that represent unique and

248. *See* Mix, *How BitConnect Pulled the Biggest Exit Scheme in Cryptocurrency*, THE NEXT WEB (Jan. 17, 2018, 8:05 PM), https://thenextweb.com/hardfork/2018/01/17/bitconnect-bitcoin-scam-cryptocurrency [https://perma.cc/R8Y3-2FYP].

249. *See, e.g.*, Katherine Greifeld, *High-Flying Crypto Fund Dumps XRP with Ripple in SEC 'Hot Water*,' BLOOMBERGQUINT (Dec. 23, 2020, 11:58 PM), https://www.bloombergquint.com/markets/high-flying-crypto-fund-dumps-xrp-with-ripple-in-sec-hot-water [https://perma.cc/Z5VB-AXBB] (explaining ongoing SEC investigation into the parent company of what was at one point the third-largest crypto asset by market capitalization, XRP, due to the company's alleged systematic selling of unregistered securities to retail investors to fund their operations).

250. *See* Clayton, *supra* note 244 (explaining how dangerous investing in any of these ICOs could be in an official SEC press release). Indeed, this press release came out less than a month before Ethereum's theretofore historical price peak, after which the price crashed around 80 percent in three months. *See Cryptocurrency Prices by Market Cap*, *supra* note 235.

251. Petersen, *supra* note 244.

252. *See, e.g.*, United States v. Zaslavskiy, No. 17 CR 647, 2018 WL 4346339, at *4–7 (E.D.N.Y. Sept. 11, 2018).

253. *See* Jeffrey Gogo, *SEC Looking to Buy a Blockchain Forensics Tool That Analyzes Smart Contracts*, BITCOIN.COM (Aug. 6, 2020), https://news.bitcoin.com/sec-looking-to-buy-a-blockchain-forensics-tool-that-analyzes-smart-contracts [https://perma.cc/BZ5W-V655].

254. *See* Richard Best, *2 Funds That Invest in Bitcoin*, INVESTOPEDIA (Jan. 21, 2020), https://www.investopedia.com/articles/etfs-mutual-funds/042816/2-funds-invest-bitcoin-gbtc-arkw.asp [https://perma.cc/HXA7-D9MJ] (explaining two trusts that act like "exchange-traded funds (ETFs)," which allow investors to gain exposure to cryptocurrency without the difficulties of procuring the cryptocurrencies themselves). Some publicly traded companies have also begun adding cryptocurrencies to their balance sheets, allowing investors to indirectly invest in the cryptocurrency itself. *See* Brian Denyeau & Michael Bizovi, *MicroStrategy Adopts Bitcoin as Primary Treasury Reserve Asset*, BUSINESSWIRE (Aug. 11, 2020, 6:00 AM), https://www.businesswire.com/news/home/20200811005331/en [https://perma.cc/PHM9-7VMR].

individual assets.[255] This differs from fungible assets or tokens, like cash, which represent the same "thing," and can be exchanged with something identical to it with ease.[256] NFTs are popularly used to represent unique assets, like collectibles, art, and real estate (both digital and real-world).

Using NFTs to represent real world real estate has been a slowly growing industry. There now exist dozens of websites that offer tokenized real estate, from tokenized houses to larger scale, million-dollar construction or renovation projects.[257] Yet the NFT real estate market remains almost comically small compared to the professionally managed, global real estate market, which nears ten trillion dollars in value.[258] Difficulty in comprehending blockchains, and the fact that most investment projects on the platforms require accredited status, remain major roadblocks in more widespread adoption.[259]

The conceptualization of tokenized real estate was indicated directly in Ethereum's whitepaper.[260] Indeed, by 2017 and 2018, the concept had attracted somewhat of a cult following by individuals and firms who saw the efficiency potential of blockchain technology alongside the uniquely disruptive real estate market.[261] Most institutional grade applications were, and continue to be, built on the Ethereum network, which remains the largest and most

255. Connor Blenkinsop, *Nonfungible Tokens, Explained*, COINTELEGRAPH (July 26, 2018), https://cointelegraph.com/explained/non-fungible-tokens-explained [https://perma.cc/22TX-ST5W].

256. *Id.*

257. Sam Daley, *19 Blockchain Companies Boosting the Real Estate Industry*, BUILT IN (July 30, 2021), https://builtin.com/blockchain/blockchain-real-estate-companies [https://perma.cc/8PSA-9MGJ].

258. MSCI, REAL ESTATE MARKET SIZE 2019/20, at 5 (2020), https://www.msci.com/documents/1296102/19878845/MSCI_Real_Estate_Market_Size_2020.pdf/06a13e2c-0230-f253-26fa-3318cecb1c59 [https://perma.cc/LQ8V-EGMS].

259. If one runs through any number of online tokenized real estate websites, nearly all require accredited status. *E.g.*, REALT, LEGALLY COMPLIANT OWNERSHIP OF TOKENIZED REAL ESTATE 21 (2019), https://cdn-realt.junglewp.net/wp-content/uploads/2019/05/RealToken_White_Paper_US_v03.pdf [https://perma.cc/TEL9-9HA5]. There are some companies that allow unaccredited investors to participate, but they are few and far in between. Thus, the market has been stymied from growth by two facets of the traditional market. First, the actual traditional regulatory apparatus, like requiring accredited investor status to invest in the first place. Second, the slow adoption that follows most burgeoning industries, especially if that industry looks to disrupt the current system. *See* Andrew Singer, *Crypto Mass Adoption Will Be Here When . . . [Fill in the Blank]*, MAG. BY COINTELEGRAPH (Aug. 24, 2020), https://cointelegraph.com/magazine/2020/08/24/crypto-mass-adoption [https://perma.cc/7JTZ-ZPH4] (arguing that crypto assets will really only have a chance to reach their full potential when "things in the real world break").

260. *See* BUTERIN, *supra* note 233, at 1. Although it is not clear the extent to which Buterin believed in the application of tokenized, real-world real estate, he at least conceptualized "ownership of an underlying physical device," which he deemed "smart property." *Id.*

261. *See Property Tokenization: The Future of Real Estate Investing*, INVAO (Sept. 30, 2019), https://invao.org/property-tokenization-the-future-of-real-estate-investing [https://perma.cc/MQP5-3U54].

trustworthy layer-one platform onto which smart contracts are built.[262] Given the relative importance of real estate in the private offering market,[263] real estate's long and ongoing position in the American psyche,[264] and real estate's relative annual returns,[265] the real estate market as a whole represents perhaps the largest and most formidable traditional financial sector that blockchain could interact with.

2. Benefits of Tokenized Real Estate

Indeed, this technology represents perfectly how financially attractive small and emerging markets can be for offerors and investors alike. Blockchains improve on existent real estate markets by building on top of preexisting value that exists from an asset's "core cash flow generating ability" and add additional sources of value including "reduced transaction and administrative costs," as well as "enhanced liquidity."[266] When compared directly against the traditional real estate market, blockchains offer an attractive tool at first glance because they allow increased access to real estate investment opportunities, increased liquidity in a notoriously illiquid market, transparency over ownership and equity, and lower transaction costs.[267] Additionally, the immutability of blockchain can broadcast existing legal issues like liens, financing issues, or concurrent claims publicly, creating transparency in the real estate market broadly, and perhaps lowering legal

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262. The last year has seen a marked increase in the usage of other layer-one technology due to some technical difficulties with Ethereum's scaling solutions. These layer-ones have offered investors incredible returns, though how many long-lasting, unique applications will be built on them is yet to be seen. *See* Andrew Asmakov, *Near Hits All-Time High as Layer-1 Blockchain Competition Heats Up*, DECRYPT (Jan. 4, 2022), https://decrypt.co/89703/near-hits-all-time-high-layer-1-blockchain-competition [https://perma.cc/VCL2-2Y3C].

263. Final Rule, *supra* note 4, at 64,261 tbl.2 (indicating that 23.9 percent of individual accredited investors had participated in a private real estate offering, and that this number is probably much higher given overlapping data).

264. Frederick Peters, *The American Dream of Homeownership Is Still Very Much Alive*, FORBES (Apr. 8, 2019, 2:18 PM), https://www.forbes.com/sites/fredpeters/2019/04/08/the-american-dream-of-homeownership-is-still-very-much-alive/#764640f93e80 [https://perma.cc/8XDA-C9B2]; Derek Thompson, *America's Weird, Enduring Love Affair With Cars and Houses*, ATLANTIC (Feb. 25, 2014), https://www.theatlantic.com/business/archive/2014/02/americas-weird-enduring-love-affair-with-cars-and-houses/284049 [https://perma.cc/3AUA-SN89].

265. Some forms of real estate investments, like retail and equity REITs, outperformed mortgage instruments, debt instruments, and commodity prices (though they largely underperformed stock indices). *See* Jack Clark Francis & Roger G. Ibbotson, *Contrasting Real Estate with Comparable Investments, 1978 to 2008*, J. PORTFOLIO MGMT., Fall 2009, at 141, 145 fig.4. However, many advisors urge at least a portion of exposure to real estate in some form or another, given how they represent an entire sector according to the Global Industry Classification Standard and are thought to be a relatively safe, stable, non-correlated long-term investment. *See The Global Industry Classification Standard (GICS)*, MSCI, https://www.msci.com/gics [https://perma.cc/LUB4-L2KR].

266. PHILIP PANG ET AL., REAL ESTATE TOKENIZATION 12 (2020), https://assets.kpmg/content/dam/kpmg/cn/pdf/en/2020/04/real-estate-tokenization.pdf [https://perma.cc/HVW2-GJNF].

267. Levin, *supra* note 75, at 41–44.

costs individually.[268] All these attributes of blockchain utilization represent positive changes that, if implemented widely, could introduce more efficiency and trust into the real estate market.[269]

In this context, increased access operates in a twofold manner. First, blockchains improve access by offering the possibility of direct participation in real estate transactions in both primary offerings and later in secondary markets. This is opposed to the current system which limits real estate exposure to very limited private offerings or publicly traded Real Estate Investment Trusts ("REITs").[270] Second, increased access also means the ability for more individuals to become aware of the investment opportunity in the first place as transactions "on the blockchain allow for investors around the world to be made aware of investment opportunities" instead of them being confined to a smaller group of insiders.[271]

Increasing liquidity for the real estate has always been a challenge, as it is inherently capital intensive and historically has been used as a longer-term investment vehicle.[272] Tokenizing real estate "[r]educ[es] the cost per unit of investment in real assets [which] brings down a significant barrier to entry [and] gives investors who are interested in exposure to real assets but either don't have or don't want to invest the amount typically required for real asset exposure."[273] Tokenization allows an individual to "[s]ell[] a fraction of a real asset versus a full [asset, which] opens the door to more buyers and thus increases the chance of selling the token as there are more buyers able to purchase a fraction of a project than a full project."[274] Further, the smaller chunks of real estate would be represented as tokens on the central blockchain platform, like Ethereum, which would allow owners to quickly buy and sell these portions with relative ease. In this way, liquidity would be

268. *See* DELOITTE CTR. FOR FIN. SERVS., BLOCKCHAIN IN COMMERCIAL REAL ESTATE: THE FUTURE IS HERE! 17–20 (2017), https://www2.deloitte.com/content/dam/Deloitte/us/Documents/financial-services/us-dcfs-blockchain-in-cre-the-future-is-here.pdf [https://perma.cc/C8R2-N7Q9].

269. *See* MASS. INST. OF TECH. DIGIT. CURRENCY INITIATIVE, TOKENIZED SECURITIES & COMMERCIAL REAL ESTATE 14–36 (2019), https://mitcre.mit.edu/wp-content/uploads/2019/11/Tokenized-Security-Commercial-Real-Estate2.pdf [https://perma.cc/W4ZJ-JELJ]; Levin, *supra* note 75, at 41–44.

270. Private offerings are obviously largely precluded from retail investors. *See* 17 C.F.R. § 230.501(a) (2021). Additionally, while REITs offer a nice vehicle for exposure in real estate, the underlying assets included in REITs offer only a fraction of exposure to the real estate market broadly. *See* MASS. INST. OF TECH. DIGIT. CURRENCY INITIATIVE, *supra* note 269, at 20 (explaining that "[i]n North America, listed property [represented in REITs] as a percentage of the overall underlying real estate market was only 11.5%").

271. Levin, *supra* note 75, at 42–43.

272. Rebecca Baldridge, *Add Some Real Estate to Your Portfolio*, INVESTOPEDIA (Oct. 29, 2020), https://www.investopedia.com/articles/mortgages-real-estate/08/real-estate-mutual-fund.asp [https://perma.cc/CQ3K-5N6K].

273. Levin, *supra* note 75, at 44.

274. *Id.* at 43.

improved both by knocking down initial entry barriers, and by expanding existing exit avenues.

Transparency over ownership has been a bane of real estate title rights for an extended time. Blockchains help alleviate issues related to filing deeds and transferal of ownership because "once the asset is placed on the blockchain," one can easily "verify that the asset or holding exists" and can look back at independently and automatically verified transaction data by viewing the public ledger.[275]

Lastly, real estate has atypically high barriers of entry due to costs associated with third-party intermediaries.[276] These typical fees could be drastically reduced by the implementation of blockchain technology, which would eliminate the need for third-parties to exchange money between the parties to the transaction (done over the blockchain itself), eliminate the need for paying brokerage fees (unless one was charged by the blockchain intermediary), and eliminate the hassle of audits and due diligence (issues with the asset would be replicated in the memo portion of previous transaction hashes).[277]

3. Synergies of the Emerging Tokenized Real Estate Market and an Expanded Accredited Investor Definition

The deficiencies of the current accredited investor definition are apparent when surveying the stunted growth of this potentially disruptive technology. Niche markets, such as tokenized real estate, require critical masses of investors in order for offerors to be willing to undertake the offerings in the first place. The SEC acknowledged that these emerging markets, and often the smaller startup offerors that participate in them, stand the most to gain from its newly adopted accredited investor amendments, stating that the changes could greatly impact the outlook of "issuers that are small, in development stages, or in geographic areas that currently have lower concentrations of accredited investors."[278] These niche markets, often centered around technological developments, can offer fantastic asymmetry in expected return, both for investors and offerors alike. However, these opportunities are often stifled because individuals are not able to participate in the opportunity due to their unaccredited status or because the offeror is unable to conduct the offering in the first place because of a limited accredited investor pool.[279]

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275. *Id.* at 43–44.

276. *Id.* at 41–42.

277. *Id.*

278. Final Rule, *supra* note 4, at 64,260.

279. In essence, the current accreditation standards form a kind of doom loop. Offerors are unable to offer, or have their offers fail, precisely because there does not exist a large enough pool of investors to draw upon. Investors may want to participate, but they are not allowed to do to the lack of accreditation. Both parties see their wishes snuffed out, and the entire niche

i. Increased Initial Capitalization

While the tokenized real estate market does show some encouraging signs of life,[280] it remains remarkably undercapitalized. Though investment opportunities do exist—from single unit homes in Detroit or Akron,[281] to multi-hundred-million-dollar commercial ventures,[282] to smaller, high end commercial endeavors[283]—full utilization of blockchains in real estate transactions has proven tricky. Indeed, several projects have either gone belly up, or have failed to offer even after extensive discussions to do so.[284]

A variety of reasons could explain this trend, including uncertainty regarding tokenization legality,[285] limited investor pools due to accreditation standards (and unwillingness to offer to individuals who are unaccredited),[286] and a lack of full institutional engagement.[287] These last two points garner specific consideration, as the two feed off one another inherently. Niche markets need a critical mass of excitement, clarity, and capital to grow. Often what is needed is an initial push by an extremely dedicated group of

industry suffers as a result. In a way, this doom loop mirrors how the current accreditation standards discourage investment in certain geographic areas. *See supra* Section III.B.3.

280. *Security Token Market Report: July 2020*, SEC. TOKEN MKT. (Aug. 3, 2020), https://medium.com/security-token-group/security-token-market-report-july-2020-cbba8d2e6249 [https://perma.cc/E9K9-9MS5] (stating that the total market capitalization for tokenized real estate assets stood at over $392,000,000, a 159% increase from the previous month).

281. *See* REALT, *supra* note 259, at 4–5. RealT offers tokenization of smaller family homes that can be bought by individual's interested in owning factional shares of rental properties. *Id.*

282. *See* Jack Martin, *Tokenized Real Estate Marketplace Launches with $237M in Assets*, COINTELEGRAPH (Sept. 10, 2020), https://cointelegraph.com/news/tokenized-real-estate-marketplace-launches-with-237m-in-assets [https://perma.cc/ET2J-9D4L]. Reinno largely offers investment opportunity into commercial properties, and nearly all of their offerings require accredited investor status. *Id.*

283. *See* Danny Nelson, *tZERO Plans to Support Trading of Aspencoin Ski Resort Digital Security*, COINDESK (July 22, 2020, 1:11 PM), https://www.coindesk.com/tzero-aspencoin-st-regis-elevated-returns [https://perma.cc/7FZ6-S4T9] (explaining the tokenized sale of a nearly 20 percent stake in a five-star ski-resort in Aspen, Colorado).

284. *See* Ian Allison, *Tokenized Real Estate Falters as Another Hyped Deal Falls Apart*, COINDESK (Nov. 26, 2019), https://www.coindesk.com/tokenized-real-estate-falters-as-another-hyped-deal-falls-apart [https://perma.cc/EDS6-LAZ2].

285. *See* Samuel Haig, *Tokenized Real Estate Hasn't Lived Up to the Hype: Property Researcher*, COINTELEGRAPH (July 31, 2020), https://cointelegraph.com/news/tokenized-real-estate-hasnt-lived-up-to-the-hype-property-researcher [https://perma.cc/4BE4-7YDA] (reporting that Matthew McAuley, director of global research for a real estate service company, argues that a "legislative apparatus" is needed for further growth in the space).

286. *See infra* notes 289–90 and accompanying text. Interestingly, this same kind of problem mirrored the issue some smaller offerors were having with private offerings in the 1970s and 1980s. *See supra* notes 33–38 and accompanying text. It is likely that, much like the previous small offerors in the 1970s and 1980s, offerors of tokenized real estate today fear regulatory ambiguity, especially in a space as legally amorphous as crypto assets.

287. *See* Haig, *supra* note 285.

individuals[288] who are able to define and refine the scope of the market—while over time providing adequate baseline liquidity—before institutional interest is formed.[289] Tokenized real estate as a market has struggled to attain this base layer of liquidity, and the dearth of individual accredited investors able to participate plays a large role in the problem.[290]

Institutional investors are less likely to get into the market without existing liquidity, which can be due to concerns over price stability or risk appetites of these firms. The CEO of a major tokenized real estate company summarized the first part of the conundrum as such: "Most [clients] prefer having [. . .] offerings that do not allow selling securities to unaccredited investors . . . ."[291] An expanded individual accreditation standard could thus enable the critical mass of capital to form more easily, in turn assuaging concerns by institution investors, which lastly would encourage more offerings in the market. The chain reaction starts at the individual level, and without expansion of the individual accreditation standard, the tokenized real estate market, and markets like it, cannot achieve their potential.

As the SEC indicates, the recently amended individual accredited investor definition is unlikely to change this group's impact on capital formation much, due to the fact that the investor pool likely will not grow dramatically. However, the changes made to accredited investment firms could certainly help the tokenized market grow. Indeed, one of the biggest issues that the market has faced has been a lack of broad institutional support and involvement.[292] This addition of institutional support should allow, all else equal, better capital formation, though the limitations to this statement have already been made clear.[293]

ii. Increased Breadth of Liquidity and Outsized Asymmetric Returns

However, allowing a larger pool of individual investors access to this market provides those investors the same opportunity for asymmetric returns, helps build a more legitimate and broader base of capital formation, and

288. Bitcoin provides an excellent example of how an emerging asset class was first supported by a small group of dedicated users before being adopted by institutions, banks, and hedge funds. *See* Eric Rosenbaum, *With Bitcoin Near All-Time High, This Is Where Visa's CEO Sees Crypto Going*, CNBC (Nov. 21, 2020, 11:09 AM), https://www.cnbc.com/2020/11/20/where-visa-sees-crypto-going-with-bitcoin-near-all-time-high-.html [https://perma.cc/9ENC-W7W7] (detailing an interview with a major institutional payment company's CEO, in which he says that after nearly a decade, big financial players are entering the market because Bitcoin has passed the "litmus tests").

289. Previously described as a "doom loop," *see supra* note 279 and accompanying text, the problem has also been explained this way: "Institutions want to see liquidity before they will go ahead and re-engineer their entire back office. Meanwhile, issuers have to get tokens into the market to prove their thesis, leading to a chicken-and-egg problem." Allison, *supra* note 284.

290. *See* Allison, *supra* note 284.

291. Martin, *supra* note 282 (alterations in original).

292. *See supra* notes 285–90 and accompanying text.

293. *See supra* notes 285–90 and accompanying text.

could help increase the adoption of this niche market across a broader spectrum of the populous at large. The SEC stated in its Final Ruling that it "expect[s] that small issuers that face more challenges in raising external financing may benefit more from expanding the pool of accredited investors."[294] This is true and, by extension, small and niche markets also stand with the most to gain from a further expanded pool of individual accredited investors.

Investors and offerors alike will gain from a simultaneous expansion of accreditation, right as a newly formed and highly promising market begins to emerge. A broader individual definition could allow the positive benefits of the tokenized market, like immutability, lower barriers to entry and transaction costs, and increased liquidity, to create synergies prefaced on creating a safer and more stable market ecosystem for offerors and investors. This market confidence, in turn, would help increase capital formation and participation, and would lure in other parties that see the stability, yet ongoing asymmetry, that the tokenized real estate market offers.

In a nutshell, tokenized real estate requires an expanded individual accredited investor definition to truly reach its full potential, and a further expanded definition consequently has the best chance at achieving the SEC's goal of broader and more diversified capital formation, especially for smaller offerors and markets.[295] Working in concert, both the tokenized market and the expanded individual definition offer a chance at heightened efficiency, broader market participation, increased transparency, asymmetric return, and investor and offeror protections.

V. CONCLUSION

Since *Ralston*, the SEC and courts alike have undertaken the task of enforcing the 1933 Act, always keeping in mind that in any offering, "[t]he focus of inquiry should be on the need of the offerees for the protections afforded by [nonexempt] registration."[296] Years later, the SEC continues to propagate an "accredited investor" definition as a way to effectuate the intent of the 1933 Act as *Ralston* interpreted it. After years of a static accreditation definition, the SEC finally undertook the task of amending in a broader attempt "to simplify, harmonize, and improve the exempt offering framework under the [1933] Act to promote capital formation and expand investment opportunities while maintaining and enhancing appropriate investor protections."[297] However, the definition continues to be overly restrictive, especially as it relates to the process by which an individual becomes accredited. Further amending the accreditation standard—both by adjusting

294. Final Rule, *supra* note 4, at 64, 271.

295. *Id.*

296. Sec. & Exch. Comm'n v. Ralston Purina Co., 346 U.S. 119, 127 (1953).

297. Final Rule, *supra* note 4, at 64,235.

income and wealth requirements by geographic location, and by creating a more expansive tiered system for gaining individual accreditation through certification—offers greater ability for capital formation and provides investors an incredible chance at tapping a new investment market. The risks associated with such changes are dwarfed by the positive benefits to both offerors and investors. This holds especially true for new and emerging markets, like tokenized real estate, where offerors and investors can seek the greatest asymmetric returns and gain first mover advantages.