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SEC Amends Definition of Accredited Investor

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On August 26, 2020, the Securities and Exchange Commission (SEC) adopted long anticipated amendments to the "accredited investor" definition. The SEC said that the amendments are intended to update and improve the definition to identify more effectively investors that have sufficient knowledge and expertise to participate in securities offerings that are not registered under the Securities Act of 1933.

The "accredited investor" definition is a central component of the Rule 506 exemptions from registration, sometimes referred to as Regulation D, and plays an important role in other exemptions and other federal and state securities law contexts. Qualifying as an accredited investor, as an individual or an institution, is significant because accredited investors may, under SEC rules, participate in investment opportunities that are generally not available to non-accredited investors, including private placements. The SEC estimates that in 2019, approximately $2.7 trillion was raised through exempt offerings.

Prior to the adoption of these final rules, the accredited investor definition has generally used wealth—in the form of a certain level of income or net worth—as a proxy for financial sophistication. For example, the SEC established the $200,000 individual income and $1 million net worth threshold for accredited investors in 1982 and the $300,000 joint income threshold in 1988. These standards have gone largely unchanged since then, with the exception of amending the net worth standard to exclude the value of the investor's primary residence in 2011. The amendments create new categories of individuals and entities that qualify as accredited investors irrespective of their wealth, on the basis that such investors have demonstrated the requisite ability to assess an investment opportunity.

The amendments to the accredited investor definition:

- add a new category that permits natural persons to qualify as accredited investors based on certain professional certifications, designations or credentials or other credentials issued by an accredited educational institution, which the SEC may designate from time to time by order. In conjunction with the adoption of the amendments, the SEC designated by order holders in good standing of the Series 7, Series 65, and Series 82 licenses as qualifying natural persons. This

approach provides the SEC with flexibility to reevaluate or add certifications, designations, or credentials in the future.

- include as accredited investors, with respect to investments in a private fund, natural persons who are "knowledgeable employees" of the fund;
- clarify that limited liability companies with $5 million in assets may be accredited investors and add SEC- and state-registered investment advisers, exempt reporting advisers, and rural business investment companies (RBICs) to the list of entities that may qualify;
- add a new category for any entity, including Indian tribes, governmental bodies, funds, and entities organized under the laws of foreign countries, that own "investments," as defined in Rule 2a51-1(b) under the Investment Company Act, in excess of $5 million and that was not formed for the specific purpose of investing in the securities offered;
- add "family offices" with at least $5 million in assets under management and their "family clients," as each term is defined under the Investment Advisers Act; and
- add the term "spousal equivalent" to the accredited investor definition, so that spousal equivalents may pool their finances for the purpose of qualifying as accredited investors.

The SEC determined not to modify the definition's existing financial thresholds at this time, and thus investors that meet the current accredited investor standards will be unaffected. The SEC said removing investors from the current pool, particularly those who have participated, or are currently participating, in the private placement market would be inappropriate on various grounds, including the imposition of costs and principles of fairness more generally. The SEC also noted that at a more general level, a significant reduction in the accredited investor pool through an increase in the definition's financial thresholds could have disruptive effects on certain aspects of the Regulation D market.

These amendments expand the potential universe of investors available for fundraising through private placements, and will reduce transaction costs related to the verification of the accredited status with respect to certain investors. Since general solicitation in private placements is only permitted if, among other requirements, all purchasers are "accredited", the expanded definition may also increase the benefits of engaging in such offerings. Issuer's engaged in private placements should review their investor documentation to reflect the new definition, and consider how these changes may impact how they engage in private offerings and sales of their securities.

The amendments become effective 60 days after publication in the Federal Register. The SEC may have additional guidance as effectiveness grows closer and the questions and implications surrounding these amendments come into focus.

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