

SEC Proposes Changes to Accredited Investor Definition—But Are More Changes Coming?

January 13, 2020

On December 18, 2019, the SEC proposed amendments (the “Proposed Amendments”) to the definition of “accredited investor” in Rule 501(a) of Regulation D under the Securities Act of 1933 (the “Securities Act”).¹ The definition of “accredited investor” plays an important role in federal securities laws by identifying persons and/or entities with the financial sophistication and ability to bear the risk to participate in certain securities offerings. For example, private funds and many other private issuers often rely on Rule 506 of Regulation D to exempt certain private securities offerings from registration under the Securities Act. Among other requirements, Rule 506 of Regulation D requires that, with certain limited exceptions, purchasers of the securities offered are limited to accredited investors. The Proposed Amendments follow up on a Concept Release published by the SEC on June 18, 2019 seeking comment on the harmonization of securities offering exemptions.²

The Proposed Amendments would modify certain of the existing categories of accredited investors and create certain new categories, including, in particular, new categories for persons with professional certifications, “knowledgeable employees” of private funds, and certain family offices and their family clients. Importantly, the Proposed Amendments would not amend the asset, net worth or income thresholds in the definition.

The utility of these changes for private fund sponsors would likely be limited since, in most circumstances, the “qualified purchaser” thresholds under the Investment Company Act of 1940 (the “Investment Company Act”) are generally more difficult to satisfy. However, the Proposing Release and related statements indicate that more significant changes may be coming that will increase the ability of retail investors to have access to private investment opportunities.

¹ Amending the “Accredited Investor” Definition, SEC Release Nos. 33-10734; 34-87784 (Dec. 18, 2019) (the “Proposing Release”).

² Concept Release on Harmonization of Securities Offering Exemptions, Release No. 33-10649 (June 18, 2019) (the “Concept Release”).

NEW AND AMENDED ACCREDITED INVESTOR CATEGORIES

The Proposed Amendments would amend or add the following categories of “accredited investor”:

- *Knowledgeable Employees.* The Proposed Amendments would add a new category for “knowledgeable employees” (as defined in Rule 3c-5 under the Investment Company Act) of a private fund with respect to investment in that fund. This new category would be particularly useful for junior or other employees who meet the “knowledgeable employee” standard but do not meet the current financial thresholds in the “accredited investor” definition.
- *Natural Persons with Professional Certifications.* The Proposed Amendments would add a new category to the definition of “accredited investor” for natural persons “holding in good standing one or more professional certifications or designations or credentials from an accredited institution” that the SEC has designed by order. The Proposing Release states that the SEC expects that the following professional certifications would qualify: a licensed general securities representative (Series 7), licensed investment adviser representation (Series 65) and licensed private securities offerings representative (Series 82).
- *Family Offices and Family Clients.* The Proposed Amendments would add a new category for any “family office” with at least \$5 million in assets under management and its “family clients” (as such terms are defined in Rule 202(a)(11)(g)-1 under the Investment Advisers Act of 1940). The family office must be directed by a person with knowledge and experience in financial and business matters and the family office and the client may not have been formed for the purpose of acquiring the securities being offered.
- *SEC- and State-Registered Investment Advisers and RBICs.* The Proposed Amendments would add as accredited investors (i) investment advisers registered with the SEC or states and (ii) rural business investment companies (as defined in Section 384A of the Consolidated Farm and Rural Development Act). The Proposing Release also solicits comments on whether clients advised by registered investment advisers should also be considered “accredited investors.”
- *LLCs.* The Proposed Amendments would codify an SEC staff position and add limited liability companies to the list of entities that are “accredited investors” if the entity has more than \$5 million in total assets and was not formed for the purpose of acquiring the securities being offered.

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- *Other Entities.* The Proposed Amendments also propose to add a “catchall” of other entities that are not already listed, which are not formed for the purpose of acquiring the securities offered and own \$5 million or more in “investments” (as defined in Rule 2a51-1(b) under the Investment Company Act). This “catchall” would capture certain existing entity forms (such as Indian tribes and governmental bodies) as well as future entity types.

The Proposed Amendments would add a note that clarifies that an investor relying on the joint net worth test in Rule 501(a)(5) is not required to purchase the security jointly with his or her spouse or spouse equivalent. The Proposed Amendments would also amend the joint income and joint net worth thresholds to capture “spousal equivalents” in addition to “spouses.” Finally, the Proposed Amendments would include a note that would clarify the ability to look through multiple layers of entities who are equity owners.

ASSETS, NET WORTH AND NET INCOME THRESHOLDS

The SEC did not propose any changes to the financial thresholds contained in the definition of “accredited investor.” Currently, the relevant thresholds under the definition are \$5 million for total assets, \$1 million for individual or joint net worth (excluding primary residence), and \$200,000 for individual income or \$300,000 for joint income. The Proposing Release notes that these thresholds have not been adjusted for inflation since 1982. The SEC concluded that adjusting these thresholds was not necessary due to, among other things, (i) the availability of information and advances in technologies, (ii) the absence of “widespread problems or abuses” associated with Regulation D offerings to accredited investors, (iii) the potential disruptive effects on U.S. capital formation and (iv) the disparate impacts on certain investors, particularly geographically. However, two Commissioners dissented from this approach and the SEC is requesting comment on whether it should adjust these thresholds in the final rule.³

³ See Statement Reducing Investor Protections around Private Markets, Commissioner Robert J. Jackson Jr. (Dec. 18, 2019) (discussing signs of potential risk of fraud in exempt offerings), [available here](#); Statement at Open Meeting on Amending the “Accredited Investor” Definition, Commissioner Hester M. Peirce (Dec. 18, 2019) (noting that differences in the cost of living means that salaries are lower in some areas of the country, but such persons may still have the requisite financial sophistication), [available here](#).

MORE TO COME?

As noted above, the SEC published a Concept Release in 2019 seeking comment on the harmonization of securities offering exemptions. The Proposing Release notes that the SEC is “continuing to evaluate the comments received on the Concept Release in connection with possible future rulemaking proposals relating to the exemptions from registration under the Securities Act.”⁴ Further to this point, Chairman Clayton noted in his statement concerning the Proposed Amendments that “[he] expect[s] more to come in this space in the coming months, including examining whether appropriately structured funds can facilitate greater Main Street investor access to private investments, particularly as a component of an investment portfolio that is analogous to the portfolio of a well-managed pension fund” and that the SEC will “focus on solutions that provide access to investment opportunities on substantially the same terms as those that would be available to institutional investors with protections—including alignment of interest between individuals and institutions, and transparency—that are akin to the protections in our public market.” This suggests that the SEC is carefully considering ways in which more investors can gain access to privately offered investments.

The Proposed Amendment has not been published in the Federal Register as of this publication; however, comments on the Proposed Amendments will be due within 60 days after the publication in the Federal Register.

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Please do not hesitate to contact us with any questions.

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⁴ Proposing Release at p. 6.