SEC Proposes to Expand Definition of "Accredited Investor"

On December 18, 2019, the Securities and Exchange Commission (the "SEC") published for comment proposed amendments to the definition of "accredited investor" under the Securities Act of 1933, which would expand the category of investors eligible to participate in private offerings under Regulation D.[1] The amendments would create new categories of accredited investors, including those that qualify irrespective of wealth, on the basis that they have the requisite ability to assess an investment opportunity. The amendments would also codify certain staff interpretative positions. Key changes proposed are discussed at a high level below.

New Categories of Accredited Investors

The SEC proposes to expand the categories of accredited investors for both natural persons and entities.

- Professional Certifications, Designations, or Credentials. Under a new category in the proposed definition, natural persons would be able to qualify as accredited investors based on certain professional certifications, designations, or credentials from an accredited educational institution that the SEC designates as qualifying an individual for accredited investor status.[2] Such designations would be issued by an SEC order and posted to the SEC website, as opposed to being codified in the new definition, which would allow the SEC to modify the list over time.

  The SEC expects to accompany the final rule amending the accredited investor definition with an initial order that would include designations for (1) licensed general securities representatives (Series 7); (2) licensed investment adviser representatives (Series 65); and (3) licensed private securities offerings representatives (Series 82). Individuals holding such licenses in good standing would qualify as accredited investors even if they do not meet the income or net worth standards in the accredited investor definition. In determining whether to qualify a professional certification, designation, or credential under the new category, the SEC would consider (1) whether it requires an examination administered by a self-regulatory organization, industry body, or accredited educational institution, (2) whether the examination is designed to reliably and

[1] Amending the "Accredited Investor" Definition, Release Nos. 33-10734; 34-87784. (Dec. 18, 2019) ("Proposing Release"). The proposed amendments build upon a June 2019 concept release issued by the SEC, a December 2015 staff report that examined the background and history of the accredited investor definition, amendments that the SEC proposed in 2007 but did not adopt, and comments received on the foregoing. The SEC also proposes to amend the definition of "qualified institutional buyer" to expand the list of entities that are eligible to qualify as qualified institutional buyers.

[2] Proposed Rule 501(a)(10).

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validly demonstrate an individual's comprehension and sophistication in the areas of securities and investing, (3) whether persons obtaining such certification, designation, or credential can reasonably be expected to have sufficient knowledge and experience in financial and business matters to evaluate the merits and risks of a prospective investment, and (4) whether the relevant self-regulatory organization or other industry body has made information publicly available to indicate that an individual holds the certification or designation (e.g., FINRA's BrokerCheck or the SEC's Investment Adviser Public Disclosure database).

- Knowledgeable Employees. The proposed amendments would allow individuals who are "knowledgeable employees," as defined in Rule 3c-5 under the Investment Company Act of 1940 (the "Investment Company Act"), of an issuer to qualify as accredited investors of that issuer.[3] These would be the same individuals that qualify as knowledgeable employees for purposes of Section 3(c)(1) and Section 3(c)(7) of the Investment Company Act.

- Catch-All for Entities Owning More than $5 Million in Investments. Under the proposed amendments, "any" entity would be able to qualify as an accredited investor if it (1) owns more than $5 million in "investments," as defined in Rule 2a51-(b) under the Investment Company Act, and (2) was not formed for the specific purpose of acquiring the securities offered.[4] This catch-all category is intended to capture all existing entity forms not already included in the current definition, such as Native American tribes and governmental bodies, as well as those entity types that may be created in the future.[5]

- Family Offices and Family Clients. The proposed amendments would create a new category of accredited investors for certain "family offices" and their "family clients," each as defined in rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940. A family office would qualify as an accredited investor if (1) it has more than $5 million in assets under management, (2) it was not formed for the specific purpose of acquiring the securities offered, and (3) its prospective investment is directed by a person with knowledge and experience in financial and business matters that the family office is capable of evaluating the merits and risks of the prospective investment.[6] Family clients of a family office that meets these requirements would also be accredited investors.[7]

- Registered Investment Advisers and Rural Business Investment Companies. The proposed amendments would add SEC- and state-registered investment advisers to the list of entities that qualify as accredited investors based on their status alone.[8] The proposed amendments would also add rural business investment companies to the list, allowing such companies to also qualify as accredited investors based on their status alone.[9]

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3 Proposed Rule 501(a)(11).

4 Proposed Rule 501(a)(9).

5 The current definition lists only the following types of entities: a corporation, Massachusetts or similar business trust, partnership, or organization described in section 501(c)(3) of the Internal Revenue Code. See Rule 501(a)(3).

6 Proposed Rule 501(a)(12).

7 Proposed Rule 501(a)(13).

8 Proposed Rule 501(a)(1).

9 Id.

Clarifications and Codification of Staff Interpretative Positions

The SEC proposes to codify certain staff interpretative positions that relate to the accredited investor definition and otherwise address uncertainties.

- The proposed amendments would codify a longstanding staff position that limited liability companies are eligible to qualify as accredited investors if they satisfy the other requirements of Rule 501(a)(3).[10]
- The proposed amendments would add a note to Rule 501(a)(8) to make it permissible to look through various forms of equity ownership to natural persons when determining the accredited investor status of entities.[11] This proposed note is consistent with an existing staff interpretation, which permits multiple look-throughs to qualify as an accredited investor.[12]
- The proposed amendments would add a note to Rule 501(a)(5) to clarify that the calculation of "joint net worth" for individuals may be the aggregate of their net worth with their spouses, and that the securities being purchased by an investor relying on the joint net worth test need not be purchased jointly.[13] This proposed note is consistent with an existing staff interpretation.[14]
- The proposed amendments would allow individuals to include spousal equivalents when calculating joint income or determining joint net worth.[15] "Spousal equivalent" would be defined to mean any cohabitant occupying a relationship generally equivalent to that of a spouse.[16]

Request for Comment

The SEC requests comment on the proposed amendments, as well as on amendments that are not being proposed. Notably, the SEC is not proposing to raise the current financial thresholds or adjust them for inflation. In addition, the SEC notes that the new category for professional certifications, designations, and credentials would be useful for issuers relying on Rule 506(c) that need to take reasonable steps to verify whether an investor is an accredited investor because information on whether an individual actively holds a particular certification or designation will be readily available. The SEC requests comment on whether there would be concerns about meeting the verification requirement in Rule 506(c) with respect to the proposed new categories of accredited investors, and whether the amendments would make it more likely or less likely that an issuer would conduct a Rule 506(c) offering.

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10 Proposed Rule 501(a)(3).
11 Proposed Rule 501(a)(8).
12 See Question 255.06 of Securities Act Rules Compliance and Disclosure Interpretations.
13 Proposed Rule 501(a)(5) and Proposed Rule 501(a)(6).
14 See Question 255.11 of Securities Act Rules Compliance and Disclosure Interpretations.
15 Proposed Rule 501(a)(5) and Proposed Rule 501(a)(6).
16 Proposed Rule 501(j).

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