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SEC Proposes Update to Accredited Investor Definition

On December 18, 2019 the Securities and Exchange Commission proposed amendments to the definition of “accredited investor” (available [here](#)). The proposed amendments are intended to update the accredited investor definition to include institutional and individual investors that have the knowledge and expertise to participate in private capital markets and therefore do not need the additional protections of registration under the Securities Act of 1933 (the “Securities Act”).

The accredited investor concept was designed to identify a category of investors who do not need the protections of registration under the Securities Act. Qualifying as an accredited investor allows an investor to participate in private offerings that generally are not available to non-accredited investors. The proposed amendments would allow more investors to participate in private offerings by adding new categories of natural persons who may qualify as accredited investors based on their professional knowledge, experience or certifications and would expand the list of entities that may qualify as accredited investors by, among other things, including entities that meet investment threshold tests.

Background

In June 2019, the SEC issued a Concept Release that solicited public comment on possible ways to improve the exempt offering framework under the Securities Act “to promote capital formation and expand investment opportunities while maintaining appropriate investor protections.” In the Concept Release, the SEC requested comments on possible approaches to amending the accredited investor definition, which is a central component of several exemptions from registration. The Concept Release was preceded by an SEC staff report issued in December

2015 on the accredited investor definition, which examined the background and history of the definition and considered comments and recommendations on amending the definition.

In coming up with the proposed amendments, the SEC balanced several considerations. The SEC weighed that, on the one hand, an overly broad definition could potentially undermine investor protections and reduce public confidence; and on the other hand, an unnecessarily narrow definition could limit investor access to investment opportunities where there may be adequate investor protection, given such factors as an investor's financials sophistication, net worth, knowledge and experience in financial matters, or amount of assets under management.

After considering the views expressed by members of the public as well as SEC internal recommendations, and balancing various considerations, the SEC proposed amendments to the accredited investor definition.

Amendment Highlights

The proposed amendments to the accredited investor definition would:

- add new categories to the definition that would permit natural persons to qualify as accredited investors based on certain professional certifications and designations, such as a Series 7, 65 or 82 license, or other credentials issued by an accredited educational institution;
- with respect to investments in a private fund, add a new category based on a person's status as a "knowledgeable employee" of the fund;
- add limited liability companies and certain other entity types that meet certain conditions to the current list of entities that may qualify as accredited investors;
- add a new "catch all" new category for any entity owning "investments," as defined in 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 in 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.

To avoid inconsistencies, the SEC also proposed to amend the definition of "qualified institutional buyer" in Rule 144A under the Securities Act, to expand the list of eligible entities under that definition. Under the proposed amendments, entities that qualify for accredited investor status would be included in the definition of qualified institutional buyer, provided they meet the existing \$100 million in securities owned and invested threshold of Rule 144A.

Conclusion

The proposed amendments are expected to allow a wider range of individuals and entities to access the private capital markets. Although the definition of accredited investor still uses net worth as the test for qualification, SEC Chairman Jay Clayton stated that “the proposal would add additional means for individuals to qualify to participate in our private capital markets based on established, clear measures of financial sophistication.”

Comments to the proposed amendments are due 60 days after publication in the Federal Register.

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If you would like to submit a comment to the proposed amendments or if you would like to discuss the effect of the proposed amendments on your business, please contact Meryl Wiener, any of the undersigned or your regular Warshaw Burstein attorney.

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