

SEC Expands "Accredited Investor" Definition

On August 26, 2020, the U.S. Securities and Exchange Commission (SEC) adopted amendments to expand the "accredited investor" definition in Rule 501 of Regulation D under the Securities Act of 1933. Rule 506 of Regulation D is the key federal exemption for private placements, and nearly all offerings under Rule 506 are limited to accredited investors. Key new categories include natural persons with certain professional credentials, knowledgeable employees of private funds, and family offices and other entities with investments in excess of \$5 million.

There are two alternatives under Rule 506. Rule 506(b) permits sales to an unlimited number of accredited investors and up to 35 non-accredited investors, but requires the issuer to satisfy significant disclosure and other requirements if any sales are made to non-accredited investors and prohibits any general solicitation or general advertising. Rule 506(c) permits general solicitation and general advertising but prohibits sales to any non-accredited investors and requires that the issuer take reasonable steps to verify accredited investor status.

Notably, while the final rules expand the categories of individuals and entities that qualify as accredited investors, they do not cut back on the prior categories. For example, the SEC did not increase the net worth or income thresholds for natural persons to account for inflation. The net worth standard remains at \$1 million and the income standard remains at \$200,000 (or \$300,000 jointly with a spouse).

The new accredited investor standards in the final rules include the following:

Natural Persons Holding Professional Certifications or Designations or Other Credentials. This category allows natural persons to be accredited investors based on objective standards for knowledge and experience rather than wealth or income. Examples of the types of standards that could be covered include FINRA certifications (based on passing exams for securities brokers or investment adviser representatives), Certified Financial Analysts and Certified Public Accountants.

The final rules do not specify the necessary credentials. Instead, the rule provides that the SEC will designate by order over time the types of credentials that will qualify for accredited investor status after notice and comment by posting the list of qualifying credentials on the agency's website. To qualify, a person must maintain the credential in good standing at the time of investment.

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Simultaneous with issuing the final rules, the SEC issued an order designating three FINRA certifications for accredited investor status: the General Securities Representative license (Series 7), the Private Securities Offerings Representative license (Series 82) and the Licensed Investment Adviser Representative (Series 65).

Knowledgeable Employees of Private Funds. Accredited investors will include any natural person who is a "knowledgeable employee" of the issuer if the issuer is a private fund. "Knowledgeable employee" is defined in Rule 3c-5(a)(4) under the Investment Company Act of 1940 and includes trustees and advisory board members of a private fund or an affiliated person of the fund that oversees the fund's investments as well as employees of the fund or affiliated person (other than employees performing solely clerical, secretarial or administrative functions) who, in connection with the employee's regular functions or duties, have participated in the investment activities of the fund for at least 12 months. A private fund is a fund which is exempt from investment company status under Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act and includes most private equity funds, hedge funds, venture capital funds and similar funds.

Registered Investment Advisers. All SEC and state-registered investment advisers will now be accredited investors. In addition, exempt reporting advisers, which generally are managers of private funds, will be accredited investors.

Rural Business Investment Companies. Accredited investors will include rural business development companies, which are investment companies approved by the Secretary of Agriculture to invest in ways that promote economic development in rural areas.

Limited Liability Companies. Rule 501(a)(3) includes as accredited investors certain types of entities with total assets in excess of \$5 million that were not formed for the purpose of acquiring the securities offered. Limited liability companies were not included in the types of entities specifically included in Rule 501(c)(3), although the SEC staff had indicated that they can be included through informal guidance. Now Rule 501(a)(3) has been amended to specifically include limited liability companies.

Other Entities Meeting an Investments Owned Test. Accredited investors will include any other type of entity not already covered which is not formed for the purpose of acquiring the securities offered and owns investments in excess of \$5 million. "Investments" are defined in Rule 2a51-1(b) under the Investment



Company Act and includes securities, real estate, commodity interests, and non-security investment contracts held for investment purposes. The types of entities under this category include Indian tribes, labor unions, governmental bodies and funds, and non-U.S. entities.

Family Offices and Family Clients. Accredited investors will include any family office as defined in Rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940 if the family office meets the following criteria:

- It has assets under management in excess of \$5 million;
- It was not formed for the specific purpose of acquiring the securities offered; and
- Its investment is directed by a person with such knowledge and experience in financial and business matters that such family office is capable of evaluating the risks and merits of the prospective investment.

A family office, which is an entity formed by a family to manage the family's investments, is exempt from registration as an investment adviser. A family client of such a family office will also be an accredited investor. In general, a family client consists of members of the applicable family, certain related trusts and other entities, and key employees of the family office.

Spousal Equivalents. The final rules also add spousal equivalent to the categories that previously included spouses. Spousal equivalent is defined broadly to include any cohabitant occupying a relationship generally equivalent to that of a spouse.

The final rules take effect 60 days after publication in the Federal Register, which should be in early November. Companies relying on Rule 506 to raise capital after that point should begin to use new forms of questionnaires and subscription agreements reflecting accredited investor changes.

If you have any questions about the new rules or other securities law matters, please contact a member of the [Securities Team](#) or your Reinhart attorney.

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