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# Alerts

## SEC Updates Definition of Accredited Investor to Facilitate More Participation in Private Offerings

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*Hinshaw Alert*

For the first time since 2011, the Securities and Exchange Commission (SEC) has amended the definition of "accredited investors" under Rule 501(a) of Regulation D, promulgated under the Securities Act of 1933, as amended. This is important for securities issuers, because it means their *existing* subscription documents are now out of date and must be amended if they are to continue to raise money!

In widening the scope of accredited investors, the SEC is very plainly trying to expand investment opportunities. Unlike nonaccredited investors, accredited investors can participate in unregistered investment opportunities, such as private offerings under Regulation D. The SEC is indicating it believes that accredited investors can fend for themselves, have enough money to hire persons who have appropriate financial sophistication or knowledge, and that they can bear the risk of loss.

After the most recent changes, the SEC figures accredited investors make up 13% of the U.S. population. According to the SEC, in 2019 public offerings raised 1.2 trillion while exempt private offerings are estimated to have raised 2.7 trillion.

*Currently*, the three most frequent used categories of accredited investors are:

1. those with a net worth of at least $1 million (*excluding* the value of their primary residence); or
2. those having an annual income of at least $200,000 for single investors in each of the past two years and the expectation of the same in the current year; or
3. those having an annual income of at least $300,000 including a spouse in each of the past two years and the expectation of the same in the current year.

These definitions have not changed since 1982 and have never been indexed to inflation. The value of the dollar has been eroded by inflation in the last 38 years: in today's money, the dollar amounts listed above would be approximately $2.7 million, $547,000, and $821,000, respectively.

With its most recent change, the SEC has provided an alternative measure to prove financial sophistication, in addition to a binary income or asset based test. These prior measures were—and are—simply proxies for sophistication.

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Securities

The new types of accredited investors fall into two distinct categories, i.e., individuals and entities. We explore these categories further below.

The new individuals meeting the definition of an accredited investor are:

1. Natural persons who have achieved select professional designations or certifications
    - Examples are FINRA licenses including: (i) Series 7 (general securities representative) (ii) Series 65 (investment adviser representative) and (iii) Series 82 (private securities offering representatives) who remain in good standing).

2. Knowledgeable employees of private funds
    - This is similar to the pre-existing classification of executive officers, directors. or general partners of an issuer. An example of this is a private fund manager who oversees the fund's investments.

3. Spousal equivalents
    - These were defined as cohabitants occupying a relationship similar to that as a spouse. An example of the same could be a domestic partner.

The following entities now meet the definition of accredited investors:

1. Investment advisers licensed by the SEC or the states
    - This also expressly includes exempt reporting advisers who manage a single private fund and have no more than $150 million under management.

2. Family offices and family clients
    - The family office must manage at least $5 million in assets and be directed by a knowledgeable and experienced person in financial and business matters so that the family office can both appreciate the risks of an investment and is capable of evaluating the merits thereof. Family clients who have their prospective investments managed by the family office now also meet the definition of accredited investor.

3. Limited liability companies that otherwise satisfy the accredited investor definition
    - The limited liability company (LLC) must not be formed for the purpose of investing in the securities at issue and be made up members who are accredited investors themselves. An example of this is an LLC where all the individual members have a net worth of $1 million, excluding the value of their primary residence.

4. Catch-all entities, i.e., Native American tribes and government entities
    - If these entities were not formed for the specific purpose of acquiring the securities being offered—and these entities have at least $5 million in investments—they meet the updated definition of an accredited investor.

Should you have any questions about this rule change or any other securities laws, please contact Andrew May or your Hinshaw attorney. We can assist in amending your subscription documents even if we did not draft them.