

SEC Expands the Definition of Accredited Investor

On August 26, 2020, the Securities and Exchange Commission (SEC), by a 3-to-2 vote, adopted amendments to the definition of “accredited investor” in Rule 501(a) of Regulation D under the Securities Act of 1933, as amended (Securities Act), to allow individuals to invest in unregistered private securities offerings based on certain professional certifications or designations or other credentials, rather than based on their wealth or income, as well as to expand the list of entities that will qualify as accredited investors. Currently, individuals generally qualify as an accredited investor if they either have (i) a net worth of at least \$1 million (excluding the value of their primary residence), or (ii) annual income of at least \$200,000, or joint income with their spouse of \$300,000, for each of the last two years, and a reasonable expectation of reaching the same income level for the current year.

SEC rules governing accredited investors are designed to protect individual investors from risks that could result from the lack of regulatory oversight associated with unregistered private securities offerings. By expanding the definition of “accredited investor,” the SEC has provided more investors with the opportunity to access alternative investments and given companies, private-equity firms, and hedge funds access to a larger pool of investors.

The test for individuals and entities to qualify as accredited investors had remained largely unchanged for more than 35 years and used specified levels of net worth as proxies for financial sophistication. Commenting on the previous definition of accredited investors in support of the amendment, Chairman Jay Clayton added, “[U]sing only a binary test for wealth disadvantages otherwise financially sophisticated Americans living in lower income/cost-of-living areas.” Under the new definition of “accredited investor,” the SEC will allow individual investors to participate in the private markets based on certain professional certifications or designations or other credentials.

The SEC did not update the accredited investor net worth thresholds or income standards, which were set in 1982, to adjust for inflation. As a result, more households are likely to qualify as accredited investors over time and not all agree that the SEC’s updates provide sufficient protections to investors dealing with the risks of private markets. Commissioners Allison Herren Lee and Caroline Crenshaw voted against the amendment, explaining in a joint statement that the changes purport to update the accredited investor definition while leaving in place “38-year old wealth thresholds, declining to index the thresholds to inflation, and declining to provide economic analysis to show how the failure to index will affect American investors — the bulk of whom are seniors — going forward.”

The SEC made, among others, the following updates to the definition of accredited investor:

- Added a new category for persons who hold and maintain in good standing certain professional certifications or designations or credentials from an accredited educational institution, with specific qualifying certifications, designations, or credentials to be designated as qualifying for accredited investor status by an SEC order based on a consideration of the facts pertaining to such certification, designation or credential.
 - In a separate order, the SEC designated as the initial qualifying certifications, designations or credentials: general securities representatives; investment adviser representatives; and private securities offerings representatives.
- Included as an accredited investor with respect to an investment in a private investment fund, an individual recognized as a “knowledgeable employee” (as defined in the rules under the Investment Company Act of 1940) of that fund. We note that this category is similar to the existing classification of directors, executive officers, or general partners of an issuer as



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qualifying as an accredited investor for that issuer.

- Expanded the list of non-individual accredited investors, to include a number of new categories, such as family offices with at least \$5 million in assets under management and with the prospective investment being directed by a person with a specified level of knowledge and experience, as well as Indian tribes, governmental bodies, and foreign entities with at least \$5 million in assets.
- Allowed individuals to meet the joint net worth or income standard through “spousal equivalents,” defined as a cohabitant occupying a relationship generally equivalent to that of a spouse.

The amendments also expand the definition of “qualified institutional buyer” in Rule 144A under the Securities Act to include a number of additional entities, including limited liability companies and certain other entities added to the definition of accredited investor that meet the \$100 million in securities owned and invested threshold in the definition of qualified institutional buyer.

The amendments go into effect 60 days after publication in the Federal Register.

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