



Who are the New Accredited Investors?

On August 26, the Securities and Exchange Commission adopted amendments to Regulation D to cautiously expand the definition of “accredited investor” in their rules. The change will give additional categories of investors access to certain private offerings of securities that rely upon Regulation D. This regulation has always allowed a small number of persons who are “non-accredited investors” to make investments under the rule. However, the added complications of sales to such persons often caused issuers to forgo sales to non-accredited investors.

The Commission also made changes to allow some other entities to qualify as accredited investors. The changes become effective 60 days after publication in the Federal Register.

The definition as it has operated since the 1970s has only ever received minor amendments. It says that individual investors were generally required to meet specific tests of annual incomes during the two prior years, or an asset test that was changed only slightly over the intervening decades. The annual income tests qualified a natural person with income exceeding \$200,000 in each of the two most recent years or joint income with a spouse exceeding \$300,000 for those years and a reasonable expectation of the same income level in the current year. The asset test qualified a natural person who has individual net worth, or joint net worth with the person's spouse, that exceeds \$1 million at the time of the purchase, or has assets under management of \$1 million or above, excluding the value of the individual's primary residence.

More than a year ago the Commission requested public comments on possible changes to the definition of “accredited investor.” In the end, it appears that the Commissioners’ considerations focused on two key areas of interest:

- a) Should individuals with measurable knowledge and understanding of investments in securities be permitted to qualify as accredited investors, regardless of their personal assets or income?
- b) Should the asset-based tests that focus on worth or income be relaxed to permit more individual investors to qualify under the definition?

A divided Commission voted to approve changes to allow knowledgeable persons to qualify as accredited investors, but it did not act at this time to change the asset or income tests. In addition to the financial tests, the amendments allow individuals to qualify as accredited investors based on defined measures of professional knowledge, experience, or certifications.

- The amendments to the accredited investor definition permit natural persons to qualify as accredited investors based on certain professional certifications, designations, or other credentials issued by an accredited educational institution. The Commission has identified persons holding examination licenses under Series 7 (general brokerage),

Series 65 (investment adviser), and Series 82 (private securities brokerage) as qualifying, and the Commission can add criteria in the future.

- The amendments add as accredited investors in a private fund natural persons who are “knowledgeable employees” of the fund.

The Commission did not approve a change in the asset and income tests for individuals. Some commentators expressed concern that without the requisite knowledge, or the financial resources to obtain the assistance of expert advisors, access as accredited investors should not be allowed at this time to individuals who do not meet the original annual income numbers.

The amendments also expand the list of entities that may qualify as accredited investors. The amendments are summarized in the Commission's release, and:

- clarify that limited liability companies with \$5 million in assets may be accredited investors and add SEC- and state-registered investment advisers, exempt reporting advisers, and rural business investment companies (RBICs) to the list of entities that may qualify;
- add a new category for any entity, including Indian tribes, governmental bodies, funds, and entities organized under the laws of foreign countries, that own “investments,” as defined in Rule 2a51-1(b) under 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 under 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.

One Commissioner issued a statement indicating her view that the Commission should have gone forward to provide access to additional individual investors, but the Commission was not prepared to take that leap at this time.

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