

SEC Expands Accredited Investor Definition

Potentially broadens market for private offerings

In the 1953 case *Securities and Exchange Commission v. Ralston Purina Co.*, the U.S. Supreme Court ruled that the availability of the so-called private offering exemption from registration under the Securities Act of 1933 turns upon whether potential investors are “able to fend for themselves ...”; and, since adopting the safe harbor of Regulation D in 1982 under this exemption, the SEC has primarily used individual investors’ wealth as a proxy for determining financial sophistication sufficient to make the protections afforded by Securities Act registration unnecessary.

Under Regulation D, Rule 506, unlimited amounts can be raised by sales of securities solely to “accredited investors,” making this definition key to avoid the expense and delay often accompanying SEC registration. Natural persons were generally considered accredited investors only if they met specified income or net assets tests. The SEC has now amended the definition of accredited investor to include direct tests of financial sophistication.

As amended, the SEC may designate holders of categories of professional certifications, designations and other credentials as accredited investors. The SEC has initially designated the holders of a General Securities Representative license (Series 7) or Private Securities Offerings Representative license (Series 82) and Licensed Investment Adviser Representatives (Series 65) as accredited.

In addition, the SEC added the following categories of persons as accredited investors:

- “Knowledgeable employees” (as defined under Investment Company Act rules) of a private fund qualify as accredited investors for investments in the fund and other funds managed by their employer



- Federal- and state-registered investment advisers
- Family offices (as defined under Investment Adviser Act rules)
 - Having assets under management exceeding \$5 million
 - Not formed for the specific purpose of acquiring the offered securities
 - Acting under the direction of a financially sophisticated person
- Family clients (as defined under Investment Adviser Act rules) of family offices
- Entities not otherwise included in the definition of accredited investor—including non-U.S. entities, Native American tribes and limited liability companies not formed for the specific purpose of acquiring the securities offered—owning “investments” (as defined under Investment Company Act of 1940 rules) exceeding \$5 million

Although the SEC provided information regarding the number of persons in many of these categories, the SEC was unable to determine how many of such persons already qualify as accredited investors under previously

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existing definitions, so the precise extent to which the private placement market will benefit is unclear.

In addition to correlating changes in other rules and technical, clarifying changes to the existing definition of accredited investor, the SEC expressly declined to include a "continuing education" element to the professional certification standard or to modify the various 1982 financial thresholds included in the definition.

The amendments become effective 60 days after publication in the Federal Register..

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6430 REV1 09-04-2020