

SEC Proposes to Update Accredited Investor Definition

On December 18, 2019, the Securities and Exchange Commission (SEC) voted to propose amendments to the definition of “accredited investor” in Rule 501(a) of Regulation D under the Securities Act of 1933, as amended, one of the principal tests for eligibility to participate in most private offerings. According to the SEC’s press release, the proposal seeks to update and improve the definition to more effectively identify institutional and individual investors that have the knowledge and expertise to participate in our private capital markets.

SEC Chairman Jay Clayton stated “The current test for individual accredited investor status takes a binary approach to who does and does not qualify based only a person’s income or net worth. Modernization of this approach is long overdue. The proposal would add additional means for individuals to qualify to participate in our private capital markets based on established, clear measures of financial sophistication.”

The proposed amendments would expand the categories of natural persons and entities that may qualify as accredited investors. The following table provides a comparison of the categories of accredited investors under existing Rule 501(a) of Regulation D and the proposed amendments to these categories.

Accredited Investor

Natural Persons	Any director, executive officer, or general partner of the issuer of the securities being offered or sold, or any director, executive officer, or general partner of a general partner of that issuer (Rule 501(a)(4))	No change but the proposal notes that this category would extend to managers of limited liability companies because the SEC believes that “a manager of a limited liability company performs a policy making function for the issuer equivalent to that of an executive officer of a corporation”
	Subject to certain limitations, any natural person whose individual net worth, or joint net worth with that person’s spouse, exceeds \$1 million (Rule 501(a)(5))	For purposes of “joint net worth,” this category would include a person’s “spousal equivalent” and clarify that 1) assets need not be held jointly to be included in the calculation and 2) reliance on the “joint net worth” standard would not require that the securities be purchased jointly
	Any natural person who had an individual income in excess of \$200,000 in each of the two most recent years or joint income with that person’s spouse in excess of \$300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year (Rule 501(a)(6))	For purposes of “joint income,” this category would include a person’s “spousal equivalent”



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N/A	Adds the following new category: Any natural person holding in good standing one or more professional certifications or designations or credentials from an accredited educational institution that the SEC has designated by order as qualifying an individual for accredited investor status, preliminarily expected to include natural persons with active Series 7, 65, and 82 licenses (Proposed Rule 501(a)(10))
N/A	Adds the following new category: Any natural person who is a “knowledgeable employee” of a private fund, e.g., hedge funds, venture capital funds, and private equity funds, for purposes of investments in such private fund ¹ (Proposed Rule 501(a)(11))
Entities	<p>A bank, savings and loan association, registered broker or dealer, insurance company, registered investment company, registered business development company, licensed small business investment company, an employee benefit plan maintained by a state whose total assets exceed \$5 million, or employee benefit plan within the meaning of Title 1 of ERISA whose plan fiduciary is either a bank, insurance company or registered investment adviser or whose total assets exceed \$5 million² (Rule 501(a)(1))</p> <p>Adds the following new types of institutional investors: 1) any investment adviser registered pursuant to section 203 of the Investment Advisers Act of 1940 or registered pursuant to state law and 2) any rural business investment company (RBIC) as defined in Section 384A of the Consolidated Farm and Rural Development Act</p>
Private business development company as defined in section 202(a)(22) of the Investment Advisers Act of 1940 (Rule 501(a)(2))	No Change
Any organization described in section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of \$5 million (Rule 501(a)(3))	Adds limited liability company to the list of entities eligible for accredited investor status
Any trust, with total assets in excess of \$5 million, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in Rule 506(b)(2)(ii) of Regulation D (Rule 501(a)(7))	No change
Any entity in which all of the equity owners are accredited investors (Rule 501(a)(8))	Clarifies that if an equity owner is an entity rather than a natural person, then one could look through various forms of equity ownership to natural persons in determining accredited investor status

N/A	Adds the following new category: Any entity, not already listed in Rule 501, not formed for the specific purpose of acquiring the securities offered, owning investments in excess of \$5 million; the proposal listed “Indian tribes, labor unions, governmental bodies and funds, and entities organized under the laws of a foreign country” as examples (Proposed Rule 501(a)(9))
N/A	Adds the following new category: Any “family office” as defined under the Investment Advisers Act of 1940 1) with assets under management in excess of \$5 million, 2) that is not formed for the specific purpose of acquiring the securities offers, and 3) whose prospective investment is directed by a person who has such knowledge and experience in financial and business matters that it is capable of evaluating the merits and risks of the prospective investment (Proposed Rule 501(a)(12))
N/A	Adds the following new category: Any “family client” as defined under the Investment Advisers Act of 1940, of a family office meeting the requirements listed in the immediately preceding row (Proposed Rule 501(a)(13))

The SEC is accepting public comments on the proposed amendments within 60 days of their publication in the Federal Register. The proposed rule can be found [here](#).

¹ “Knowledgeable employee” is defined in Rule 3c-5(a)(4) of the Investment Company Act of 1940, and the proposed amendments state that this category “would include, among other persons, trustees and advisory board members, or persons serving in a similar capacity, of a Section 3(c)(1) or 3(c)(7) fund or an affiliated person of the fund that oversees the fund’s investments, as well as employees of the private fund or the affiliated person of the fund (other than employees performing solely clerical, secretarial, or administrative functions) who, in connection with the employees’ regular functions or duties, have participated in the investment activities of such private fund for at least 12 months.”

² These categories are limited in Rule 501 as follows: Any bank as defined in section 3(a)(2) of the Securities Act of 1933 (Act), or any savings and loan association or other institution as defined in section 3(a)(5)(A) of the Act whether acting in its individual or fiduciary capacity; any broker or dealer registered pursuant to section 15 of the Securities Exchange Act of 1934; any insurance company as defined in section 2(a)(13) of the Act; any investment company registered under the Investment Company Act of 1940 or a business development company as defined in section 2(a)(48) of that Act; any Small Business Investment Company licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958; any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of \$5,000,000; any employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974 if the investment decision is made by a plan fiduciary, as defined in section 3(21) of such act, which is either a bank, savings and loan association, insurance company, or registered investment adviser, or if the employee benefit plan has total assets in excess of \$5,000,000 or, if a self-directed plan, with investment decisions made solely by persons that are accredited investors.