
ALERT

SEC Expands “Accredited Investor” Definition

The Securities and Exchange Commission (“SEC”) has amended Rule 501(a) of Regulation D under the Securities Act of 1933 to expand the definition of “accredited investor.” The amendment will be effective December 8, 2020.

Qualification as an accredited investor is one of the principal tests for determining who is eligible to participate in private capital markets. Prior to the adoption of the amendments, the test for qualification as an accredited investor relied exclusively on an individual’s income or net worth. The amendments were designed to allow more investors to participate in private securities offerings by adding additional categories of investors who may qualify as accredited investors based on their professional knowledge, experience or certifications.

New Categories of Accredited Investors

In particular, the amendments add the following categories of investors to the definition of “accredited investor”:

- **Certifications and Credentials:** Individuals who possess certain professional certifications, designations or other credentials that demonstrate a background and understanding in the areas of securities and investing. The SEC has designated the General Securities Representative license (Series 7), the Licensed Investment Adviser Representative (Series 65), and the Private Securities Offerings Representative license (Series 82) as the initial qualifying certifications or credentials;
- **Knowledgeable Employees:** Individuals who are “knowledgeable employees” of a private fund that is the issuer of the securities being offered. “Knowledgeable employees” is defined under Rule 3c-5(a)(4) of the Investment Company Act of 1940, and includes executive officers, directors, trustees, general partners, advisory board members or persons serving in a similar capacity of a Section 3(c)(1) or 3(c)(7) fund, or affiliated persons of the fund who oversee the fund’s investments; as well as (ii) employees or affiliated persons 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;
- **Limited Liability Companies:** Limited liability companies that satisfy the other requirements of the “accredited investor” definition (\$5 million in assets, not formed for the specific purpose of acquiring the securities being offered);
- **Registered Investment Advisers:** Investment advisers registered under Section 203 of the Investment Advisers Act of 1940 or under the laws of the various states, and exempt reporting advisers;
- **Rural Business Investment Companies:** Rural business investment companies as defined under Section 384A of the Consolidated Farm and Rural Development Act;
- **Foreign and Other Entities:** Any entity, including Native American 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 acquiring the securities offered; and

- **Family Offices and Family Clients:** “Family Offices” under Rule 202(a)(11)G)-1 of the Investment Advisers Act established by families to manage their assets that: (i) have assets under management in excess of \$5 million, (ii) are not formed for the specific purpose of acquiring the securities offered and (iii) are directed by a person who has such knowledge and experience in financial and business matters that such Family Office is capable of evaluating the merits and risks of the prospective investment. “Family Clients” of a Family Office that meets the above requirements will also be considered accredited investors.

Look-Through to Equity Owners

Under Regulation D Rule 501(a)(8), an entity can qualify as an accredited investor if all of the owners are accredited investors. In some cases, however, the entity seeking to be an accredited investor is owned by another entity. The amendment clarifies that all of the entities in the chain may be looked through to the ultimate owners to determine accredited investor status in cases where the owner-entity does not qualify on its own merits as an accredited investor (such as an LLC that does not meet the \$5 million assets test, but all of its natural-person members are accredited investors).

Spousal Equivalents

The definition of “accredited investor” was also amended to allow individuals to include spousal equivalents when determining joint net worth under Rule 501(a)(5), and to include joint income from spousal equivalents when calculating joint income under Rule 501(a)(6), so that both spouses and spousal equivalents may pool their finances for the purpose of qualifying as accredited investors. “Spousal equivalent” is defined as a cohabitant occupying a relationship generally equivalent to that of a spouse.

Please feel free to reach out to us with any questions or to discuss how the amendment to the definition of “accredited investor” may impact you or your business.



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