

The SEC Proposes Amendments to the Accredited Investor Definition

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On December 18, 2019, the SEC proposed amendments to its definition of “accredited investor” to add new categories of qualifying natural persons and entities able to participate in certain exempt offerings without specific disclosures or other limitations.¹ The proposal marks the first step in the SEC’s efforts to improve the regulatory framework for exempt offerings, with the stated goals of promoting capital formation and expanding investment opportunities for retail investors, while maintaining appropriate investor protections. The proposal reflects comments received by the SEC in response to its June 2019 Concept Release on Harmonization of Securities Offering Exemptions.²

The proposed changes themselves are modest and include the following:

- Natural persons who hold certain financial industry professional certifications would qualify as accredited investors without regard to their net worth or income levels;
- “Knowledgeable employees” of private funds would automatically qualify as accredited investors in an offering of securities of their fund employers;
- Unmarried “spousal equivalents” could pool their assets and incomes to meet net worth and income tests for accredited investor status, to the same extent as married couples;
- “Family offices” with at least \$5 million in assets under management would qualify as accredited investors, as would the “family clients” of such family offices;
- Entities with at least \$5 million in investments would qualify as accredited investors even if the type of entity is not listed in the accredited investor definition, thus permitting entities such as tribal governments or labor unions to qualify as accredited investors; and
- “Rural Business Investment Companies” and SEC- or state-registered investment advisers would qualify as accredited investors without regard to assets owned or managed.

The new types of accredited investor entities would be eligible for treatment as “institutional accredited investors” and thus could, for example, receive “testing the waters” communications before a registered offering and purchase so-called penny stocks without special disclosures.

What the SEC Did Not Do

Perhaps the most significant aspect of the proposals, however, was what the SEC did not do. The dollar amount thresholds used in the accredited investor definition have remained largely unchanged since their adoption in 1982,³ with the result that a much larger percentage of U.S. households are able to

¹ SEC Release Nos. 33-10734; 34-87784 (December 18, 2019)(the “Proposing Release”).

² SEC Release No. 33-10649 (June 18, 2019).

³ The joint spousal income standard of \$300,000 was added in 1988. In 2011, the SEC modified the net worth test to exclude the value of an investor’s personal residence from the computation of net worth.

qualify as accredited investors than when the rules were originally formulated.⁴ Following the recommendations of many commentators and advocates in the small business and angel investment communities, the SEC declined to propose a change in the dollar thresholds. One reason given for this by the SEC is the disparity in wealth and access to capital in different regions of the United States. Small businesses in the South and Midwest, for example, may rely on capital from individual angel investors who would not meet an inflation-adjusted test for accredited investors. In addition, regardless of region, removing potential investors from a broad category of investment could have significant adverse effects on the availability of capital.

Under the proposed rules, by administrative order from time to time, the SEC would identify the financial industry tests that would confer accredited investor status. The release noted that the tests would most likely include the Series 7 (Licensed General Securities Representative), Series 65 (Licensed Investment Adviser Representative) and Series 82 (Licensed Private Securities Offering Representative), administered by FINRA. The SEC rejected the idea of using other professional qualifications, education or experience to satisfy the requirements for accredited investor status.

The SEC proposals ultimately reflect a cautious response to concerns raised by some that individual retail investors are unfairly left out of opportunities to participate in the growth of pre-IPO companies. In commenting on the proposals, Commissioner Peirce notably cited the Declaration of Independence as grounds for her belief that individual investors should have the power to determine what investments they can make without governmental interference, while Commissioner Roisman expressed hope that accredited investor qualifications could be further expanded based on a range of possible criteria. SEC Chair Clayton endorsed the proposals and said that he expected them to be followed by other measures to increase retail investor access to private markets, possibly through managed investment funds. By contrast, Commissioners Jackson and Lee (who both voted against the proposals) raised concerns about the extent of fraud in private markets, the lack of data concerning those markets and the inability of some individuals who currently qualify as accredited investors to assess or bear the risks of privately placed investments. The SEC's proposals represent a valiant attempt to strike a balance among these competing views, by recommending sensible but limited modifications that may be helpful in a variety of exempt offerings.

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⁴ In the Proposing Release, the SEC estimates that the number of qualifying U.S. households was 1.3 million, or 1.6%, of U.S. households in 1983, as compared to 16.0 million, or 13.0%, in 2019.

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