

SEC Expands Categories of “Accredited Investors”

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SEC EXPANDS CATEGORIES OF “ACCREDITED INVESTORS”

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Effective December 8, 2020, more investors will now qualify as “accredited investors,” including clients of family offices, certain investment professionals, and knowledgeable employees of private funds, regardless of their net worth or income. The SEC amended its rules to make it easier for small companies and private investment funds to raise capital from investors who have established financial sophistication through avenues besides wealth or income. Please also see our article on exempt offerings in this newsletter.

New categories of accredited investors include:

- Family Offices with at least \$5 million in assets under management, and their family clients;
- SEC and state Registered Investment Advisers;
- Exempt Reporting Advisers;
- Rural Business Investment Companies;
- Licensed investment professionals with Series 7, Series 65, or Series 82 certifications;
- Knowledgeable Employees of private funds; and
- Entities owning more than \$5 million in investments, including Native American Tribes, governmental bodies, funds, and non-US entities.

Accredited Investors Under Reg. D

Qualification as an accredited investor is one of the principal tests for determining who is eligible to participate in private securities offerings. Traditionally, most companies and private funds have relied on the exemption provided by Rule 506(b) of Regulation D (“Reg. D”) to raise capital because of the preemption of state registration requirements and the ability to reasonably rely on self-certification of accredited status by investors. While up to 35 non-accredited investors may participate in a Rule 506(b) offering, as a practical matter, most Rule 506(b) offerings are limited to accredited investors because of the additional disclosures, including financials statements, that Reg.

D requires to be given to non-accredited investors. The downside of a Rule 506(b) offering is that general solicitation or advertising is not allowed.

Companies and private funds that wish to use general solicitation to find investors may rely on Rule 506(c) of Reg. D, but the issuer must take extra steps to verify that all investors are accredited. Nevertheless, the SEC has recently indicated that the steps to verify that investors are accredited may not be as onerous as many lawyers previously thought.

New Accredited Investor Categories for Individuals

For nearly 40 years, individuals had to meet certain net-worth or annual-income levels (generally net worth of over \$1 million, or individual annual income of at least \$200,000, or joint income of \$300,000) to be Accredited Investors. While the new rules leave these financial thresholds undisturbed, the SEC has added two new categories that are not based on wealth or income. First, the SEC has designated licensed investment professionals that have Series 7, Series 65, or Series 82 certifications as accredited investors, and the SEC may add additional professional certifications in the future. Second, “knowledgeable employees” of private fund managers will now be able to invest in the private funds managed by their employer, regardless of their net worth or income. This knowledgeable employee qualification is the same one that allows knowledgeable employees to invest in funds that rely on the exemptions provided by 3(c)(1) or 3(c)(7) of the Investment Company Act.

Family Offices

The updated accredited-investor definition will allow family offices to make investments on behalf of their family clients regardless of the net worth or assets of the family client if:

- the family office manages over \$5 million for its family clients;
- the family client was not formed for the purpose of making the investment; and
- the person with the family office that is directing the investment for the family client has the knowledge and experience to evaluate the merits and risks of the investment.

Conclusion

The amendments to the accredited-investor definition mark a significant step by the SEC to modernize its thinking about investors’ financial sophistication. They remove unnecessary barriers, and substantially increase access to private markets for those deemed qualified to participate in them. Those looking to issue private securities can now do so to a larger audience and with fewer restrictions.

Please contact [George Lee](#) or your favorite Carrington Coleman attorney if you would like more information on how these changes may help you.

