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## SEC CONSIDERS BROADENING ACCESS TO PRIVATE INVESTMENT OPPORTUNITIES THROUGH AMENDMENTS TO THE “ACCREDITED INVESTOR” DEFINITION

On December 18, 2019, the Securities and Exchange Commission (“SEC”) **proposed** much anticipated amendments to the accredited investor definition that would essentially expand the pool of investors permitted to invest in private securities offerings by adding new categories for individuals and entities to qualify as accredited investors. The SEC has not substantively reassessed the accredited investor requirement, a classification that serves as a gatekeeper to private capital market investment opportunities, since it was first put in place in 1982. In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act effectively increased the threshold to classify as an accredited investor, by disallowing the inclusion of an individual’s primary residence from their net worth calculation.

### WHO ARE “ACCREDITED INVESTORS”?

The definition of accredited investor set forth in Rule 501 of Regulation D of the Securities Act of 1933 uses specific wealth thresholds to determine who is permitted to invest in unregistered offerings which utilize certain exemptions from registration with the SEC, such as the commonly used Rules 506(b) and 506(c) to avoid the stringent registration requirements imposed by the Securities

Act (e.g., an initial public offering). Currently, to qualify as an accredited investor an individual needs to have income that exceeds \$200,000 individually or \$300,000 jointly with their spouses for the two most recent years and they must reasonably anticipate that their income will remain constant in the current year or an individual must have a net worth that exceeds \$1 million either alone or jointly with their spouse, excluding the value of their primary residence. Entities, including banks and insurance companies, as well as charities, trusts, and employee benefit plans with assets in excess of \$5 million may also be considered accredited investors.

The current accredited investor definition has a binary focus whereby an investor either hits the wealth threshold or not – the SEC’s longstanding defense of the existing accredited investor definition has been that it is critical for the protection of investors.

### THE SEC’S PROPOSED CHANGES TO THE “ACCREDITED INVESTOR” DEFINITION

The Accredited Investor definition attempts to identify those individuals who are deemed financially “sophisticated”

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enough to not need the SEC to evaluate the merits and risks of the prospective investment for them. The SEC's proposed amendments do not eradicate the existing wealth thresholds. Rather, they expand the current definition to ensure that wealth is not the sole means of establishing financial sophistication. The SEC stated that its proposed amendments are intended to update and improve the definition of accredited investor to more effectively identify institutional and individual investors with the competency to participate in the private capital markets without the need of the protections afforded them through the registration requirements of the Securities Act. Notably, the SEC's proposed amendments to the accredited investor classification adds categories for:

- individuals to qualify based on certain professional certifications and designations or other credentials that demonstrate an understanding in the areas of securities such as a Series 7, 65, or 82 license, or other credentials issued by an accredited educational institution;
- "knowledgeable employees" of a private fund to qualify as accredited investors for investments in that particular fund;
- limited liability companies, registered investment advisers, and rural business investment companies (RBICs) on the current list of entities that may qualify as accredited investors, provided that they meet certain conditions;
- any entity, including Indian tribes, owning "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 investing in the securities offered;

- "family offices" with at least \$5 million in assets under management and their "family clients," as each term is defined under the Investment Advisers Act; and
- a "spousal equivalent" to the accredited investor definition, so that spouses may pool their finances for the purpose of qualifying as accredited investors.

### THE POTENTIAL IMPACT OF THE SEC'S PROPOSED CHANGES

Currently, investors who do not meet the previously discussed wealth thresholds are deemed to be nonaccredited investors, and, therefore, are primarily permitted to invest in companies providing more disclosure, such as securities bought and sold on public exchanges (and in certain private offerings in specific limited circumstances). The definition of an accredited investor is central to the ability of emerging companies seeking to raise capital because it allows these issuers to fundraise from a broader audience of "sophisticated" investors while still relying on the exemptions found within Regulation D. By increasing the pool of accredited investors, issuers may be better able to fulfill their financing needs while maintaining a high-quality pool of investors.

The proposal will be subject to a 60-day public comment period following publication in the Federal Register.

*For more information on the SEC's proposed amendments please contact **Evan Kipperman** or **Jermaine Brookshire, Jr.**, members of Wiggin's **Emerging Companies and Venture Capital** practice.*