



## ALERTS

### SEC Amends 'Accredited Investor' Definition Seeking To Expand Private Capital Raising

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#### Highlights

The SEC expands categories of persons qualifying as “accredited investors”

The purpose is to increase private capital raising transactions

The new rules to become effective in the 4th quarter of 2020

On Aug. 26, 2020, the U.S. Securities and Exchange Commission (SEC) [adopted amendments to the definition of “accredited investor”](#) in Regulation D under the Securities Act of 1933, as amended (Securities Act), which are expected to expand the pool of investors eligible to invest in private securities offerings. The “accredited investor” definition is one of the principal tests for determining who is eligible to participate in private offerings, which are typically conducted by privately held companies and utilized to raise start-up capital for small businesses.

Until the SEC’s recent action, the test for individuals to qualify as accredited investors remained largely unchanged for over 40 years. Accordingly, the final rules modernize and give much needed flexibility to the “accredited investor” definition by adding new categories of qualifying individuals and entities that have demonstrated knowledge, expertise and

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financial sophistication, which are in addition to the current categories based on income and net worth.

## Background

The “accredited investor” definition forms the basis for determining the class of investors permitted to invest in private offerings relying on the exemption in Rule 506(b) of Regulation D under the Securities Act. Rule 506(b) provides an exemption from registration for offerings of an unlimited dollar amount of securities to accredited investors and up to 35 additional non-accredited investors. Rule 506(b) offerings comprise the vast majority of exempt private offerings conducted in the United States. Therefore, the ability of an individual or entity to meet the accredited investor definition is vitally important to the capacity of thousands of private companies and investment funds to raise the necessary capital for operations and expansion, especially small start-up and venture capital companies which often have a more difficult time accessing capital compared to larger more established companies.

The definition of “accredited investor” is set forth in Rule 501(a) of Regulation D and includes any person who comes within or whom the issuer reasonably believes comes within certain enumerated categories at the time of the sale of securities to that person. Before the SEC’s recent amendments, the accredited investor criteria for natural person investors (other than officers, directors, and partners of the issuer) were focused exclusively on financial metrics – specifically a net worth threshold of at least \$1 million, or an individual income threshold of more than \$200,000 (or \$300,000 jointly with the person’s spouse) in each of the last two years. However, the amendments now permit individuals to meet the accredited investor definition not only based on their income or net worth, but also based on measures of financial sophistication, which is intended to expand the number of individuals who will be able to invest in private offerings. The adopted amendments also would expand the list of entities that may qualify as accredited investors by, among other things, allowing any entity that meets an investments ownership test to qualify.

## Amendments to “Accredited Investor” Definition

Under the amendments, the SEC adopted the following changes to the “accredited investor” definition in Rule 501(a) of Regulation D:

- Add a new category to the definition that permits natural persons to qualify as accredited investors based on certain professional certifications, designations, or credentials or other credentials issued by an accredited educational institution, which the SEC may designate from time to time by order. In conjunction with the adoption of the amendments, the SEC designated by order holders in good standing of the Financial Industry Regulatory Authority, Inc. (FINRA) General Securities Representative (Series 7), Investment Adviser Representative (Series 65), and Private Securities Offerings Representative (Series 82) licenses as qualifying natural persons. This approach provides the SEC with flexibility to reevaluate or add certifications, designations, or credentials in the future.



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### RELATED PRACTICE AREAS

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- Include as accredited investors, with respect to investments in a private investment fund (such as a private equity fund, venture capital fund, or hedge fund), natural persons who are “knowledgeable employees” of the fund.
- Clarify that limited liability companies with \$5 million in assets may be accredited investors and add SEC- and state-registered investment advisers, exempt reporting advisers, and rural business investment companies (RBICs) to the list of entities that may qualify.
- Add a new category of accredited investor for any entity, including Indian 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 of 1940, in excess of \$5 million and that was not formed for the specific purpose of investing in the securities offered.
- Add “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 of 1940.
- Add the term “spousal equivalent,” so that spousal equivalents may pool their finances for the purpose of qualifying as accredited investors.

## Purpose and Effective Date

The adopted amendments are part of the SEC’s stated objective to open up private markets to a wider range of investors. The amendments will become effective 60 days after publication in the Federal Register, which is expected to be in November 2020.

To obtain more information, contact the Barnes & Thornburg attorney with whom you work, [David P. Hooper](#), chair of the [Securities and Capital Markets Practice Group](#), at 317-231-7333 or [dhooper@btlaw.com](mailto:dhooper@btlaw.com); [Joshua P. Hollingsworth](#), co-chair of the [Entrepreneurial and Emerging Companies Practice Group](#), at 317-261-7854 or [joshua.hollingsworth@btlaw.com](mailto:joshua.hollingsworth@btlaw.com); Scott L. Beal at 646-746-2021 or [sbeal@btlaw.com](mailto:sbeal@btlaw.com); Travis Stegemoller at 317-231-7815 or [tstegemoller@btlaw.com](mailto:tstegemoller@btlaw.com); Alexander Swider at 317-261-7861 or [alex.swider@btlaw.com](mailto:alex.swider@btlaw.com); or Thomas J. Lyons, III at 317-261-7844 or [thomas.lyons@btlaw.com](mailto:thomas.lyons@btlaw.com).

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