

# SEC Proposes to Expand Potential Investor Pool for Private Placements

**THE SEC RECENTLY PROPOSED TO EXPAND THE DEFINITION OF “ACCREDITED INVESTOR” TO INCREASE THE POOL OF INVESTORS THAT CAN READILY PARTICIPATE IN PRIVATE CAPITAL MARKETS TRANSACTIONS.**

The proposal includes certain financially sophisticated individuals (regardless of income or net worth) in the definition of accredited investor. It also expands the category of entities that are considered accredited investors to include certain entities that have the ability to make sound investment decisions without the protection provided by the securities registration process. The full text of the SEC release can be found at:

<https://www.sec.gov/rules/proposed/2019/33-10734.pdf>

## The Significance of the Accredited Investor Definition

The SEC’s Regulation D sets forth several exemptions from the federal requirement to register securities offered and sold to investors. Rule 506 of Regulation D in particular plays a substantial role in capital raising transactions in the U.S. It is estimated that Rule 506 offerings raised approximately \$1.7 trillion in 2018 – more than the \$1.4 trillion raised in registered offerings.

Rule 506 allows issuers to sell securities to an unlimited number of “accredited investors” and up to 35 non-accredited investors. Because of the rather burdensome disclosure requirements that apply to non-accredited investors, as a practical matter the overwhelming majority of investors in Rule 506 offerings are accredited investors. Thus, the definition is very important to issuers seeking to engage in private capital raising.

Regulation D currently defines accredited investors to include the following:

### Individuals

- Directors, executive officers and general partners of the issuer of the securities, or any director, executive officer or general partner of a general partner of that issuer;
- Individuals with net worth, or joint net worth with spouse, exceeding \$1 million (not including primary residence); and
- Individuals with income of over \$200,000 (or \$300,000 with spouse) in each of two most recent years, with reasonable expectation of earning at least same in current year.



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## Entities

- Banks, registered broker-dealers, certain insurance companies and certain employee benefit plans with more than \$5 million in assets;
- Private business development companies;
- 501(c)(3) companies, corporations, business trusts and partnerships, in each case exceeding \$5 million in assets and not formed to acquire the offered securities;
- Trusts with assets exceeding \$5 million not formed to acquire the offered securities, whose purchase is directed by a sophisticated person; or
- Entities in which all of the equity owners are accredited investors.

## Expansion of Categories for Individuals

In its December 18, 2019 release, the SEC stated in its belief that wealth and income should not be the exclusive means of establishing financial sophistication for individuals under the accredited investor definition. Accordingly, the SEC proposes to add the following categories to the definition of accredited investors for individuals:

- Individuals with a license as a general securities representative (Series 7 exam), investment adviser representative (Series 65 exam) or private securities offerings representative (Series 82 exam);
- “Knowledgeable employees” of a private fund, as to investments in that fund; and
- Registered investment advisers (but not “exempt reporting advisers” relying on the venture capital adviser exemption or private funds adviser exemption).

The SEC also introduced the concept of a “spousal equivalent” to the definition of accredited investor. A spousal equivalent means a cohabitant occupying a relationship generally equivalent to that of a spouse. To qualify as accredited investors, spousal equivalents will be permitted to pool finances for purposes of satisfying the joint net worth and joint net income tests described above. This change is intended to capture domestic partnerships, civil unions and same-sex marriages.

## Expansion of Categories for Entities

Similarly, the SEC believes that there are additional categories of entities that “...may exhibit attributes of financial sophistication and an ability to fend for themselves...” Accordingly, the following categories of entities were added to the definition of accredited investor:

- “Family offices” (as defined for purposes of the Investment Advisors Act) with at least \$5 million in assets under management, directed by a sophisticated person and not formed to invest in the offered securities, as well as their “family clients;”
- Entities owning “investments” of more than \$5 million, so long as the “investments” fall within Rule 2a51-1(b) of the Investment Company Act and so long as the entity was not formed for the specific purpose of investing in the offered securities;
- Limited liability companies with more than \$5 million in assets not formed to acquire the offered securities; and
- Rural business investment companies.

The proposed rules are subject to public comment and are not yet effective.