



## SEC Updates

# Accredited Investor Definition

Effective December 8, 2020, there is a new definition of “accredited investor” in Rule 215 and Rule 501(a) of the Securities and Exchange Commission’s (SEC) Regulation D. Accredited investors—considered to be sufficiently sophisticated and risk tolerant—are permitted to participate in certain private offerings under Regulation D that are not subject to the same investor protections as public offerings. The new accredited investor definition expands the class of individuals and entities who qualify, widening the pool of potential investors for private offerings and better harmonizing the definition with other securities regulations.

The current regulations use wealth as a rough proxy to gauge financial sophistication. Individuals qualify if:

- (1) their income exceeds \$200,000 a year (or \$300,000 in joint income with a person’s spouse) in each of the two most recent years and is reasonably expected to do so for the current year; or
- (2) their net worth exceeds \$1 million (individually or jointly with a spouse), excluding the value of their primary residence.

Certain entities also qualify, such as banks, registered broker-dealers, registered investment companies, business development companies, small business investment companies, private business development companies, certain employee benefit plans, certain tax exempt organizations, an enterprise in which all owners are accredited investors, and certain trusts.

In August 2020, the SEC adopted amendments to the accredited investor definition that go into effect on December 8, 2020. The amendments include the following notable changes.

### Qualifying Individuals

The current accredited investor definition limits qualifying individuals based on wealth, without regard to their financial sophistication. One of the most significant changes in the new definition alters this, allowing individuals to qualify when they hold certain professional certifications, designations, or credentials. Initially, this will include individuals holding Series 7, 65, and 82 licenses. The new regulations give the SEC the



flexibility to adjust the qualifying certifications, designations, or credentials by order after notice and opportunity for public comment.<sup>1</sup>

The regulations also add a new category of accredited investor, making a “knowledgeable employee” of a private fund a qualifying accredited investor for investments in that fund.<sup>2</sup> A “knowledgeable employee” includes, among others, an executive officer, director, trustee, general partner, advisory board member or person serving in a similar capacity of a fund exempt from registration under Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940 (the “Investment Company Act”), or a person serving in an a similar capacity at an affiliated company that oversees the fund’s investments. It also includes an employee of the fund (other than an employee performing solely clerical, secretarial or administrative functions with regard to such company or its investments) who, in connection with his or her regular functions or duties, participates in the investment activities of the fund, provided he or she has done so, or performed substantially similar functions or duties for or on behalf of another entity, for at least 12 months.

Income and asset based accreditation remain available under the new regulation. Despite considering an amendment to the required income and asset levels in light of inflation, geography, or other factors, the SEC left the existing levels intact. The amendments do clarify the calculation of joint income and assets, allowing the joint income or assets of unmarried spousal equivalents (i.e. cohabitants in a relationship “generally equivalent” to that of a spouse) to be counted.

### Qualifying Entities

In addition to updating the qualifications for individual accredited investors, the new definition also expands the types of entities that qualify as accredited investors and codifies the qualification of some entities previously recognized as accredited investors by SEC interpretation. The new regulations define qualifying entities to include:

- Investment advisers registered pursuant to section 203 of the Investment Advisers Act of 1940 (the “Investment Advisers Act”), investment advisers registered

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<sup>1</sup> The new regulations require that a qualifying certification, designation, or credential arise out of an examination or series of examinations administered by a self-regulatory organization, industry body, or accredited educational institution. In order to qualify, the certification, designation, or credential must be independently verifiable.

<sup>2</sup> A “knowledgeable employee” is defined by Rule 3c-5(a)(4) of the Investment Company Act.



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pursuant to the laws of a state, or investment advisers exempt from reporting under section 203(l) or (m) of the Investment Advisers Act;

- Limited liability companies (LLCs) that have total assets in excess of \$5 million and were not formed for the specific purpose of acquiring the securities being offered;<sup>3</sup>
- Rural Business Investment Companies as defined in section 384A of the Consolidated Farm and Rural Development Act;
- A catch-all category, designed to capture Native American tribes and government bodies and other types of entities not in existence today, covering any additional entities (1) not formed for the specific purpose of acquiring the securities offered and (2) owning investments in excess of \$5 million;<sup>4</sup> and
- Certain “family offices” and their “family clients.”<sup>5</sup> A family office qualifies if it (1) has over \$5 million in assets under management, (2) was not formed for the specific purpose of acquiring the securities offered, and (3) the prospective investment is directed by a person who has such knowledge and experience in financial and business matters that such family office is capable of evaluating the merits and risks of the prospective investment. Family clients of such a family office also qualify if their investments are directed by such family office.

## Contact Us

If you have questions about the new definition, please contact a member of Hemenway & Barnes LLP’s [Business Law Group](#) or the authors of this alert:

John J. Siciliano  
617.557.9729  
[jsiciliano@hembar.com](mailto:jsiciliano@hembar.com)

Matthew J. Carey  
617.557.9740  
[mcarey@hembar.com](mailto:mcarey@hembar.com)

Dylan S. O’Sullivan\*  
[dosullivan@hembar.com](mailto:dosullivan@hembar.com)  
\*Dylan S. O’Sullivan is a third year law student at Northeastern University School of Law and is not a practicing attorney.

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<sup>3</sup> This is a codification of a longstanding staff position that LLCs otherwise satisfying the requirements of Rule 501(a)(3) are eligible to qualify as accredited investors under the existing Rule 501(a)(3).

<sup>4</sup> Investments as defined in Rule 2a51-1(b) under the Investment Company Act.

<sup>5</sup> Both as defined under rule 202(a)(11)(G)-1 of the Investment Advisers Act.