

More Accredited Investors? SEC Contemplates Expanding the Pool of Individuals That May Invest In Private Placements

Article

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On December 18, 2019, the Securities and Exchange Commission (SEC) released a proposed amendment to 17 CFR Parts 230 and 240 that would expand the definition of “accredited investor” in the U.S. securities laws. This expanded definition has the potential to have a profound positive effect on the ability to raise capital through private placements for real estate developers and operating companies alike. The positive effects would be derived from the expanded pool of investors that are qualified to participate in private placements.

A. Current Definition of Accredited Investor.

The current definition of “accredited investor” is set forth in 17 CFR § 230.501, otherwise known as Rule 501. It encompasses a variety of categories of individuals and entities including: (1) banks and other similar financial institutions; (2) private business development companies; (3) directors, executive officers, or general partners of the issuer of securities; and (4) natural persons with a net worth of more than \$1,000,000 (excluding the value of such person’s principal residence) or an annual income in the two most recent years of \$200,000 if single and \$300,000 if married so long as such person reasonably believes he or she will make the same or more income in the coming year.

The purpose of the accredited investor standard is to designate those individuals and entities that are deemed to not need the protections of the securities laws due to their sophistication and ability to withstand poor investment decisions. The SEC currently uses net worth or annual income to determine a potential investor’s sophistication and ability to withstand a poor investment outcome. If an investor is not an accredited investor, he or she cannot easily participate in private placements under Regulation D.

B. Amendment to Definition of Accredited Investor.

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The SEC's proposed amendment would add another method of qualifying as an accredited investor that is not dependent on income or net worth. Under the proposed amendment, a potential investor would qualify as an accredited investor if he or she is:

[a] natural person holding in good standing one or more professional certifications or designations or credentials from an accredited educational institution that the Commission has designated as qualifying an individual for accredited investor status. In determining whether to designate a professional certification or designation or credential from an accredited educational institution for purposes of this paragraph (a)(10), the Commission will consider, among others, the following attributes:

(i) the certification, designation, or credential arises out of an examination or series of examinations administered by a self-regulatory organization or other industry body or is issued by an accredited educational institution;

(ii) the examination or series of examinations is designed to reliably and validly demonstrate an individual's comprehension and sophistication in the areas of securities and investing;

(iii) persons obtaining such certification, designation, or credential can reasonably be expected to have sufficient knowledge and experience in financial and business matters to evaluate the merits and risks of a prospective investment; and

(iv) an indication that an individual holds the certification or designation is made publicly available by the relevant self-regulatory organization or other industry body.

As can be seen from the text of the proposed amendment, the SEC is leaving the door open for the accredited investor status to expand to include more individuals as the SEC determines proper. Currently, the SEC is contemplating including only those individuals with securities related credentials (e.g., Series 7, Series 65, and Series 82 license holders).

While this is a good first step in expanding the definition of accredited investor to allow individuals with requisite knowledge and experience in investments to participate in private placements, it still falls short of its potential. For real estate developers and investors, a definition that allows for licensed real estate professionals to be deemed accredited investors would greatly increase the pool of potential investors in real estate deals. While the SEC is leaving the door open for an expanded definition of the accredited investor in the future, and one that could include real estate professionals, it is not clear when and if that change could occur. Currently, there has been opposition to the change from various consumer protection groups and even major financial publications. However, if support is evident from public comments, the SEC may very well approve additional credentials.

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The proposed amendment is currently in the public comment period of the rulemaking process. The public has until February 16, 2020 to provide comments and suggestions on the proposed amendment.

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