

SEC Proposes to Expand Access to Private Offerings

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Proposed amendments to definitions of “accredited investor” and “qualified institutional buyer” would expand private-offering access for individuals and entities beyond current tests

Last summer, the SEC observed that primary capital raised through private-offering exemptions and safe harbors was double that raised in registered offerings. However, because of statutory provisions and SEC rules, private offerings were generally limited to “accredited investors,” a category which for individuals is based on income and wealth. Investments by non-accredited investors represented less than 1% of all capital raised in private offerings in 2018, even though companies can sell to up to 35 non-accredited investors. This is likely because when a non-accredited investor participates in a private offering, Regulation D requires the company to prepare a detailed offering document, which can be time-consuming and expensive.

On December 18, the SEC proposed amendments to the definition of “accredited investor” in Regulation D. The **proposal** would expand the definition to include individual and institutional investors that presumptively have sufficient knowledge and expertise to qualify them for participation in private offerings, even if they do not meet the current financial tests.

The proposal is open for public comment through February 17, 2020.

Expansion of “Accredited Investor” Definition for Individuals

Today, to be an “accredited investor,” an individual must have net worth exceeding \$1 million (excluding primary residence) or income exceeding \$200,000 (\$300,000 with spouse) in each of the two most recent years, or be a director, executive officer or general partner of the issuer.

The SEC believes that certain credentials can indicate an appropriate level of financial sophistication for individuals who possess them, rendering these individuals less in need of the protections of registration under the Securities Act of 1933, even if they do not meet the current net worth, income or employment standards. To this end, the proposed amendments would expand the accredited-investor definition to include individuals holding a professional credential issued by an institution designated by the SEC.

The SEC would consider the following attributes in determining which professional credentials qualify their holders for accredited-investor status:

- the 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;
- the examination or series of examinations is designed to demonstrate the individual’s comprehension and sophistication in the areas of securities and investing;
- individuals obtaining the 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
- the indication that an individual holds the credential is made publicly available by the accrediting authority.

The SEC recognizes that professional credentials may evolve with changes in the market and industry practices, and the proposed amendments would allow the SEC to adapt its list of qualifying credentials over time. The SEC expects that the FINRA Series 7, Series 65 and Series 82 certifications will be recognized in an order accompanying the final rule, if adopted.

For private-fund offerings, the SEC proposed to add a new category of “accredited investor” based on the individual’s status as a “knowledgeable employee” of the fund. This would harmonize Regulation D with rules under the Investment Company Act of 1940 that permit such employees to invest in private funds without regard to the 100-investor limit or “qualified purchaser” requirement for oft-used exemptions under the Investment Company Act, and therefore allow such employees to invest in private funds even if they do not meet current accredited-investor standards. Knowledgeable employees include senior officers of a private fund’s manager and certain other employees who, in connection with their regular duties, have participated in the investment activities of the manager’s funds for at least 12 months.

Expansion of “Accredited Investor” Definition for Entities

The SEC also proposed to amend the accredited-investor definition to include investment advisers registered under the Investment Advisers Act of 1940 and registered under state law. The SEC believes these advisers should have the financial sophistication needed to conduct meaningful investment analyses, a hallmark of financial sophistication.

In addition, the SEC proposed to expand the definition to include any “family office” with at least \$5 million in assets under management, as well as its “family clients” as defined under the Investment Advisers Act.

Expansion of “Qualified Institutional Buyer” Definition

Rule 144A provides a safe harbor from Securities Act registration for resales of securities to “qualified institutional buyers”; generally speaking, institutions that own and invest on a discretionary basis at least \$100 million in securities of non-affiliates. The SEC views such investors as sophisticated enough to not need additional protection by securities laws.

The current definition of “qualified institutional buyer” contains a list of the legal entities that can qualify which excludes some commonly used entity types. The proposed amendment would add limited liability companies and rural business investment companies to the current entities, and would also add a catch-all category that would permit institutional accredited investors of an entity type not already included in the “qualified institutional buyer” definition when they satisfy the \$100 million threshold. (In practice, this change will have limited impact, as many capital markets participants have always presumed that such entities are “qualified institutional buyers”.)

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