Anchin Alert

Anchin, Block & Anchin LLP
Accountants and Advisors

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Expanded Accredited Investor Definition Could Be Coming Soon

If someone wants to invest in SEC-exempt private market assets, like hedge funds and venture capital funds, they must meet the SEC's standards as an accredited investor. The SEC limits who can invest in these assets because they believe non-accredited investors do not have the sophistication or knowledge to understand these investments, or their risks.

However, these markets could be opening soon. On December 18th, 2019, the SEC commissioners voted three to two for expanding the accreditation scope to include more potential investors. Here's what could be changing.

Accredited Investor Definition

Currently, an individual is an accredited investor if their annual adjusted gross income was more than $200,000 in each of the past two years, or over $300,000 in combined income if they are married and filing jointly. Another way an individual can qualify is if their net worth is greater than $1 million, not including their personal residence.

Certain entities, including banks, partnerships, corporations, nonprofits and trusts, can also be accredited investors. An entity can qualify if it has assets exceeding $5 million or if all of the owners are accredited investors. In addition, the entity must not have been formed for the sole purpose of purchasing specific securities.

New Categories

Under the SEC's proposed changes, several new groups would be added to the accredited investor definition, including:

- Individuals with professional knowledge, certification or experience, including those holding the SEC's Series 7, 65 or 8 licenses.
- "Knowledgeable employees" of private funds being allowed to invest in those funds.
- LLCs, provided they meet the conditions outlined above.
- Family offices with at least $5 million in assets under management, as well as their family clients.

In addition, rule 144A, which allows for trading of privately-placed securities among Qualified Institutional Buyers (QIB) would be expanded to include institutional accredited investors that meet the QIB definition, but don't currently fall under the rule. In other words, they meet the $100 million minimum threshold for securities owned and invested.

Potential Concerns and Looking Ahead

While the SEC commissioners voted to approve these changes, it was on a close 3-2 split as certain commissioners did have concerns. One worry is that this expansion could drive even more capital into private markets, which already exceed SEC-registered offerings. In 2018, there was $1.7 trillion in such offerings versus $1.4 trillion for SEC-registered offerings.

SEC Commissioner Jackson was also concerned about expanding the definition without first conducting a review of the potential costs of doing so. He noted a higher rate of adviser misconduct in the private placement market and wondered whether investors would have adequate protection.

Finally, during this discussion, the SEC commissioners questioned whether the accredited investor income thresholds would still be appropriate over time, given that they are not indexed for inflation. Rather than adding an automatic inflation index, they proposed reviewing the limits every four years to make sure they remain suitable.

The 3-2 SEC vote established the framework for expanding the accredited investor definition and they are now collecting comments about the potential new rules. We will update you as these changes become clearer.

In the meantime, please contact your Anchin Relationship Partner or Jeffrey Rosenthal at 212-840-3456 with any questions that you may have.

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