Who Gets Accredited Investor Status Under New SEC Rule?

By Olivia Durnell (September 4, 2020)

Olivia Durnell

On August 26, the U.S. Securities and Exchange Commission released its **final regulations** amending the definition of "accredited investor."

The final regulations reflect much of what the SEC recommended back in December, as most of its proposed rules received support from the public. This decision to change the definition was of great import to the private lending industry, as most issuers of securities in this space rely on exemptions that center around this definition.

Those in the private lending industry were most concerned with the expansion of the definition regarding individuals with certain certifications and designations. This category is important to the industry because the vast majority of individuals who operate in the private lending world have a background in business or finance and have relationships with potential investors who have similar backgrounds.

The industry is full of attorneys, masters of business administration, certified public accountants, chartered financial analysts, chartered alternative investment analysts and others with various Financial Industry Regulatory Authority licenses who may not meet the strict income and net worth requirements under the previous definition of an accredited investor. These individuals are more than capable of evaluating the risks of exempt, private offerings because they are uniquely trained in topics such as economics, statistics, corporate finance and securities — but they have been barred from participating in such investments.

If this category were expanded to include all individuals with backgrounds in business and finance, the number of available investors would increase considerably, allowing for more individuals to invest in the private lending space than ever before. Additionally, this would grant issuers access to new pools of investors that would not only grow existing securities offerings, but could pave the way for new offerings in the future.

All of these benefits would likely lead to an influx of capital in the private lending industry that could create consistent and long-lasting growth in the market.

Unfortunately, instead of including all natural persons with significant experience in business and finance in the revised definition, the SEC has retained control over who may attain accredited investor status by providing a list of attributes that will be used to consider potential accredited investors with certain certifications and designations.

These attributes appear to provide a path to accredited status for individuals such as attorneys, MBAs, CPAs, CFAs and CAIAs, but this will only be possible through an order from the SEC granting that status via a commission order.

At this time, little is known about the commission order process, except that a final order from the SEC will not be provided until after a public comment period regarding the proposed certification or designation.

However, the SEC has noted its intention to automatically give status to individuals with Series 7, 65 and 82 licenses if they are in good standing. Since there are individuals in the private lending industry with these licenses, this signals a potential for growth in the industry, nevertheless, until more information is disclosed regarding the commission order process, the total impact on the private lending space is yet to be determined.

All in all, this amendment will be of value to investors and issuers of securities alike. The revised rules will allow for more individuals and entities to attain accredited investor status than ever before. This will be of great benefit to investors who have traditionally been excluded from obtaining accredited investor status because they lacked the net worth or income required under the SEC rules.

The final rules provide individuals with significant experience in business and financial matters the opportunity to grow their investment portfolios through access to lucrative private offerings.

The final rules will also be of value to companies, especially for those making private offerings, because the amendments significantly grow their pool of potential investors. They can now engage investors who did not meet the strict net worth and income requirements of the prior definition alone.

This will also be of benefit to companies who hope to invest in offerings as well. Companies may obtain accredited investor status if all their equity owners are deemed accredited investors. With new categories of natural persons being eligible for accredited investor status, it will be considerably easier for companies to obtain accredited investor status via its equity owners and thus gain access to new investment opportunities.

While this final rule provides excellent insight and opportunity for certain entities and individuals who now qualify as accredited investors, much is still left unsaid when it comes to who may become accredited investors through a commission order.

Investors and issuers will face a new challenge in navigating the process of applying for a commission order. The SEC has noted that these commission orders will be subject to public comment before being officially issued so this indicates that the process is unlikely to be a quick one.

Thankfully, the SEC has assured the public that it will maintain an updated list on its website of those individuals who successfully gained approval through this process which will likely provide valuable guidance to those hoping to apply for a commission order as well.

Issuers who rely on SEC exemptions, such as Regulation D, which hinge on the definition of "accredited investor," will need to take several steps in the coming months as we await the final rules to take effect.

First, issuers will need to update their offering documents to include the revised rule and the new paths for achieving accredited investor status.

Second, issuers will need to consider how this change might affect their existing investor base. For example, does the issuer have investors who, under the current rule, were not considered accredited, but now would be?

Third, issuers will want to consider how they may, in abiding by all SEC rules regarding advertising, reach this new group of investors who now may be eligible for their offering.

Lastly, both issuers and investors will need to monitor the SEC as it releases more information in the coming months about how one may apply for a commission order, which would grant accredited investor status.

While many of these changes do not come as a surprise to the public who have monitored the SEC in its process to amend the "accredited investor" definition, this final rule still presents a major change that will have a great effect on issuers of and investors in private offerings.

Issuers who rely on exemptions that require investors attain accredited investors have gained new pools of investors to which they may offer to. And investors who have historically been unable to participate in private offerings, despite significant experience or knowledge, will now have the opportunity to invest in ways they have never been able to before.

Olivia Durnell is an associate at Geraci LLP.

Disclosure: Geraci wrote a comment letter to the SEC in which the firm advocated for many of the changes in the final rule regarding the definition of an accredited investor.