

# Small Business

Minnesota Department of Employment and  
Economic Development (MN DEED)

## Securities and Exchange Commission Releases Report With Recommendations for Changes to Definition of Accredited Investor

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- **Securities and Exchange Commission Releases Report With Recommendations for Changes to Definition of Accredited Investor**

Citing the importance of accredited investors to capital formation under Regulation D, and noting that the definition of accredited investor had not been “comprehensively re-examined since its adoption in 1982,” the U.S. Securities and Exchange Commission on December 18, 2015 released its Report on the Review of the Definition of “Accredited Investor.” The 115 page report provided an overview of the purposes, history, and approaches to defining accredited investors and made several recommendations noting that “The staff believes that the Commission should consider any one or more of the following methods of revising the accredited investor definition.”

1. The Commission should revise the financial threshold requirements for natural persons to qualify as accredited investors and the list based approach for entities to qualify as accredited investors.
  - A. For individuals, leave in place the current income and net worth thresholds (\$200,000 and \$1 million respectively) but limit investments to a percentage of prior year’s income or a percentage of net worth in any 12 month period. The report noted that limiting amounts for individuals who qualify as accredited investors based solely on income or net worth “could provide protections for those individuals who are less able to bear financial losses.”
  - B. Add new inflation adjusted income and net worth thresholds not subject to investment limitations. For example, the report notes, the thresholds for individual income and net worth could increase to \$500,000 and \$2.5 million respectively to reflect inflation and maintain the ratios in the current definition.
  - C. Index all financial thresholds for inflation on a going-forward basis (for example, every four years).

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- D. Permit spousal equivalents to pool finances for the purpose of meeting income or net worth thresholds for accreditation. The report suggests defining “spousal equivalent” as “a cohabitant occupying a relationship generally equivalent to that of a spouse”; the definition used in the new crowdfunding rules.
  - E. Permit all entities with investments in excess of \$5 million to qualify as accredited investors. The report notes that this would enable entities like limited liability companies, labor unions, and social enterprises not currently on the list of entities qualifying to be able to qualify on the basis of amount of investment. This change would focus in investments rather than assets as a “more meaningful standard for ascertaining whether an entity is likely to have sufficient knowledge in financial and business matters to enable it to evaluate the merits and risks of a potential investment....”
  - F. Permit an issuer’s investors that meet the current accredited investor definition to be grandfathered with respect to future offerings of the issuer’s securities.
2. Revise the definition to allow individuals to qualify as accredited investors based on other measures of sophistication.
- A. Permit individuals with a minimum amount of investments to qualify as accredited investors. The report notes that investments may be a more meaningful measure of an individual’s experience and exposure to financial markets than income or net worth.
  - B. Permit individuals with certain professional qualifications to qualify as accredited investors. The examples given in the report include individuals who have passed the Series 7 examination, Series 65 examination, or Series 85 examination.
  - C. Permit individuals who have experience in investing in exempt offerings to qualify as accredited investors. The report notes that, for example, individuals who have invested in at least ten private offerings, each by a different issuer, under the safe harbor provision or Rule 506 (e.g., angel investors) could qualify as accredited investors.

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D. Permit knowledgeable employees of private funds to qualify as accredited investors for investments in their employer's funds. These are, the report notes, likely to have significant investing experience and information access to allow for informed investment decisions.

E. Permit individuals who pass an accredited investor examination to qualify as accredited investors. The report notes that "This approach could enable financially sophisticated individuals to qualify as accredited investors regardless of their wealth, educational background, or professional experience."

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It is important to remember that these recommendations are part of a staff report and it is not presently known when, and if, the Securities and Exchange Commission will consider them.

...Note that on February 1, 2016 the U.S. House of Representatives passed the "Fair Investment Opportunities for Professionals Act" (H.F. 2187) which would require the SEC to create an examination such as that recommended above for determination of accredited investor status.

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## Minnesota Department of Employment and Economic Development

1<sup>st</sup> National Bank Building ■ 332 Minnesota, Suite E-200 ■ Saint Paul, MN 55101-1351 USA  
651-259-7114 | Toll Free: 800-657-3858 | Fax: 651-296-5287 | TTY/TDD: 651-282-5909 | <http://mn.gov/deed/>

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