

SEC Proposes to Amend “Accredited Investor” Definition and Expand Pool of Investors Eligible to Invest in Private Placement Offerings

On December 18, 2019, the Securities and Exchange Commission (SEC) proposed amendments to the definition of “accredited investor” in the SEC’s rules under the Securities Act of 1933. These proposed amendments would expand the pool of investors eligible to invest in private placement offerings. If the final rules are adopted, this expanded accredited investor definition may provide particular benefits to startups and early-stage companies that rely on securities offerings on a private placement basis to raise much-needed capital.

The proposed amendments are intended to update the accredited investor definition to more effectively identify investors that have knowledge and expertise to participate in the U.S. private capital markets. The proposed amendments are subject to a 60-day public comment period, which is will end in late February.

The current accredited investor definition is based virtually exclusively on an investor’s financial profile, i.e., whether the investor meets certain income, net worth or asset ownership thresholds. For instance, an individual can qualify as an accredited investor if he/she has had, in each of the last two years, income in excess of \$200,000 (or joint annual income with a spouse in excess of \$300,000), or a net worth of over \$1 million (individually or jointly with a spouse) not including the value of the investor’s home. An investor which is an entity, such as a corporation or limited liability company, will meet the definition of an accredited investor if it, among other things, has total assets in excess of \$5 million.

Since unregistered securities offerings, also known as private placements, prevalently rely on investors meeting the accredited investor standard, expanding the accredited investor definition is vitally important to expand the quantity of and type of investors eligible to invest in these companies, especially small startup and “venture capital” companies that have struggled to raise capital.

Under the SEC’s proposed amendment, the definition of accredited investor will be expanded to include new categories of individuals that may qualify based on their professional knowledge, certifications,



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and/or experience. The proposed amendments also would expand the list of entities that may qualify as accredited investors.

According to the SEC's proposal, the new amendments would:

- add new categories to the definition that would permit natural persons to qualify as accredited investors based on certain professional certifications and designations, such as a Series 7, 65, or 82 license, or other credentials issued by an accredited educational institution;
- with respect to investments in a private investment fund, add a new category based on the person's status as a "knowledgeable employee" of the fund;
- add a new category for any entity, including Indian tribes, owning "investments," as defined in Rule 2a51-1(b) under the Investment Company Act of 1940, in excess of \$5 million and that was not formed for the specific purpose of investing in the securities offered;
- add "family offices" with at least \$5 million in assets under management and their "family clients," as each term is defined under the Investment Advisers Act of 1940; and
- add the term "spousal equivalent" to the accredited investor definition, so that spousal equivalents may pool their finances for the purpose of qualifying as accredited investors.

The proposed amendments are part of the SEC's stated objective to open up private markets to a wider range of investors. In this connection, whenever the pool of eligible investors increases, this is expected to improve the prospects of private companies of raising capital, especially early stage companies who have struggled in the past to obtain financing from high net worth individuals and institutional investors. By expanding the accredited investor pool to include investors based on measures of financial sophistication, and not merely dollar thresholds, the chances of private companies to raise the capital they need for growth and operations increases as well.

This proposed amendment, if accepted following the 60-day public comment period at the end of February, may have significant influence on the Israeli Securities Authority ("ISA"), which in general over the years has used the SEC as a benchmark against which it forms Israeli securities laws and regulations.

Currently, there are significant differences between the qualification requirements for Israeli investors according to the ISA and American investors according to the SEC.



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According to the SEC threshold, a natural person can qualify as an accredited investor if the person has had, in each of the last two calendar years, individual income in excess of \$200,000 or joint annual income with a spouse in excess of \$300,000. An accredited investor in Israel must have individual annual income of at least \$351,640 and joint annual income of \$527,459.

According to the SEC, an accredited investor's net worth must be over \$1 million (individually or jointly with a spouse) not including the value of the investor's home, whereas according to the ISA laws in Israel such net worth must be at least \$2,344,263.

A US investor which is an entity may qualify if it has total assets in excess of \$5 million. In Israel, such an entity must have total assets of at least \$14,478,904.

Amending the ISA thresholds, to amounts closer to those used by the SEC, would likely have a positive effect on private companies looking to raise funds for their continued growth, especially early stage start-ups who do not have access to institutional money and who are under the radar of venture capital funds. Those start-ups often rely on angel investors who are often individuals (high earners and those with significant funds, however certainly not powerful "tycoons") looking to invest their wealth directly into the markets, rather than through brokers, investment funds, etc.

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