

New Accredited Investor Rules Will Expand Eligibility for Private Fund Investments

By: Scott J. Bakal, Michael B. Gray and Wesley G. Nissen

August 31, 2020

On August 26, 2020, the SEC adopted several changes to expand the definition of an “accredited investor.” For the first time, a new category will enable natural persons to qualify as accredited investors based upon their professional certifications, designations or other credentials even if they would not have otherwise qualified on the basis of their income or net worth. Because the financial thresholds for accreditation are not adjusted for inflation, the number of natural persons satisfying those requirements have increased substantially. Accordingly, the expansion of the definition for natural persons is unlikely to significantly increase the number of natural persons qualifying as accredited. The new rules also define the term “spousal equivalent,” thereby enabling spousal equivalents to be treated in the same manner as the rules historically have treated spouses.

Potentially more significant than the expansion of the definition for natural persons, is the expansion of the list of entities that qualify as accredited.

The new rules clarify that any entity owning more than \$5 million in investments that is not formed for the specific purpose of acquiring a specific security being offered will qualify as an accredited investor.

The qualification of certain trusts as accredited, specifically irrevocable trusts (including dynasty trusts, annual gift trusts and insurance trusts) historically has been somewhat problematic. Under current rules, a trust generally is deemed to be accredited only if it has total assets in excess of \$5,000,000, and was not formed for the specific purpose of acquiring the securities offered, and investment decisions for which are directed by a financially “sophisticated person.” Once the new rule becomes effective on or about October 25, 2020, “family offices” and their “family clients,” *including trusts*, will be accredited investors. Trusts which are family clients of a family office may, therefore, qualify as accredited investors, *even if those trusts have \$5,000,000 or less in total assets*.

“Family Offices” are entities established by families to manage their assets, plan for their families’ financial future, and provide other services to family members. In addition:

- The Family Office must have at least \$5 million in assets under management.
- The office cannot have been formed for the specific purpose of investing in the securities offered.
- Purchases must be made by a competent person who has the knowledge and capability of evaluating the merits and risks of a potential investment.

Families that have established trusts that desire to make hedge fund, private equity fund or other investments in privately offered securities where the trusts have less than \$5 million will now be able to make such investments through those trusts by forming a family office and qualifying the trusts as family clients of the family office. Creation of a family office that qualifies under this rule requires the establishment of a legal entity (such as a corporation or LLC or LP) entity.

However, it does not require any filings with the SEC, so the establishment of a family office entity is relatively easy and cost efficient, even if there is little need to create a family office for purposes *other than* taking advantage of the expanded accredited investor definition. We expect that some family groups that have, to date, operated relatively informally may now wish to establish family offices for the first time, in order to take advantage of the new accredited investor rules.

This alert was authored by

Scott J. Bakal | 312-269-8022 | sbakal@nge.com

Michael B. Gray | 312-269-8086 | mgray@nge.com

Wesley G. Nissen | 312-269-5697 | wnissen@nge.com

If you have any questions about these new regulations, please contact [Scott Bakal](#), [Michael Gray](#), [Wesley Nissen](#) or your [Neal Gerber Eisenberg](#) attorney.

The content above is based on information current at the time of its publication and may not reflect the most recent developments or guidance. Please note that this publication should not be construed as legal advice or a legal opinion on any specific facts or circumstances. The contents of this publication are intended solely for general purposes, and you are urged to consult a lawyer concerning your own situation and any specific legal questions you may have.

The alert is not intended and should not be considered as a solicitation to provide legal services. However, the alert or some of its content may be considered advertising under the applicable rules of the supreme courts of Illinois and certain other states.

© Copyright 2020 Neal, Gerber & Eisenberg LLP