

# Defining An Accredited Investor

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One of the key rules for private investment funds is that their investors generally need to be “accredited investors.” This is the gateway to an exemption from the registration requirement under the federal securities laws.

The exemption is generally targeted so that experienced investors with significant financial resources and their own advisers are in less need of the Securities and Exchange Commission’s regulatory protection. In theory, they can protect themselves better than the SEC could protect them.

Who qualifies as an accredited investor? The answer is spelled out in [Rule 501 of Regulation D](#):

- Any bank as defined in [section 3\(a\)\(2\)](#) of the Act, or any savings and loan association or other institution as defined in section 3(a)(5)(A) of the Act whether acting in its individual or fiduciary capacity;
- Any broker or dealer registered pursuant to [section 15](#) of the Securities Exchange Act of 1934; any insurance company as defined in [section 2\(a\)\(13\)](#) of the Act;
- Any investment company registered under the Investment Company Act of 1940 or a business development company as defined in [section 2\(a\)\(48\)](#) of that Act;
- Any Small Business Investment Company licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958;
- Any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of \$5,000,000;
- Any employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974 if the investment decision is made by a plan fiduciary, as defined in section 3(21) of such act, which is either a bank, savings and loan association, insurance company, or registered investment adviser, or if the employee benefit plan has total assets in excess of \$5,000,000 or, if a self-directed plan, with investment decisions made solely by persons that are accredited investors
- Any private business development company as defined in [section 202\(a\)\(22\)](#) of the Investment Advisers Act of 1940
- Any charitable organization, corporation, or partnership with assets exceeding \$5 million (not formed for the specific purpose of acquiring the securities offered);
- Any director, executive officer, or general partner of the company selling the securities;
- Any natural person who has individual net worth, or joint net worth with the person’s spouse, that exceeds \$1 million at the time of the purchase;
- Any natural person with income exceeding \$200,000 in each of the two most recent years or joint income with a spouse exceeding \$300,000 for those years and a

reasonable expectation of the same income level in the current year;

- Any trust with assets in excess of \$5 million, not formed to acquire the securities offered, whose purchases a sophisticated person makes
- Any entity in which all of the equity owners are accredited investors.

In addition to the definition of accredited investor, you also need to understand how accredited investor status relates to the common exemptions from the registration requirements of the federal securities law.

[Rule 504](#) permits allows a business to sell up to \$1 million in securities during a 12 month period to an unlimited number of non-accredited investors. Additionally, Rule 504 does not require the issuer to provide any specific disclosure to the investors, regardless of whether they are accredited.

[Rule 505](#) allows a business to sell up to \$5 million in securities during a 12 month period to an unlimited number of accredited investors, and up to 35 non-accredited investors. The disclosure requirements when selling to non-accredited investors are significantly more difficult to meet and are very similar to the disclosures required in a public offering.

[Rule 506](#) allows a business to raise an unlimited amount of capital via the sale of securities to an unlimited number of accredited investors and up to 35 non-accredited investors. In addition to the disclosure requirements for Rule 505, any non-accredited investors must also meet a “sophistication” standard, either themselves or through a qualified representative. The status of an investor as “sophisticated” is a high standard. Investors who are merely knowledgeable about the particular industry are not necessarily sophisticated. They must have such knowledge and experience in financial and business matters that they are capable of evaluating the merits and risks of the prospective investment.

*References:*

- [Rule 501 of Regulation D](#)
- SEC’s [guide to help you understand how to raise capital and comply with the federal securities laws](#)

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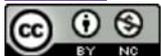


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