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# SEC Releases New Guidance on Accredited Investor Determination and Verification

**July 15, 2014**

On July 3, 2014, the Securities and Exchange Commission (SEC) issued six new Compliance and Disclosure Interpretations (CDIs) regarding the determination and verification of accredited investor status for purposes of Rule 506(b) and Rule 506(c) of Regulation D under the Securities Act of 1933.

The first two CDIs clarified the application of the income test to income reported in a non-U.S. currency and the net worth test to joint assets held by a purchaser with a person other than his or her spouse:

- **Income Reported in a Non-U.S. Currency.** For purposes of determining whether a purchaser is an accredited investor using the income test, where the purchaser's annual income is reported in a non-U.S. currency, the issuer may use either the exchange rate as of the last day of the year being reported or the average exchange rate for that same year.
- **Joint Assets with a Non-Spouse.** For purposes of determining whether a purchaser is an accredited investor using the net worth test, where the purchaser has assets in an account and/or property held jointly with a person other than his or her spouse, the issuer may consider such account and/or property, but only to the extent of the purchaser's percentage ownership of the account and/or property.

The remaining four CDIs offered guidance on the "safe harbor" accredited investor verification methods under Rules 506(c)(2)(ii)(A) and 506(c)(2)(ii)(B). Rule 506(c) permits an issuer to use general solicitation for a private offering conducted in reliance on Rule 506. To rely on Rule 506(c), the issuer must take reasonable steps to verify that all purchasers in the offering are accredited investors. An issuer may do so by adopting a principle-based approach tailored to the nature and circumstances of the investor and the transaction or, if the purchaser is an individual, by using one of the four non-exclusive "safe harbor" methods under Rule 506(c)(2)(ii) that are deemed to satisfy the verification requirement.[1]

**Rule 506(c)(2)(ii)(A).** Where a purchaser is seeking to qualify as an accredited investor on the basis of income, an issuer may satisfy the verification requirement by reviewing the purchaser's Internal Revenue Service (IRS) forms for the two most recent years and obtaining a written representation from the purchaser that the purchaser has a reasonable expectation of reaching the income level necessary to qualify as an accredited investor during the current year.

The CDIs provided that an issuer may not rely on the safe harbor if: (i) none of the purchaser's IRS forms for the most recent completed year is available; or (ii) the purchaser's tax forms are from a non-U.S. jurisdiction. Nevertheless, a purchaser may still meet the verification requirement under the principle-based approach, if the issuer has otherwise taken reasonable steps to verify the purchaser's status. For instance, the issuer may review the purchaser's IRS forms for the two years preceding the recently completed year and obtain written representations from the purchaser that (i) an IRS form for the most recently completed year is not available; (ii) specify the amount of income the purchaser received for the recently completed year and that such amount reached the level needed to qualify the purchaser as an accredited investor; and (iii) the purchaser has a reasonable expectation of reaching the requisite income level for the current year. The issuer also may consider a purchaser's non-U.S. tax forms, if the non-U.S. jurisdiction imposes penalties for falsely reported information comparable to those imposed under U.S. law. In both cases, the issuer should take additional steps to verify the purchaser's status if red flags arise (*e.g.*, the income reported for the most recently completed year barely meets the required minimum).

**Rule 506(c)(2)(ii)(B).** Where a purchaser is seeking to qualify as an accredited investor on the basis of net worth, an issuer may satisfy the verification requirement by reviewing certain documentation dated within the prior three months regarding the purchaser's assets (which may include bank statements, brokerage statements and other statements of securities holdings, certificates of deposit, tax assessments and appraisal reports by independent third parties) and liabilities (which must be a consumer report from a U.S. nationwide consumer reporting agency).

The CDIs provided that an issuer is not eligible for the safe harbor if it is relying on: (i) a tax assessment that is more than three months old, even if tax assessments are often prepared only annually; or (ii) a consumer report prepared by a non-U.S. consumer reporting agency. As in the case with outdated or non-U.S. tax forms described above, however, an issuer may still rely on these documents to satisfy the verification requirement, if it otherwise has taken reasonable steps to verify the purchaser's status. For instance, where the issuer is relying on a non-U.S. consumer report, it may seek additional confirmation from the purchaser by requesting a written representation stating that all liabilities have been disclosed. The issuer should also take additional steps if it has reason to question the information reported in the documents provided.

If you have any questions on the foregoing, please feel free to contact your regular Proskauer lawyer or any of the lawyers listed in this alert.

[1] For more information on Rule 506(c), please see our prior alert here.

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