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Will Hedge Funds See Accredited Investor Bump? Don’t Bet on It

By Lydia Tomkiw September 16, 2020

Hedge funds will soon need to amend their subscription documents after the Securities and Exchange Commission adopted final amendments last month to update its definition of an accredited investor. The change may ultimately have less impact on the hedge fund industry’s investor base and the products on offer than some had expected, but could open the door to future updates, say market watchers.

The amendments, adopted in 3-2 vote, expand the potential pool of investors for private fund managers, including hedge funds, private equity firms, and venture capital investors. The regulator’s change did not alter the main income and net worth requirements – earnings of at least $200,000 in income or $300,000 in joint spousal income, or a net worth of over $1 million. But the amendments added waivers and tests, including specific investment series licenses, that expand who can qualify for the designation, including knowledgeable employees at managers, opening the door for more asset management professionals to invest in private alts strategies.

The modified definition will take effect 60 days after its publication in the Federal Register, which has not yet taken place.

The definition’s criteria broadening is fairly modest and will likely only lead to some marginal new capital fundraising, says **Kevin Neubauer**, a partner in the investment management group at **Seward & Kissel**.

“I think it will have a modest effect,” he says. “It’s largely symbolic in so far as it works toward achieving one of the policy objectives of the current commissioner.”

The change could help junior-level employees at hedge funds as well as some service providers qualify as accredited investors, Neubauer adds.

“I think at the end of the day this is going to be much ado about nothing,” says **Ernest Badway**, a litigation attorney who is co-chair of **Fox Rothschild**’s securities industry practice.

Some managers also have expressed reservations about expanding the definition to potential investors who may not be able sustain a high potential risk level. “I think you have to have the ability to sustain the potential for losing your entire investment,” Badway adds.

A few hedge fund industry consultants told *FundFire* they hadn't heard much discussion or excitement around the change from hedge fund managers.

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The definition expansion could cast a wider net, but may not matter if hedge funds and other alts managers don't also update investment minimums for their funds, which can range well into several million dollars, says **Michael McGrath**, an executive v.p. at **Thales Capital Partners** responsible for the private client solutions group.

"The other issue is what is the minimum investment? And that part needs to be married to this so that real smaller investors can have access," he says. "If the minimums are set to the previous standards, it's typically out of reach for most folks that meet the other attributes."

Still, platforms that offer feeders into alts products could see more attention with the rule change, McGrath says.

iCapital Network, one of the largest platforms, has seen the rule update effort raise greater awareness around alts. "The changes thus far have been relatively modest, but it's an important start, and will hopefully continue to open up," says **Joseph Burns**, managing director and head of hedge fund solutions at iCapital, in an email to *FundFire*.

Hedge funds can have up to 35 sophisticated non-accredited investors today under rule 506 offerings, says **Richard Shamos**, counsel in Sadis & Goldberg's financial services group. While it's doubtful the rule change will have a big impact on the hedge fund industry in terms of raising large amounts of capital, it could have more impact on the private equity and venture capital space.

The larger potential changes for the alts industry could come further down the road, he adds.

"I think the change is significant. It's an important regulatory definition," Shamos says. "The immediate impact isn't going to be huge, but the potential is there if we see the SEC continue to liberalize access to private investment products."

Contact the reporter on this story at ltomkiw@fundfire.com or 212-542-1278.