

Accredited Investor and Qualified Purchaser Rules - Considerations for Estate Planning

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Prepared and Presented by:

Robert M. Weylandt

Managing Director

J.P. Morgan Private Bank

712 Main Street, 10th Floor North

Houston, TX 77002

713-216-4688

robert.m.veylandt@jpmorgan.com

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The 33 Act¹ and 40 Act²

- ❑ The Securities Act of 1933 (often referred to as the “truth in securities” law; referred to herein as “the Securities Act” or “the 33 Act”)
 - ❑ Two main objectives of the Securities Act
 - ❑ “Ensure that the investing public receives financial and other significant information concerning securities being offered for public sale”
 - ❑ “Prohibit deceit, misrepresentations, and other fraud in the sale of securities”³
 - ❑ Those objectives are carried out through the securities registration process
 - ❑ There are certain exceptions to the registration requirement, including, most importantly for estate planning purposes, private offerings to a limited number of persons or institutions
- ❑ The Investment Company Act of 1940 (often referred to as “the Investment Company Act”; referred to herein as “the 40 Act”)
 - ❑ The 40 Act regulates the organization and activities of companies that engage primarily in investing in securities and whose own securities are offered to the public

¹Securities Act of 1933, 15 U.S.C.A. sections 77a-77aa.

²Investment Company Act of 1940, 15 U.S.C.A. sections 80a-1-80a-64.

³See: <https://www.sec.gov/answers/about-lawsshtml.html>.

The 33 Act¹

- The 33 Act created registration requirements to provide the public with information regarding potential investments so that the public could make informed investment decisions and to protect the public in the marketplace
- Applies to public offerings with **non-public** offerings being exempt from the act. “Non-public” is not defined.
- Safe harbor: a sale of securities to an unlimited number of **accredited investors** and no more than 35 non-accredited investors, that meets certain other conditions will be deemed a non-public offering.
- Accredited investors: there are eight categories:
 1. Bank, savings and loan or similar institution acting in its individual or a fiduciary capacity
 2. Private business development companies
 3. Organization described in IRC 501(c)(3), corporation, partnership, or business trust with total assets exceeding \$5MM and which was **not formed for the specific purpose of** acquiring the securities being offered
 4. Directors, executive officers or general partners of the issuer
 5. Natural person with a net worth at time of purchase in excess of \$1MM
 6. Natural person with an income in excess of \$200K (single) or \$300K (joint) in each of last two years and reasonably expects same or greater income in year of purchase
 7. Trust with assets in excess of \$5MM and not formed for the specific purpose of acquiring the security and whose purchase is directed by a **sophisticated person**
 8. Entities in which all equity owners are accredited investors under 1-7

¹Securities Act of 1933, hereinafter referred to as the 33 Act. Securities Act of 1933, 15 U.S.C.A. sections 77a-77aa and 17 C.F.R. sections 230.501-230.508 (2008), hereinafter referred to as Regulation D.

The 40 Act¹

- The 40 Act created registration requirements for investment companies² to provide the public with information regarding potential investments and also placed restrictions on the activities of registered investment companies and affiliated persons
- Safe harbor: an entity that sells its interests only to **qualified purchasers** will not be deemed to be an “investment company” for purposes of the 40 Act registration requirements
- Qualified Purchasers (QP): there are four categories:
 1. Natural person owning at least \$5MM in investments
 2. Certain family-owned companies (includes trusts) owning at least \$5MM in investments and **not formed for the specific purpose of** acquiring the securities being offered
 3. Trust not described in 1 or 2 where all of the trustees (or other person authorized to make decisions for the trust), and all of the grantors (or other person who has contributed assets to the trust), are themselves QPs, and the trust is **not formed for the specific purpose of** acquiring the securities being offered
 4. Person acting for own account or account of other QPs who owns and invests on a discretionary basis \$25MM or more in investments and **not formed for the specific purpose of** acquiring the securities being offered

¹ Investment Company Act §§ 2(a)(51) and 3(c)(7).

² Investment Company Act § 3(a)(1).

Important Terms

- **Investments**¹: generally includes securities, investment real estate, commodities, financial contracts, and cash and cash equivalents held for investment
- **Not formed for the specific purpose of**²: the SEC has indicated in a no-action letter a number of factors as relevant including (i) centralized management and decision making, (ii) proposed activities of the entity, (iii) relationship between the entity's investment and total capitalization, and (iv) extent to which all equity holders participate in entity investments
- **Sophisticated person**³: a person who has the knowledge and experience in financial and business matters so that he is capable of evaluating the merits and risks of the prospective investment
- **Related persons**⁴: siblings, spouses and descendants, and foundations/charitable entities established by or for the benefit of such persons
- **Institutional Trustee**⁵: a bank or any savings and loan or other institution defined in Section 3(a)(5)(A) of the 33 Act.
 - “Bank” means any national bank, or any banking institution organized under the laws of any State, territory, or the District of Columbia, the business of which is substantially confined to banking and is supervised by the State or territorial banking commission or similar official⁶

¹ Rule 2a-51-1(a)(4).

² See Hall, Moneytree Associates Limited Partnership I, SEC No-Action Letter, 1993 WL 29899 (November 3, 1983). Also see SEC, Response of Chief Counsel; 200055241712; SCP Private Equity Partners, File No. 132-2 (June 6, 2006) and ABA Letter, Ref. No. 97-666, File No. 132-3 (April 22, 1999); Cornish & Carey Commercial, SEC reference no. 96-105-CC (pub. avail. Jun 21, 1996), an investment equaling 40% of more of the assets has led to the presumption that the entity was formed for the purpose of.

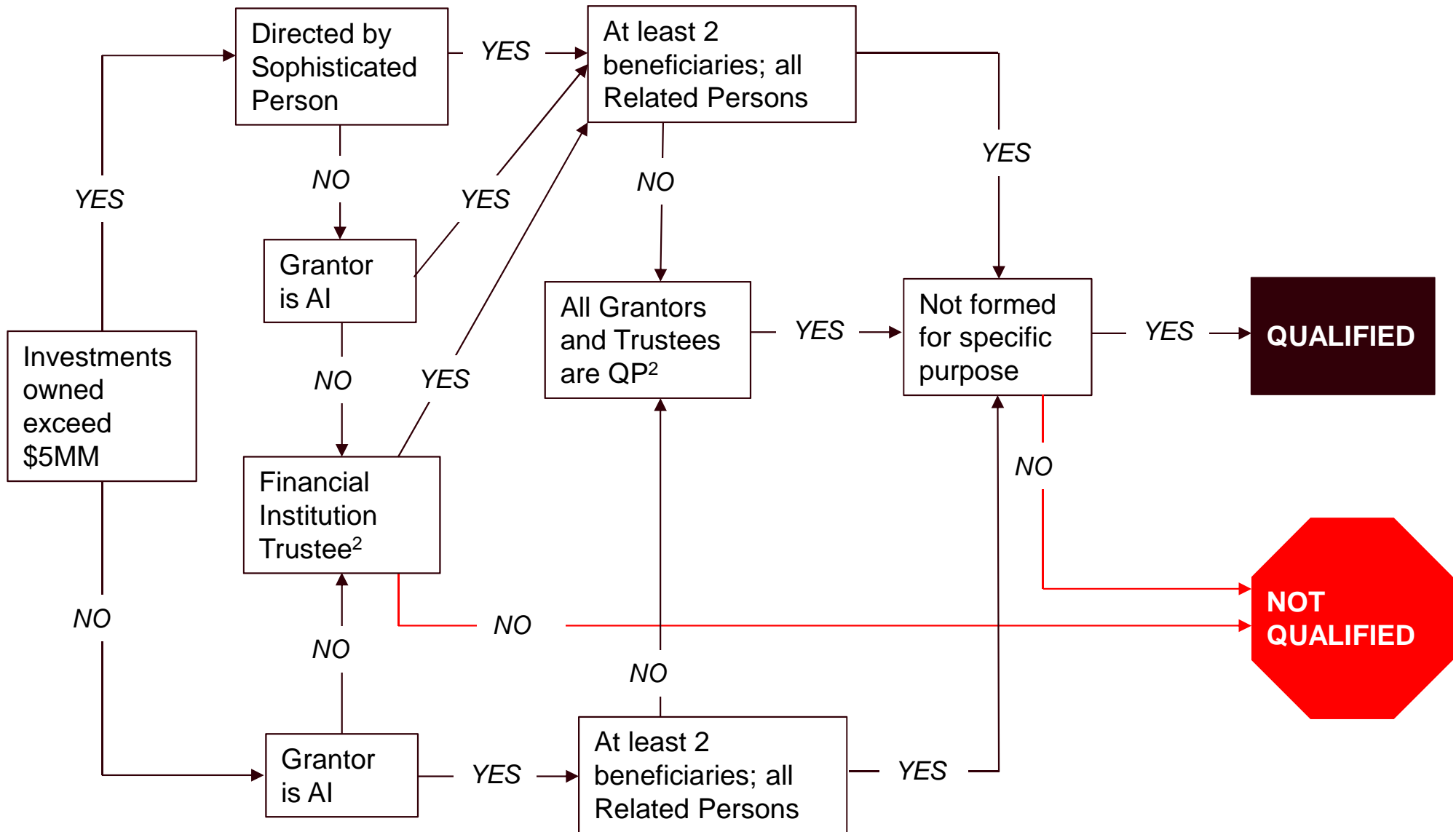
³ 17 C.F.R. §§ 230.506(b)(2)(ii).

⁴ Investment Company Act § 2(a)(51)(A)(ii).

⁵ 17 C.F.R. §§ 230.506(a).

⁶ Id @ §§ 3(a)(2) and 3(a)(5)(A).

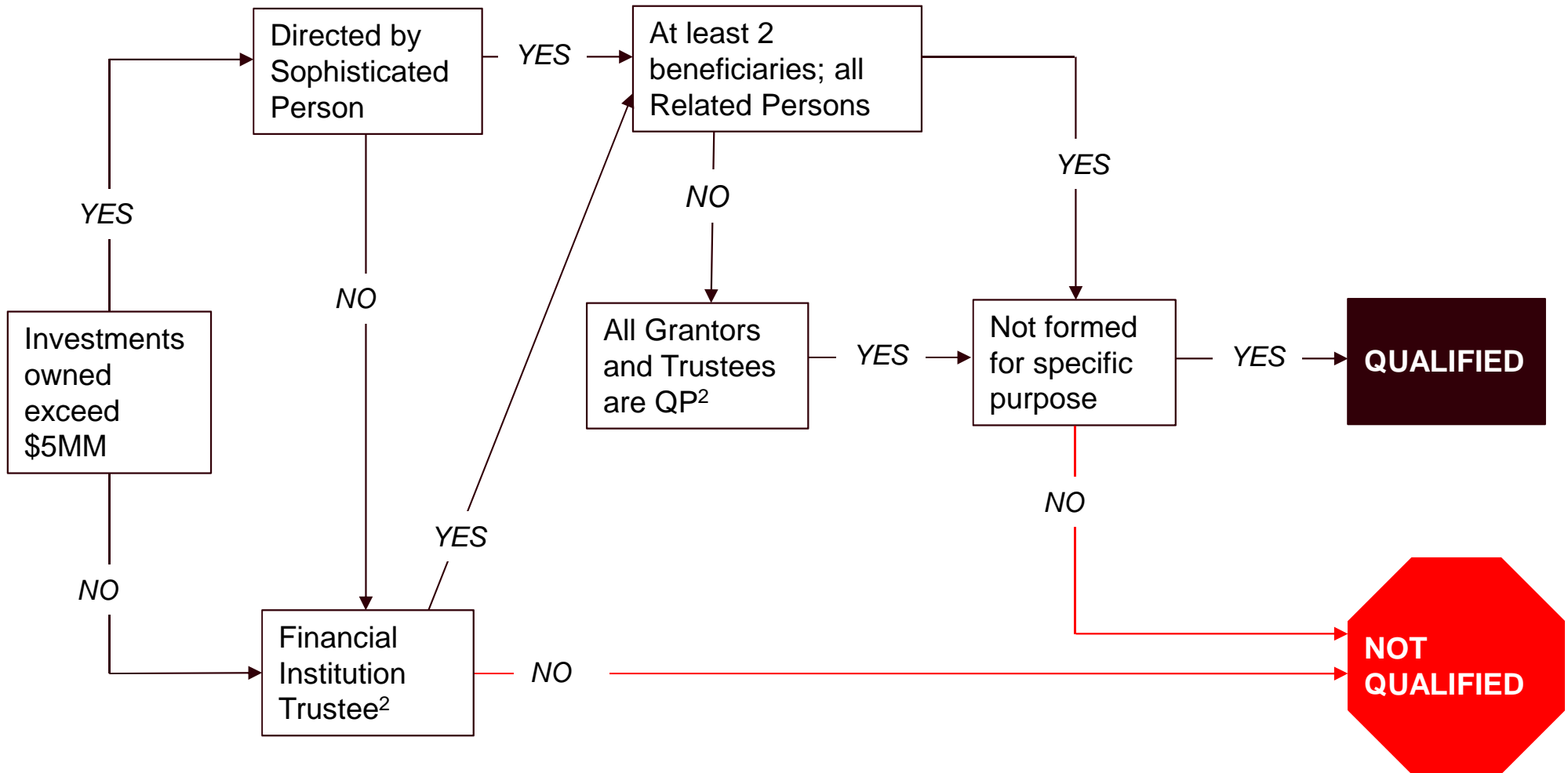
When does a revocable trust¹ qualify as AI/QP?



¹See generally Securities Act of 1933, 15 U.S.C.A. sections 77a-77aa, 17 C.F.R. sections 230.501-230.508, and Investment Company Act §§ 2(a)(51) and 3(c)(7).

² Where QP status based on status of grantor and/or trustee, all grantors and all trustees holding decision-making powers over investments must qualify.

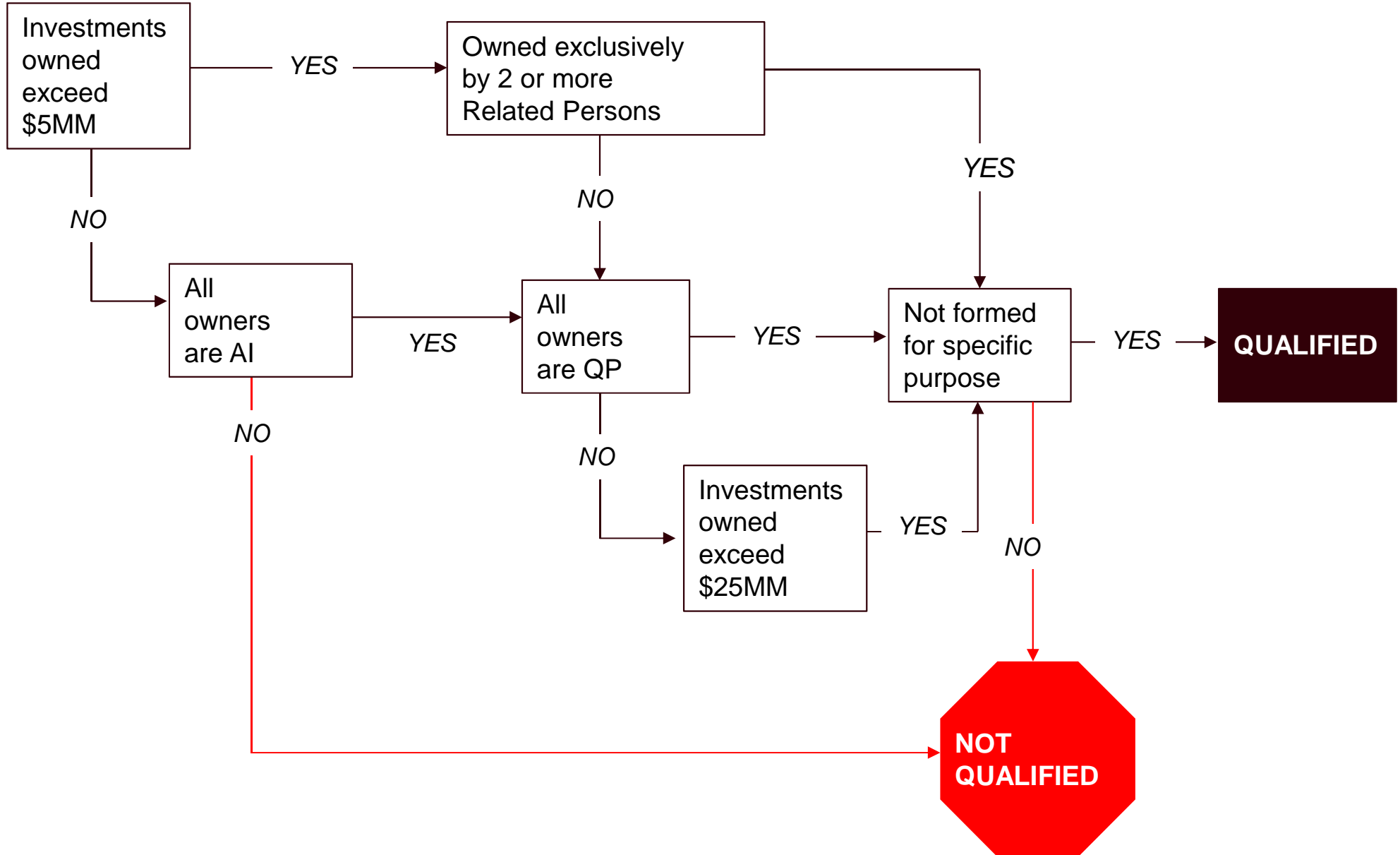
When does an irrevocable trust¹ qualify as AI/QP?



¹See generally Securities Act of 1933, 15 U.S.C.A. sections 77a-77aa, 17 C.F.R. sections 230.501-230.508, and Investment Company Act §§ 2(a)(51) and 3(c)(7).

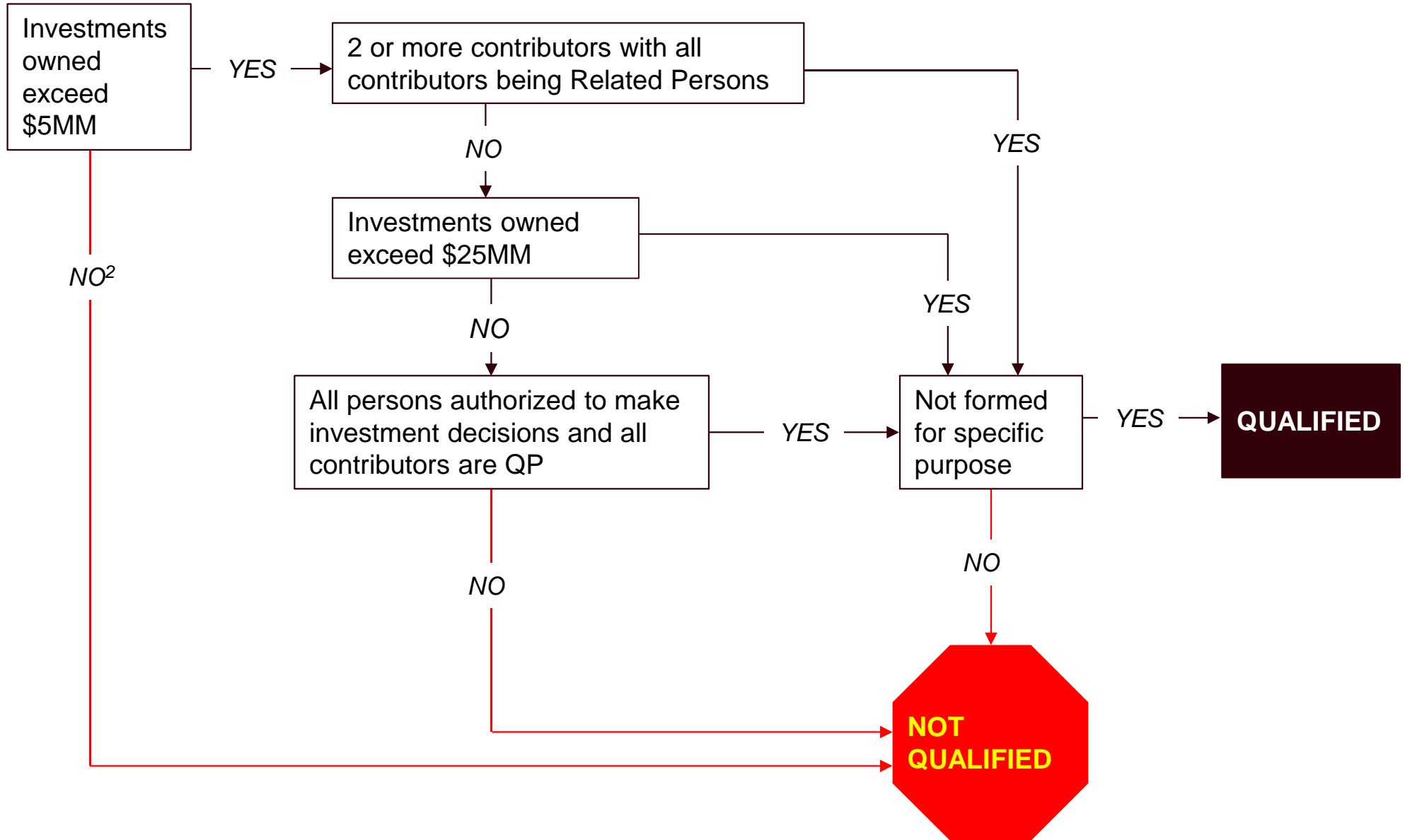
²Where QP status based on status of grantor and/or trustee, all grantors and all trustees holding decision making powers over investments must qualify.

How does a family created investment entity (other than a trust) qualify as AI/QP¹?



¹See generally Securities Act of 1933, 15 U.S.C.A. sections 77a-77aa, 17 C.F.R. sections 230.501-230.508), and Investment Company Act §§ 2(a)(51) and 3(c)(7). Also see Trans-Resources, Inc. SEC No-Action Letter, 1997 WL 280674 and Rule 501(a)(8), entities in which all equity owners are AI.

How does a charity (formed other than a trust) qualify as AI/QP¹?



¹See generally Securities Act of 1933, 15 U.S.C.A. sections 77a-77aa, 17 C.F.R. sections 230.501-230.508, and Investment Company Act §§ 2(a)(51) and 3(c)(7).

²See Previous Slide, "When does an irrevocable trust qualify as AI/QP" to analyze under trust rules.

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