A Brief Rumination On Metaphysics, Trusts and Accredited Investors

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I know that the practice of law requires a bit of abstract thinking. However, sometimes this abstract thinking takes a sharp turn into the metaphysical, if not the absurd. One such example is the SEC Staff's Compliance and Disclosure Interpretation addressing who qualifies as an accredited investor as defined by Rule 501 of Regulation D.

First, a bit of background. Sometimes, an investor in a private placement will be a trust. Rule 501 offers several possibilities for concluding that a trust is an "accredited investor". If the trustee qualifies as a financial institution under Rule 501(a)(1), then it may be possible for the trustee to participate for the benefit of the trust. Another option is for the trust to qualify under Rule 501(a)(7). However, the trust must have have total assets in excess of $5 million, the trust must not be formed for the specific purpose of acquiring the securities offered, and the purchase must be directed by a sophisticated person. If the trust can't qualify under either of those options, one might be tempted to cast longing looks at Rule 501(a)(8). Here's where the C&DI #255.21 comes in, which I've reproduced below:

Question: May a trust be accredited under Rule 501(a)(8) if all of its beneficiaries are accredited investors?

Answer: Generally, no. Rule 501(a)(8) accredits any entity if all of its "equity owners" are accredited investors. This provision does not apply to the beneficiaries of a conventional trust. The result may be different, however, in the case of certain non-conventional trusts where, as a result of powers retained by the grantors, a trust as a legal entity would be deemed not to exist. The result also would be different in the case of a business trust, a real estate investment trust, or other similar entities. Thus, where the grantors of a revocable trust are accredited investors under Rule 501(a)(5) (e.g., the net worth of each exceeds $1,000,000) and the trust may be amended or revoked at any time by the grantors, the trust as a legal entity would be deemed not to exist, and the trust would be deemed accredited, because the grantors would be deemed the equity owners of the trust's assets. See the Lawrence B. Rabkin, Esq. no-action letter (July 16, 1982) issued by the Division. [Jan. 26, 2009]

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This is what I understand the Staff to be saying. When (i) the grantors of a trust are accredited under Rule 501(a)(5); and (ii) the trust may be amended or revoked at any time by the grantors, then a trust is deemed NOT TO EXIST. Then, they seem to be saying that this non-existent trust is deemed accredited. So there you have it, a non-existent trust may be deemed to be an accredited investor.

If you've been looking for the California angle on all this, here it is. One of the conditions to the availability of the limited offering exemption in Corporations Code § 25102(f) is that the number of purchasers be 35 or less. The Commissioner has adopted a rule, 10 CCR § 260.102.13, that excludes some purchasers from this count. One such excluded purchaser is any entity in which all of the equity owners are persons specified in Corp. Code § 25102(i), Rule 260.102.10, or in subsections (a), (b), (c), (d), (f) and (g) of Rule 260.102.13. The reference to "all of the equity owners" is, of course, reminiscent of Rule 501(a)(8). However, we don't even have to take that roundabout route to Rule 501(a)(8) because Rule 260.102.13 also excludes in subsection (g) any person who is within the category of "accredited investor" in Rule 501(a).

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