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## SEC Expands Accredited Investor Definition To Allow More Participation in Private Offerings

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On August 26, 2020, the Securities and Exchange Commission (SEC) adopted amendments to expand the definition of “accredited investor” in Rule 215 and Rule 501(a) of Regulation D promulgated under the Securities Act of 1933, as amended (Securities Act). The amendments will allow more investors to participate in private offerings by adding new categories of individuals who may qualify as accredited investors based on their professional knowledge, experience or certifications. The amendments also expand the list of entities that may qualify as accredited investors by, among other things, allowing any entity that meets an investment test, rather than an asset test, to qualify.

To conform with the updated accredited investor definition, the SEC also expanded the definition of “qualified institutional buyer” (QIB) in Rule 144A under the Securities Act.

The amendments become effective 60 days after publication in the Federal Register.

### Background

Under existing SEC rules, certain sophisticated investors, such as accredited investors and QIBs, may participate in investment opportunities that are not generally available to the public and that are regarded as involving more risk, such as investments in private companies and offerings by certain hedge funds, private equity funds and venture capital funds. In such instances, investors’ ability to qualify as accredited is key for issuers seeking to take advantage of a number of exemptions from registration, such as Rules 506(b) and 506(c) of Regulation D.<sup>1</sup> The SEC estimates that issuers raised approximately \$1.56 trillion through Regulation D offerings in 2019, compared with \$1.2 trillion raised through registered offerings.

Despite the continued activity in private offerings, many investors, practitioners and regulators have observed that the income and asset thresholds used to determine accredited investor status may not capture other individuals with sufficient expertise to evaluate and invest in such offerings. Moreover, the accredited investor definition largely has been unchanged since 1982.

<sup>1</sup> Rule 506 of Regulation D provides an exemption from registration to companies that sell their securities to accredited investors. Currently, an accredited investor is defined as (i) an individual with more than \$1 million in net worth (excluding the value of any primary residence) or who has earned more than \$200,000 per year in each of the last two years, (ii) an organization with more than \$5 million in assets, or (iii) a bank, institution or other entity that meets certain legal criteria.

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In December 2015, an [SEC staff report](#) examined the history of the accredited investor definition and considered comments and recommendations on amending it. In June 2019, the SEC issued a [concept release](#) that solicited public comment on ways to simplify, harmonize and improve the exempt offering framework under the Securities Act, and in December 2019, the SEC [proposed rules](#) to amend the definition to promote capital formation and expand investment opportunities while maintaining appropriate investor protections. The adopted amendments largely track the proposed rules, key features of which are highlighted below.

## Amendments to Accredited Investor Definition

### Professional Certifications, Designations or Other Credentials

The amendments add a new category to the definition for individuals to qualify as accredited investors based on possession of certain professional certifications, designations or other credentials that demonstrate a background and understanding in the areas of securities and investing. In particular, holders in good standing of Series 7, 65 or 82 licenses will qualify as accredited investors.

In addition, the amendments provide the SEC with flexibility to evaluate and adjust the professional certifications, designations and credentials that confer accredited investor status on an ongoing basis because specific qualifying credentials are recognized by means of an SEC order. For example, if educational institutions, self-regulatory organizations, industry bodies or members of the public believe a program of study or credential qualifies, they could apply to the SEC for consideration as a qualifying certification or credential.

The SEC also committed to providing public notice and an opportunity for public comment before modifying the list of qualifying criteria. The SEC has clarified that an individual's possession of any qualifying credentials or designation would need to be publicly or otherwise independently verifiable.

### Knowledgeable Employees of Private Funds

The amendments also add a new category to the accredited investor definition for individuals that would enable "knowledgeable employees" of a private fund to qualify as accredited investors for investments in the fund.

Under the amendments, a "knowledgeable employee" has the same definition as in Rule 3c-5(a)(4) of the Investment Company Act. This includes, among other persons: (i) executive officers,<sup>2</sup> directors, trustees, general partners, advisory board members or persons serving in a similar capacity of a Section 3(c)(1) or 3(c)(7) fund, or affiliated persons of the fund who oversee the fund's investments; as well as (ii) employees or affiliated persons of the fund (other than employees performing solely clerical, secretarial or administrative functions) who, in connection with the employees' regular functions or duties, have participated in the investment activities of such private fund for at least 12 months.

### Expansion of Certain Entities

The amendments also recognize the following entities as accredited investors:

- Investment advisers registered under Section 203 of the Investment Advisers Act (Advisers Act), investment advisers registered under the laws of the various states and exempt reporting advisers under Section 203(m) or Section 203(l) of the Advisers Act;
- Limited liability companies (LLCs) that satisfy the other requirements of the accredited investor definition. This amendment codifies the long-standing staff position that LLCs, which have become a widely accepted corporate vehicle since the drafting of the 1989 rules, may qualify as accredited investors, provided they meet all other requirements applicable to entities; and
- Rural business investment companies (RBICs).<sup>3</sup>

In addition, the amendments add a catch-all provision to qualify any entity, including Native American tribes, that was not formed for the specific purpose of acquiring the securities being offered but that owns "investments" as defined in Rule 2a51-1(b) under the Investment Company Act in excess of \$5 million.

<sup>2</sup> For additional information regarding the definition of "executive officer" under the Investment Company Act, see our February 25, 2014, alert, "[SEC Provides Updated Guidance on 'Knowledgeable Employee' Status Under the Investment Company Act of 1940.](#)"

<sup>3</sup> An RBIC is defined in Section 384A of the Consolidated Farm and Rural Development Act as a company that is approved by the secretary of agriculture and that has entered into a participation agreement with the Department of Agriculture.

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## Family Offices and Family Clients

The amendments add a new category to the accredited investor definition for a “family office,” as defined by the “family office rule” set forth in Rule 202(a)(11)(G)-1 of the Advisers Act that meets the following requirements:

- It has at least \$5 million in assets under management;
- It is not formed for the specific purpose of acquiring the securities offered; and
- Its prospective investment is directed by a person who has such knowledge and experience in financial and business matters that such family office is capable of evaluating the merits and risks of the prospective investment.

“Family clients,” whose prospective investment is directed by their family office, will also be accredited investors under the amendments.

## Income and Asset-Based Accredited Investors

In its proposing release, the SEC also requested public comment on whether the income and asset-based tests for accredited investors should be adjusted in light of inflation, geography or any other factor. While many comments were received, the SEC declined to adjust the financial thresholds, noting that while more individuals qualified as accredited investors now than when the thresholds were set in 1982, it did not follow that those individuals were less able to protect themselves, including because access to timely information is more readily available to a greater variety of market participants than when thresholds were adopted. It also noted that there were no widely reported cases of fraud or abuse under the current standards.

Nevertheless, some conforming changes were added to the financial threshold tests. In particular, the amendments add the term “spousal equivalent” to the accredited investor definition when calculating joint income under Rule 501(a)(6) and include spousal

equivalents when determining net worth under Rule 501(a)(5), so that both spouses and spousal equivalents may pool their finances for the purpose of qualifying as accredited investors.

The SEC also amended its rules to clarify how certain forms of equity ownership are treated for purposes of determining accredited investor status. Codifying a long-standing staff interpretive position, the amendments add a note to Rule 501(a)(8) specifying that in determining accredited investor status under Rule 501(a)(8), one may look through various forms of equity ownership to evaluate a natural person’s accreditation.

## Amendments to QIB Definition

Rule 144A provides a nonexclusive safe harbor exemption from the registration requirements of the Securities Act for resales of certain restricted securities to QIBs. In response to investor concerns and to avoid inconsistencies between the entity types that are eligible for accredited investor status and QIB status, the SEC expanded the QIB definition by making conforming changes to Rule 144A, including adding RBICs and LLCs to the list of entities covered by Rule 144A.

Further, to ensure that entities that qualify for accredited investor status may also qualify for QIB status when they meet the Rule 144A(a)(1)(i) threshold requiring \$100 million in owned and invested securities, the amendments add a new paragraph (J) to Rule 144A(a)(1)(i), permitting certain institutional accredited investors to automatically qualify as QIBs when they satisfy the dollar-amount threshold. This new QIB category reflects the “catch-all” category in the amended accredited investor definition for entities owning investments in excess of \$5 million that are not formed for the specific purpose of acquiring securities, as well as any other entities that may be added to the accredited investor definition in the future, provided that any such entities would also have to meet the \$100 million threshold to qualify as QIBs. As a result, Indian tribes, governmental bodies and bank-maintained collective investment trusts may now qualify as QIBs.

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