

# PUBLICATION

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## SEC Expands the "Accredited Investor" Definition to Cover Additional Categories of Individuals and Entities

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The Securities and Exchange Commission (Commission) last week adopted amendments to Rule 501(a) (Rule) of Regulation D under the Securities Act of 1933, as amended (Act), to add additional categories of individuals and entities that will qualify as accredited investors under the Rule. The Commission also adopted corresponding amendments to the definition of "qualified institutional buyer" in Rule 144A under the Act and certain other rules. As noted in the adopting release for the amendments, available [here](#), these changes "are part of a broader effort to simplify, harmonize, and improve the exempt offering framework under the [Act] to promote capital formation and expand investment opportunities while maintaining and enhancing appropriate investor protections." The amendments will expand the pool of eligible investors that may participate in accredited-only private offerings of securities, which is by far the most common form of private offering.

The amendments will be effective 60 days after the adopting release is published in the *Federal Register*.

### Natural Person Accredited Investor Expansion

- **Professional Certifications, Designations, or Credentials.** As proposed, the amendments add a new category of accredited investor for "natural person[s] holding in good standing one or more professional certifications or designations or credentials from an accredited educational institution that the Commission has designated as qualifying an individual for accredited investor status." Pursuant to a Commission order issued on the same date the amendments were adopted, persons who hold Financial Industry Regulatory Authority, Inc. Series 7, 65, or 82 licenses will qualify as accredited investors under this new category. The Commission has the authority to similarly designate additional certifications, designations, and other credentials, including educational degrees, via future orders, which will be posted on the Commission's website. Amended Rule 501(a) includes a list of non-exclusive attributes that the Commission will consider in making such determinations, including: whether the certification, designation, or other credential requires an examination (or series thereof) administered by a self-regulatory organization (SRO), other industry body, or accredited educational institution; the relationship between the exam(s) or certification, etc., and securities and investing sophistication and knowledge and experience in business and financial matters; and whether the fact that a particular person holds such certification, designation, or credential is publicly available or otherwise can be independently verified. The Commission will make such designations only after notice and opportunity for public comment, and the adopting release notes that institutions, SROs, and industry bodies can apply to the Commission for designation and that the public can also propose that the Commission similarly designate particular degrees or programs of study.
- **Spousal Equivalent.** As proposed, the amendments provide that an individual will qualify as accredited if they meet the Rule's joint income or net worth thresholds together with their "spousal equivalent" (currently, the provision refers solely to a person's "spouse"). The amended Rule provides that "spousal equivalent" means "a cohabitant occupying a relationship generally equivalent to that of a spouse." This does not need to be a legally-recognized relationship, such as a domestic partnership or civil union, in order to qualify
- **Knowledgeable Employees of Private Funds.** Under the amendments, a "knowledgeable employee," as defined in Rule 3c5(a)(4) under the Investment Company Act of 1940, of an entity that

would be required to register as an investment company under the Investment Company Act but for the exclusions provided by Section 3(c)(1) or 3(c)(7) thereof, generally known as "private funds," will qualify as an accredited investor with respect to securities offerings of such fund. Under Rule 3c5(a)(4), a "knowledgeable employee" includes an executive officer, director, trustee, general partner, advisory board member, or similar, of the private fund or an affiliated management person, or an employee of the fund or "an affiliated management person" who participates in investment activities as part of his or her regular functions or duties.

While a knowledgeable employee's status as an accredited investor will extend to his or her spouse, that is only the case with respect to joint investments in the private fund, and such status does not extend to a "spousal equivalent."

### **Additional Entities Newly Qualifying as Accredited Investors**

The amendments also expand the categories of entities that will qualify as accredited investors, generally as proposed, as follows:

- **Limited Liability Companies.** Consistent with existing Commission staff guidance, limited liability companies with total assets exceeding \$5 million, not formed for the specific purpose of acquiring the securities offered, will meet the accredited investor definition pursuant to amendments to paragraph (a)(3) of the Rule. Currently, the Rule limits this provision to corporations, business trusts, and partnerships.
- **Registered Investment Advisers.** Entities registered as investment advisers under the Investment Advisers Act of 1940 (Advisers Act) or state law will qualify as accredited investors under amended Rule 501. Exempt reporting advisers, which are advisers to private funds with less than \$150 million in assets under management that file Form ADV with the SEC but are not actually required to register under the Advisers Act, will also qualify. Note that employees of registered investment advisers and exempt reporting advisers will not qualify as accredited investors based solely on such employment.
- **Rural Business Investment Companies.** Rural Business Investment Companies (RBICs), as defined in the Consolidated Farm and Rural Development Act, are companies approved by the Secretary of Agriculture and, similar to small business investment companies which currently qualify as accredited investors, "are intended to promote economic development and the creation of wealth and job opportunities in rural areas and among individuals living in such areas."
- **Other Entities with Over \$5 Million in Investments.** The amendments add a new category of entities that qualify as accredited investors if they do not fall within the other institutional categories and own "investments," as defined in Rule 2a51-1(b) of the Investment Company Act, of over \$5 million and were not formed specifically to acquire the offered securities. "Investments" include, "among other things: securities; real estate, commodity interests, physical commodities, and non-security financial contracts held for investment purposes; and cash and cash equivalents." This catch-all category should cover, among others, "Indian tribes and the divisions and instrumentalities thereof, federal, state, territorial, and local government bodies, ... and entities organized or under the laws of foreign countries," as well as entity types that might be created in the future.
- **Family Offices and Family Clients.** Family offices are set up to manage the investments for specific, usually wealthy, families. Under the amended Rule, a family office, as defined in Rule 202(a) under the Advisers Act, with over \$5 million of assets under management, not formed for the purpose of buying the specific securities being offered, and whose investments are directed by a person knowledgeable and experienced in financial and business matters who is capable of evaluating the risks and merits of the proposed investment, will be an accredited investor. The "family clients," as defined in Rule 202(a), of such a family office will also qualify, assuming their investment in the issuer in question is directed by such family office.

## Other Revisions

The Commission also adopted amendments to the definition of "qualified institutional buyer" (QIB) in Rule 144A under the Act, which exempts from registration under the Act resales of securities to QIBs. Consistent with the amendments to Rule 501(a), the amendments add RBICs, limited liability companies, and other entities that would qualify as institutional "accredited investors," as defined in amended Rule 501(a), to the list of entities that will qualify as QIBs, as long as they own and invest at least \$100 million in securities in accordance with the requirements of the Rule. Unlike in Rule 501(a), however, such entities can qualify as QIBs even if formed specifically to purchase the offered securities.

In addition, the amendments add notes to Rule 501(a) clarifying that (i) a couple's "joint" net worth means their aggregate net worth, that the assets considered in calculating a couple's net worth need not be held jointly, and that the securities being purchased need not be purchased jointly, and (ii) when determining whether all equity owners of an entity are accredited for purposes of determining whether the entity itself is accredited, one may look through multiple layers and forms of equity ownership to natural persons.

The amendments also replace the definition of "accredited investor" in Rule 215 under the Act with a cross-reference to Rule 501(a), ensuring the definition under the two rules will always be consistent.

Finally, the amendments make conforming changes to Rule 163B under the Act, which permits test-the-waters communications to QIBs and institutional accredited investors to gauge their interest in a contemplated offering, and Rule 15g-1 under the Securities Exchange Act of 1934, which exempts transactions in which a client is an institutional (entity) accredited investor from requirements that broker-dealers provide certain information to their customers in "penny stock" transactions.

Despite some comments asking it to do so, the Commission declined to amend Rule 501(a) to provide that the net worth and income tests for natural persons be adjusted for inflation, adopt geographic-specific financial thresholds to account for the lower cost of living in some parts of the country, or eliminate the "accredited investor" definition altogether.

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