

SEC Updates Definitions of Accredited Investor and Qualified Institutional Buyer

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Securities and Capital Markets

On August 26, 2020, the Securities and Exchange Commission (the "SEC") amended the definitions of "accredited investor" in Rule 501(a) of Regulation D¹ and "qualified institutional buyer" ("QIB") in Rule 144A², each under the Securities Act of 1933 (the "Securities Act"). These amendments are part of the SEC's broader effort to simplify, harmonize, and improve the exempt offering framework under the Securities Act, with the goal of promoting capital formation and expanding investment opportunities, balanced against the need to maintain appropriate investor protections. The main effect of the amendments to Rule 501(a) is to increase the number of eligible participants in the private placement market by adding additional categories of natural persons and entities that qualify as accredited investors. Similarly, the amendments to Rule 144A expand the entities that may qualify as a QIB. The amendments were proposed in December 2019 and were adopted largely as proposed.

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Accredited Investor Definition — Natural Persons

Rule 501(a) has two categories of natural persons who qualify as accredited investors – those with annual income of \$200,000 (or \$300,000 jointly with a spouse), and those with a net worth of \$1,000,000 (individually or jointly with a spouse.)³ The amendments add new categories of natural persons who qualify as an accredited investor, as described below.

- **Professional Certifications and Designations.** Under new Rule 501(a)(10), the SEC may from time to time designate a holder of certain professional certifications or designations or other credentials as an accredited investor. Along with the final rule, the SEC published an order designating holders in good standing of the General Securities Representative license (Series 7), Investment Adviser Representative license (Series 65) and Private Securities Offerings Representative license (Series 82) as qualifying natural persons, following the effective date of the amendments.⁴ Rule 501(a)(10) sets forth a non-exclusive list of criteria that the SEC will consider when determining whether

¹ See 17 CFR § 230.501(a).

² See 17 CFR § 230.144A.

³ Rule 501(a)(5) and (6).

⁴ See [Order Designating Certain Professional Licenses as Qualifying Natural Persons for Accredited Investor Status Pursuant to Rule 501\(a\)\(10\) under the Securities Act of 1933](#), Release No. 33-10823 (Aug. 26, 2020).

to designate a professional certification, designation or credential that will qualify an individual as an accredited investor. The SEC believes that holding certain credentials provides a reliable indication that an investor has the financial sophistication to participate in investment opportunities without the additional protections provided by the Securities Act.

- **Knowledgeable Employees.** Under new Rule 501(a)(11), a natural person who is a “knowledgeable employee” of a private fund will qualify as an accredited investor for investments in his or her employer’s fund. For this purpose, a “private fund” is an issuer of securities that is excluded from the definition of an investment company by either Section 3(c)(1) (generally, a fund with fewer than 100 owners) or Section 3(c)(7) (a fund owned exclusively by certain qualified purchasers) of the Investment Company Act of 1940 (the “Investment Company Act”). A “knowledgeable employee” is defined in Rule 3c-5(a)(4) under the Investment Company Act generally as an individual who participates in the management or investment activities of the private fund. This includes employees of the private fund, other than employees performing solely clerical, secretarial, or administrative functions, who, in connection with the employees’ regular duties, have participated in the investment activities of such private fund for at least 12 months. The SEC reasoned that such an employee should be expected to be financially sophisticated and capable of fending for himself or herself in evaluating investments.
- **Spousal Equivalents.** Under the amendments, a natural person may include joint income from or the net worth of a “spousal equivalent” in the financial threshold calculations in Rules 501(a)(5) and (6). A spousal equivalent is a person cohabitating with the individual and occupying a relationship generally equivalent to that of a spouse.⁵

Commentary: Financial Thresholds for Accredited Investors

- Income/Net Worth Thresholds. The adopting release expressly declined to increase the income and net worth thresholds for an individual to qualify as an accredited investor.
 - Commissioners Lee and Crenshaw released a statement noting that these financial thresholds have not changed since 1982, and they criticized the decision not to adjust those thresholds to account for inflation.
 - The remaining Commissioners reasoned that other factors over the same period, such as changes in availability of information and advances in technology, have led to more readily accessible information being available to investors. It was also contended that reducing the pool of accredited investors, including those currently participating in the private placement market, would be unnecessarily disruptive.

⁵ Under the amendments, “spousal equivalent” is conformed to the definition of that term used in Rule 202(a) under the Investment Advisers Act of 1940 and Rule 201(r) of Regulation Crowdfunding.

Accredited Investor Definition — Entities

Currently, Rule 501(a) enumerates several categories of entities that qualify as accredited investors, including entities that are owned by accredited investors, certain financial institutions and corporations, partnerships, trusts or similar entities with assets in excess of \$5 million. To this mix, the amendments add the following new categories of entities that qualify as accredited investors.

- **Registered Investment Advisers.** An SEC- or state-registered investment adviser (including a sole proprietorship) will be an accredited investor.⁶ The SEC reasoned that such an entity has the requisite financial sophistication needed to conduct meaningful investment analysis.
- **Rural Business Investment Companies.** Currently, Rule 501(a)(1) provides that a small business investment company (“SBIC”) is an accredited investor. Under the amendments, a rural business investment company (“RBIC”) under the Consolidated Farm and Rural Development Act will be added to Rule 501(a)(1). RBICs are similar to SBICs and share the common purpose of promoting capital formation in their respective sectors.⁷
- **Limited Liability Companies.** A limited liability company with assets in excess of \$5 million and not formed for the specific purpose of acquiring the securities being offered will be added to the definition of accredited investor.⁸ The amendments codify existing staff guidance.⁹
- **Other Entities.** Under the amendments, any other entity that has assets in excess of \$5 million and is not formed for the specific purpose of acquiring the securities being offered will be an accredited investor.¹⁰ The SEC wanted to capture all entity types not already included in Rule 501(a) as well as entity types that may be created in the future. The SEC noted that this new category will pick up entities such as Indian tribes, labor unions, governmental bodies and funds and entities organized under the laws of a foreign country.
- **Family Offices and Family Clients.** Under the amendments, a “family office” and its “family clients” as defined in Rule 202(a) under the Advisers Act will be accredited investors.¹¹ New Rule 501(a)(12) provides that a family office will be an accredited investor, provided that (1) the family office has at least \$5 million in assets under management and is not formed for the specific purpose of acquiring the securities being offered and (2) the prospective investment is directed by a person with adequate financial and business knowledge and experience that such person is capable of evaluating the merits and risks of the prospective investment. Any family client of a

⁶ See amended Rule 501(a)(1).

⁷ The SEC notes that both entities are treated in similarly in Sections 203(b)(7) and (8) of the Investment Advisers Act of 1940.

⁸ See amended Rule 501(a)(3).

⁹ Compliance and Disclosure Interpretations, Regulation S-K, Question No. 255.05 (Jan. 26, 2009), which can be obtained at <https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm>.

¹⁰ See amended Rule 501(a)(9).

¹¹ See amended Rules 501(a)(12) and (13).

family office which itself is an accredited investor will be an accredited investor under new Rule 501(a)(13) with respect to a prospective investment.

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Qualified Institutional Buyer Definition

Rule 144A provides a non-exclusive safe harbor exemption from the registration requirements of the Securities Act for resales of certain restricted securities to QIBs. Certain types of entities are eligible for QIB status if they own or invest on a discretionary basis at least \$100 million in securities of unaffiliated issuers. The amendments expand the list of entities eligible for QIB status to include limited liability companies and any entity that is a RBIC.¹² The amendments also add a “catch-all” category allowing any other type of entity to qualify as a QIB, so long as it meets the \$100 million threshold for securities owned and invested.

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Other

In connection with the amendments described above, the SEC also made changes that conformed other regulations to the changes made to the accredited investor definition, including changes to Rules 215 and 163B under the Securities Act, and to Rule 15g-1 under the Securities Exchange Act of 1934.

The amendments will be effective 60 days after the date of publication in the Federal Register.

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¹² Currently, the definition of a QIB in Rule 144A(a)(1)(i)(C) includes any SBIC.