

SEC Amends “Accredited Investor” Definition

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On August 26, 2020, the Securities and Exchange Commission (“SEC”) amended the definition of “accredited investor,” one of the principal tests for determining eligibility for participation in private placements of securities. The amendments are designed to identify more effectively the institutional and individual investors that have the knowledge and expertise to participate in private placements, not only based on measures of income or net worth, but also based on defined measures of professional knowledge, experience or certification. Additionally, the SEC updated and expanded the list of entities that qualify as accredited. The amendments revise Rule 501(a), Rule 215, and Rule 144A of the Securities Act, and will be effective 60 days after publication in the Federal Register.

New categories of accredited investors set forth in the rule are as follows:

- Natural persons with certain professional or academic certifications, designations or credentials, which the SEC may designate from time to time by order, based on criteria set forth in the rule. The initial order accompanying the rule will designate individuals that are holders in good standing of the Series 7, Series 65, and Series 82 licenses.
- Natural persons who are “knowledgeable employees” with respect to a private fund as defined in Rule 3c-5(a)(4) of the Investment Company Act. Note that any knowledgeable employee with respect to a given private fund is also a knowledgeable employee with respect to, and thus an accredited investor for purposes of investment in, any other private fund advised by an “affiliated management person” of the given private fund as defined in Rule 3c-5(a)(1) of the Investment Company Act.
- Registered investment advisers, including both SEC- and state-registered advisers, as well as exempt reporting advisers relying on the venture capital fund adviser and private fund adviser exemptions from registration under Sections 203(l) and (m) of the Investment Advisers Act. Note that an entity relying on a venture capital fund adviser or private fund adviser exemption only at the state level, but not the federal level (for instance due to having regulatory assets under management of less than \$25 million), would not qualify as accredited under this new category.
- Rural Business Investment Companies (RBICs), which are entities intended to promote economic development and opportunities in rural areas are included as accredited investors.
- Limited liability companies with total assets in excess of \$5 million that are not formed for purposes of making the applicable investment, clarifying a long-standing SEC position under Rule 501(a)(3) of the Securities Act. The SEC opted not to make managers of these companies accredited, but noted that in many cases managers of a limited liability company are likely “executive officers” of the company and thus would be accredited for purposes of investment in the company.
- A catch-all category for all entities not otherwise captured by the definition, as long as the entity owns at least \$5 million in “investments,” as defined for purposes of the “qualified purchaser” standard in Rule 2a51-1(b) under the Investment Company Act, and is not formed for the specific purpose of investing in the securities offered. Although the SEC gave examples of entities that could be covered by this new category, including Indian tribes, governmental bodies, funds, and entities organized under the laws of foreign countries, the SEC did not enumerate them in the Rule, instead noting its intent that the category capture all entity types not already included in the definition of accredited investor, as well as those types of entities that may be created in the future.
- All “family offices” as defined by SEC Rule 202(a)(11)(G)-1 under the Investment Advisers Act (the “Family Office Rule”), provided that (i) the family office has at least \$5 million in assets under management and is not formed for the specific purpose of acquiring the securities offered, and (ii) the family office’s prospective investment is directed by a person who has sufficient knowledge and experience in financial and business matters that he or she is able to weigh the risks and merits of the prospective investment. In

addition, “family clients” (as defined by the Family Office Rule) of a qualifying family office are accredited if the qualifying family office is directing the investment.

For purposes of applying the definition of “accredited investors”:

- The SEC defined “spousal equivalent” as “a cohabitant occupying a relationship generally equivalent to that of a spouse” in order to expand the relationships that enable natural persons to calculate jointly income or net worth in order to qualify as accredited investors. The SEC further clarified that investors relying on joint net worth with a spouse or spousal equivalent need not make the applicable investment jointly.
- The SEC clarified that under Rule 501(a)(8) (an entity in which all beneficial owners are accredited may itself be considered accredited), multiple levels of look through to the ultimate natural person equity owners are permitted if an entity relying Rule 501(a)(8) is not accredited in its own right.

In order to ensure consistency, Rule 215 was amended replace the existing definitions of “accredited investor” with a cross reference to the definition in Rule 501(a), as revised.

To ensure consistency with the amendments to Rule 501(a)(1) and Rule 501(a)(3), the amendments expand the definition of “qualified institutional buyer” in Rule 144A to include all entities that meet the threshold of have \$100 million in securities owned and invested. Despite some comments seeking expanded QIB treatment for SEC registered advisers having at least \$100 million in assets under management, and for private funds having gross assets of at least \$100 million, the SEC declined to expand the definition to include these categories. The SEC also clarified that an entity seeking qualified institutional buyer status under Rule 144A(a)(1)(i)(J) may be formed for the purpose of acquiring the 144A securities being offered.

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