

Client Alert

September 2020

SEC Amendments to the Accredited Investor and QIB Definitions

On August 26, 2020, the Securities and Exchange Commission (SEC) adopted [final rules](#) to amend the definition of “accredited investor” within the meaning of Rule 501(a) of Regulation D and “qualified institutional buyer” (QIB) within the meaning of Rule 144A. The amended rules primarily impact issuers contemplating private placements of securities, expanding the base of investors eligible to participate in an offering exempt from registration under the Securities Act of 1933 (Securities Act).

Executive Summary

- Expands the definition of accredited investors to include natural persons with particular certifications or designations that do not meet the income or net worth requirements for accredited investor status. Under certain circumstances, employees, officers and others of private funds may also become accredited investors.
- Expands the entities qualified as accredited investors to include investment advisers, limited liability companies, rural business investment companies (RBICs), “family offices” and “family clients” (as defined in Rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940 (Advisers Act)).
- Conforms the definition of accredited investor for consistency across offerings exempt from registration requirements.
- Expands QIB definition to include RBICs and limited liability companies that own and invest at least \$100 million on a discretionary basis.

Amendments to Accredited Investor Definition

Natural Persons as Accredited Investors

Under the current accredited investor definition, a natural person can only qualify as an accredited investor by meeting a wealth threshold. Under the wealth test, a natural person must demonstrate: (i) a net worth (or joint net worth with a spouse or spousal equivalent) exceeding \$1 million, (ii) individual income in excess of \$200,000 in each of the most recent two years or (iii) a joint income with a spouse or spousal equivalent in excess of \$300,000 in each of the most recent two years.¹ A “spousal equivalent” is a cohabitant occupying a relationship generally equivalent to that of a spouse. The SEC noted this is the same definition of spousal equivalent previously adopted to implement the Jumpstart Our Business Startups Act (JOBS ACT).

Amended Rule 501(a) of Regulation D expands the definition of “accredited investor” to include natural persons with eligible professional certifications or designations. The SEC adopted a non-exclusive list of factors it will use in determining whether a professional certification or designation qualifies:

¹ The SEC declined commenters’ suggestions to amend the financial thresholds for the wealth test to account for inflation, despite noting that the net worth and income requirements have vastly different implications today than in 1982.

- the certification, designation or credential arises out of an examination or series of examinations administered by self-regulatory organization or other industry body or is issued by an accredited educational institution;
- the examination or series of examinations is designed to reliably and validly demonstrate an individual's comprehension and sophistication in the areas of securities and investing;
- persons obtaining such certification, designation, or credential can reasonably be expected to have sufficient knowledge and experience in financial and business matters to evaluate the merits and risks of a prospective investment;
- the certification or designation is publicly available or independently verifiable; and
- the individual is in good standing.

The professional certifications and designations and other credentials that are recognized by the SEC will be posted on the SEC's website. So far, the SEC has recognized the following licenses by the Financial Industry Regulatory Authority, Inc. (FINRA) as certifications, designations or credentials acceptable under Rule 501(a)(10):

- Licensed General Securities Representative (Series 7)
- Licensed Private Securities Offerings Representative (Series 82)
- Licensed Investment Adviser Representative (Series 65)

The SEC notes that it believes that each of the above listed accreditations is easily independently verifiable.

Under the amended accredited investor definition, officers, directors, employees and other individuals associated with private funds (such as hedge funds, venture capital funds and private equity funds) may also be considered accredited investors if they are "knowledgeable employees." A "knowledgeable employee," as defined in Rule 3c-5(a)(4), with respect to a private fund is:

- an executive officer, director, trustee, general partner, advisory board member, or other person serving in a similar capacity of a private fund or an affiliated management person of a private fund; or
- an employee of the private fund or an affiliated management person of a private fund (other than an employee performing solely clerical, secretarial, or administrative functions with regard to such company or its investments) who, in connection with his or her regular functions or duties, participates in the investment activities of such private fund, and who has been performing such functions and duties for at least 12 months.

Entities as Accredited Investors

Limited Liability Companies

Currently, under Rule 501(a)(3), corporations, Massachusetts or similar business trusts and partnerships qualify as accredited investors if they have assets exceeding \$5 million and are not formed for the specific purpose of acquiring the securities being offered. Under the amended accredited investor definition, limited liability companies that also pass the assets and purpose tests will also qualify as accredited investors.

The SEC declined to create a special exemption for managers of limited liability companies. The SEC reasoned that managers of limited liability companies are similar to executive officers of a corporation in that they perform similar policy-making functions and thus are already considered accredited investors.

Indirect Equity Ownership

A note added to Rule 501(a)(8) of the Securities Act, clarifies that the joint net worth of equity owners can be combined to qualify an entity as an accredited investor. If all of the equity owners of an entity are accredited investors, regardless of whether the ownership is direct or indirect, then the entity itself qualifies as an accredited investor. The SEC noted “one may look through various forms of equity ownership to natural persons.”

Registered Investment Advisers

Amended Rule 501(a)(1) includes investment advisers registered under Section 203 of the Advisers Act and investment advisers registered under the laws of various states that meet the \$5 million assets test under Rule 501(a)(3). Exempt reporting advisers to private funds are also added under the amended accredited investor definition.

Rural Business Investment Companies

RBICs will be accredited investors under amended Rule 501(a)(1). RBICs promote economic development and the creation of wealth and job opportunities in rural areas and among individuals living in such areas. The purpose of RBICs is similar to the purpose of small business investment companies, which are already accredited investors. Small business investment companies increase access to capital for growth stage companies.

Certain Family Offices and Family Clients

Family offices are established by families to manage assets, plan for their families’ financial future and provide other services to family members. Under amended Rule 501(a), family offices can be accredited investors. Provided a family office is not formed for the specific purpose of acquiring the securities offered, a family office will qualify as an accredited investor with \$5 million in assets under management and investments directed by a person with knowledge and experience in financial and business matters. Spousal equivalents are included in the definition of “family members.” Family clients meeting the same criteria are also accredited investors under amended Rule 501(a)(1) accredited investor definition.

Conformed Definition of Accredited Investor

Currently, the criteria for accredited investor status pursuant to Section 4(a)(5) of the Securities Act is slightly different than the criteria for accredited investor status pursuant to Regulation D of the Securities Act. Accredited investors under Section 4(a)(5) offerings do not include banks, insurance companies, registered investment companies, business development companies or Small Business Investment Companies (SBICs).² Under the new amendments to Rule 215, Regulation D exempt offerings and offerings completed pursuant to Section 4(a)(5) will include the same requirements for accredited investor status.³

Amendments to Qualified Institutional Buyer Definition

Under current Rule 144A(1)(i), RBICs and limited liability companies are not eligible for QIB status. Amended Rule 144(a)(1)(i) expands the entities eligible for QIB status to include RBICs and limited liability companies. All entities must meet the \$100 million in securities owned and invested eligibility threshold to be QIBs. Additionally, companies qualifying as institutional accredited investors (that are not

² Offerings completed pursuant to Regulation D are far more common and require the issuer reasonably believe all of the investors are accredited investors.

³ To qualify for an exemption under 4(a)(5) exemption, the issuer must neither engage in public solicitation nor offer securities in excess of \$5 million in aggregate principal amount.

already included in Rule 144A) are eligible for QIB status if they satisfy the \$100 million owned and invested threshold.

Next Steps and Conclusion

The amendments will become effective 60 days after publication in the Federal Register.⁴ The amended accredited investor definition provides more certainty for issuers with respect to natural persons who qualify as accredited investors. Issuers relying on Rule 506(c) should consider the diligence processes in place to ascertain an investor's status as accredited. Additionally, issuers and their advisors should begin revising their offering documents for private placements to include the new categories of natural persons and entities as accredited investors.

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⁴ NTD: update if published in the federal register.