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## SEC adopts rule amendments to expand definitions of accredited investor and qualified institutional buyer to increase private capital markets participation

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On August 26, 2020, the Securities and Exchange Commission (“SEC” or the “Commission”) adopted amendments to the definition of “accredited investor” in the Commission’s rules and the definition of “qualified institutional buyer” in Rule 144A under the Securities Act of 1933 (the “Securities Act”) to increase access to investments in the private capital markets. The adopted final rules to the accredited investor definition add new categories of natural persons and entities to the definition, including a “catch-all” category for any entity owning in excess of \$5 million in investments. Corresponding changes are also made to the qualified institutional buyer definition for institutions that qualify for accredited investor status when they meet the existing \$100 million in securities owned and invested threshold under Rule 144A under the Securities Act. The final amendments were adopted substantially as proposed in December last year, except for the minor modifications specified below.

The accredited investor definition identifies sophisticated institutional and individual investors and is a central component of several exemptions from the registration requirements under the federal securities laws, including Rules 506(b) and 506(c) of Regulation D, which allow such sophisticated investors to participate in private capital markets. The definition also plays an important role in other federal and state securities law contexts. For example, some states use the accredited investor definition to determine whether investment advisers to certain private funds are required to be registered. FINRA rules also use the accredited investor definition to provide certain requirements and exemptions.

The final amendments are based on the premise that wealth — in the form of a certain level of income, net worth, or assets — should not be the sole means of establishing financial sophistication for purposes of the accredited investor definition. The final amendments add two new categories in the accredited investor definition for natural persons:

- A category that allows natural persons to qualify as accredited investors who hold a Series 7, 65, or 82 license in good standing, or hold other certifications, designations, and credentials in good standing to be later designated by Commission order (the Commission

will provide notice and an opportunity for public comment before issuing any final order);  
and

- A category that enables “knowledgeable employees,” as defined in Rule 3c-5(a)(4) under the Investment Company Act, of a private fund to qualify as accredited investors for investments in the fund.

The amendments permit natural persons to include joint income and joint net worth from spousal equivalents when determining income and net worth for purposes of qualifying as accredited investors. A “spousal equivalent” means a cohabitant occupying a relationship generally equivalent to that of a spouse (such as domestic partnerships, civil unions, and same-sex marriages), and assets do not have to be held jointly to be included in the calculation.

As proposed, the existing income and net worth tests for individual accredited investor status, which were established in 1982, are not updated or indexed for inflation in the final amendments. This is likely to substantially increase the percentage of U.S. households that will qualify as accredited investors in the future.

With respect to institutional investors, the final amendments add the following entity types to the current list of entities that may qualify as accredited investors:

- All investment advisers registered under Section 203 of the Investment Advisers Act of 1940 (the “Advisers Act”) or the laws of the various states, as well as exempt reporting advisers under Sections 203(m) or (l) of the Advisers Act;
- Rural business investment companies (“RBICs”), as defined in Section 384A of the Consolidated Farm and Rural Development Act;
- Limited liability companies that have total assets in excess of \$5 million and were not formed for the specific purpose of acquiring the securities offered;
- Any entity, including Native American tribes, labor unions, government bodies and funds, and entities organized under the laws of a foreign country, owning “investments,” as defined in Rule 2a51-1(b) under the Investment Company Act, in excess of \$5 million and that was not formed for the specific purpose of investing in the securities offered; and
- “Family offices” with at least \$5 million in assets under management and their “family clients,” as each term is defined under the Advisers Act, if such family office 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.

The adopted amendments to the qualified institutional buyer definition correspond to those to the accredited investor definition, except that qualified institutional buyers under Rule 144A continue to include entities formed solely for the purpose of acquiring restricted securities under Rule 144A as long as they satisfy the test for qualified institutional buyer status. Specifically, the amendments add RBICs and limited liability companies to the entity types that are eligible for qualified institutional buyer status if they meet the \$100 million in securities owned and invested threshold of Rule 144(a)(1)(i) under the Securities Act. Further, the amendments add a “catch-all” category to allow an institutional investor that is of an entity type not already included in the qualified institutional buyer definition but would qualify as an accredited investor, to qualify as a qualified institutional buyer when such institutional investor satisfies the \$100 million threshold.

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

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