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SEC Modernizes and Expands Accredited Investor and Qualified Institutional Buyer Definitions

On August 26, 2020, the U.S. Securities and Exchange Commission (SEC) adopted amendments to the definitions of "accredited investor" in Rule 501 of Regulation D and "qualified institutional buyer" (QIB) in Rule 144A. Below, we summarize the key takeaways from these changes.

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Key Changes

The SEC adopted amendments to the definitions of "accredited investor" in Rule 501 of Regulation D and "qualified institutional buyer" in Rule 144A, each promulgated under the Securities Act of 1933 (Securities Act). The amendments expand the scope of these definitions and will increase the number of persons and entities eligible to participate in private investments pursuant to each definition.

Amendments to the Definition of "Accredited Investor"

The amendments to the definition of "accredited investor" in Rule 501(a) are intended to create new categories of individuals and entities that qualify as accredited investors irrespective of their wealth, on the basis of their ability to appropriately assess an investment opportunity, and may be summarized as follows:

New categories of natural persons who may qualify as accredited investors include:

individuals holding certain professional certifications, designations or credentials (including certain credentials issued by accredited educational institutions), which the SEC may designate from time to time by order; and

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individuals who are “knowledgeable employees” of a private fund (as defined in Rule 3c-5(a)(4) under the Investment Company Act), solely with respect to investments in that particular private fund.

The SEC simultaneously exercised its discretion under the first of these new criteria by designating persons holding a FINRA-administered Series 7, Series 65, or Series 82 license in good standing to be “accredited investors.”

New categories were added, and clarifications to the existing definition were made with respect to the treatment of entities as follows:

the SEC codified its longstanding interpretive position that limited liability companies with $5 million in assets may be accredited investors provided they meet other requirements of Rule 501(a)(3).

SEC and state-registered investment advisers (including sole proprietorships), exempt reporting advisers (within the meaning of Section 203 of the Investment Advisers Act), and rural business investment companies (RBICs) are added to the list of entities that may qualify as accredited investors.

Rule 501(a)(9) adds a new category under which any entity may qualify as an “accredited investor,” including, without limitation, Indian tribes, governmental bodies, funds, and entities organized under the laws of foreign countries, if such entity (a) owns “investments” (as defined in Rule 2a51-1(b) under the Investment Company Act) in excess of $5 million, and (b) was not formed for the specific purpose of investing in the securities being offered.

“Family offices” (as defined in Rule 202 promulgated under the Investment Advisers Act) that (a) have at least $5 million in assets under management, (b) were not formed for the specific purpose of acquiring the securities offered, and (c) have their prospective investments 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, were added to the category of “accredited investors.” Furthermore, such qualifying family office’s “family clients” (as defined in Rule 202 promulgated under the Investment Advisers Act) were added to the category of “accredited investors,” as well, provided the investment is directed by the family office.

A note was added to Rule 501(a)(8) to clarify that one may look through various forms of ownership to determine whether all natural persons who are the ultimate owners of an entity qualify as “accredited investors” for purposes of that exemption.

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The term "spousal equivalent" was added to the accredited investor definition, so that spousal equivalents may pool their financial resources for purposes of satisfying the net worth or joint income tests to qualify as "accredited investors." The SEC also added a note to Rule 501(a)(5), clarifying that an investor may aggregate net worth with his or her spouse (or spousal equivalent) to satisfy that test, and that securities being purchased by an investor relying on the joint net worth test need not be purchased jointly.

Amendments to the Definition of "Qualified Institutional Buyer"

The definition of "Qualified Institutional Buyer" (QIB) in Rule 144A(a)(1) promulgated under the Securities Act is expanded to include limited liability companies and RBICs if they meet the "$100 million in securities owned and invested" threshold provided. In keeping with the addition of new Rule 501(a)(9) to Regulation D, the SEC also added new subparagraph (J) to Rule 144(a)(1)(i) to allow any institutional "accredited investor" within the meaning of Rule 501(a) that also satisfies the aforementioned $100 million investments threshold, but was not already covered by existing provisions of Rule 144A(a)(1), to qualify as a QIB. An explanatory note also clarifies that the "not formed for the specific purpose of acquiring the securities offered" requirement that applies to several categories of institutional accredited investors for purposes of Regulation D offerings under Rule 501(a) does not apply to institutional investors qualifying as QIBs under new Rule 144A(a)(1)(i)(J).

Conforming Changes

Rule 215 and Rule 163B promulgated under the Securities Act and Rule 15g-1 promulgated under the Securities Exchange Act of 1934 received conforming amendments, as necessary.

What This Means to You

Going forward, Rule 501(a) of Regulation D will permit natural persons to qualify as "accredited investors" based on certain professional certifications, designations, or credentials (which the SEC will designate by order), rather than relying on a strictly wealth and income-based standard. This will provide the SEC with flexibility over time to reevaluate any designations it makes, and also to add certifications, designations, or credentials to the list in the future (subject to future public review and comment, which the SEC also clarified in the adopting release). It will be important for issuers planning to include one or more of these new categories of accredited investors in future Regulation D private offerings to work with their counsel to ensure their investor qualification due diligence procedures have been modified appropriately to cover the new categories. Additionally, fund managers should work carefully with their counsel to ensure their employees fall within the scope of "knowledgeable employees"—a specifically defined term—before offering and selling their fund securities to such persons.

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For entities, broadening the definitions of "accredited investor" in Rule 501(a) of Regulation D and "qualified institutional buyer" in Rule 144A will permit more entities to qualify as accredited investors. Although monetary thresholds triggering such qualifications remain unchanged, the broader range of entities covered by new Rule 501(a), inclusion of "family offices" as accredited investors, and the breadth of additional entities that may qualify as QIBs under new Rule 144A may increase the kinds of offerings available to these investors and allow companies raising capital under Regulation D to have access to new and different pools of investors. The most significant of these entity specific changes will likely be the increased breadth of the QIB definition in Rule 144A, as newly qualifying entities will now have access to the expansive market of Rule 144A securities. The SEC specifically noted that the inclusion of Indian tribes and governmental bodies as QIBs will provide these entities with expanded access to commercial paper issuances, which commenters on its original proposal identified as a problem that needed to be addressed due to increased utilization of the 144A market for these offerings in recent years.

Finally, the amendments and related order will become effective 60 days after publication in the Federal Register. So, companies and funds currently raising capital, or planning to in the near future, should work diligently with their securities counsel to revise their offering plans and the scope of their investor outreach accordingly.

Contact Us

Husch Blackwell's Securities & Corporate Governance team will continue to monitor these changes and their implications for our clients. Should you have any questions, please do not hesitate to contact Steve Barrett, Kirstin Salzman, Brandon Warrington, Casey Kidwell or your Husch Blackwell attorney.

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