

MEMO# 32743

September 4, 2020

SEC Adopts Expanded Accredited Investor and Qualified Institutional Buyer Definitions

[32743]

September 4, 2020 TO: ICI Members

SEC Rules Committee SUBJECTS: Closed-End Funds

Compliance

Distribution RE: SEC Adopts Expanded Accredited Investor and Qualified Institutional Buyer Definitions

The Securities and Exchange Commission recently updated the definitions of accredited investor and qualified institutional buyer (QIB).[\[1\]](#) Generally, attaining accredited investor or QIB status allows individuals and entities to access certain private market offerings. The amended rules will expand the pool of persons and entities that would meet both definitions. Notably, the Commission:

- Maintained the current income and net worth test thresholds for individuals to qualify as accredited investors, without adjustment for inflation;
- Allowed individuals with credentials that provide a reliable indication that an investor has a sufficient level of financial sophistication to be accredited investors, regardless of income or net worth;
- Added limited liability companies (LLCs), registered investment advisers, family offices, rural business investment companies (RBICs), and entities that own investments in excess of \$5 million to the list of entities that qualify as accredited investors; and
- Added LLCs, RBICs, and any institutional accredited investors that own \$100 million or more in securities to the list of entities that qualify as QIBs.

Amendments to the Accredited Investor Definition for Individuals

The Commission generally expanded the pathways for individual investors to qualify as accredited investors by adding new qualifications while keeping the current financial and income tests at their current levels.

Professional Certifications and Designations

Largely as proposed, the Commission expanded the pool of individuals eligible for accredited investor status to include those who qualify based on

“certain professional certifications and designations or other credentials [that] provide a reliable indication that an investor has a sufficient level of financial sophistication to participate in investment opportunities that do not have the additional protections provided by registration under the Securities Act.”^[2]

Specifically, the Commission adopted a final rule enumerating a non-exclusive list of attributes for the Commission to use in designating professional certifications and other credentials to qualify individuals for accredited investor status.^[3] In a separate order, the Commission identified FINRA Series 7, Series 82, and Series 65 as the initial certifications permitted under the new rule.^[4] The Commission noted that it believed that individuals who passed those examinations and hold their certifications in good standing have demonstrated a sufficient level of financial sophistication to participate in investment opportunities that do not have the additional protections provided by registration under the Securities Act. Further, these certifications and designations have the advantage of being relatively easy for issuers to verify.^[5]

The Commission noted that the new rule will provide the Commission with the flexibility to designate other certifications or credentials that it determines are appropriate. It requested that if an organization believed that it has a program of study or credential that fulfills the attributes enumerated in the new rule, it may apply to the Commission for consideration.

Knowledgeable Employees of Private Funds

In a further expansion of the accredited investor definition, the Commission extended eligibility to knowledgeable employees of private funds.^[6] The Commission reasoned that these employees, through their participation in the investment activities of private funds, are likely to be financially sophisticated. Further, allowing these employees to invest in the funds for which they work may help align employee interests with those of other fund investors.

The Commission noted permitting knowledgeable employees as accredited investors will allow these employees to invest in private funds with assets of \$5 million or less without the fund losing accredited investor status. Under Securities Act Rule 501(a)(8), such private funds may qualify as accredited investors if all the fund’s equity owners are accredited investors.

Adjustments to Current Wealth and Income Qualifications

Before the adoption of the above amendments, the Securities Act permitted only individuals who met income or net worth tests to qualify as accredited investors.^[7] The Commission has not updated these qualifications for inflation in decades,^[8] and declined to do so in this rulemaking.^[9] The Commission reasoned that the qualifications should be considered in the context of the availability of information and technology and that making adjustments may reduce the pool of accredited investors.

The Commission, however, provided two other changes to the financial qualifications for accredited investor status. First, the Commission adopted amendments to allow “spousal equivalents,” who are cohabitants occupying a relationship generally equivalent to that of a

spouse, to pool their joint income from in calculating joint income to qualify as accredited investors, as spouses currently are permitted to do.[\[10\]](#) Second, the Commission also clarified that individuals relying on joint net worth with a spouse or spousal equivalent to qualify as accredited investors need not purchase securities jointly with their spouses (or spousal equivalents).

Individuals Advised by Financial Professionals

In the Proposal, the Commission requested comment on expanding the accredited investor definition to permit an individual advised by a registered investment adviser or broker-dealer to qualify as an accredited investor.[\[11\]](#) In the final rulemaking, the Commission declined to expand the definition of accredited investor in this way. It reasoned that neither a recommendation by a broker-dealer nor advice by an investment adviser should serve as a proxy for an individual investor's financial sophistication or his or her ability to sustain the risk of loss of investment or ability to fend for him or herself.

Amendments to the Accredited Investor Definition for Entities

Largely as proposed, the Commission expanded the categories of entities that would be eligible as accredited investors to include:

- Commission- and state-registered investment advisers and exempt reporting advisers;[\[12\]](#)
- RBICs;[\[13\]](#)
- LLCs that have assets in excess of \$5 million and were not formed for the purpose of acquiring the securities being offered; and
- Family offices[\[14\]](#) with at least \$5 million in asset under management, if the family office is directed by a person with knowledge and experience in financial and business matters and is not formed for the purpose of acquiring the securities being offered. Family clients of such family offices will also meet the accredited investor definition for investments directed by the family office.

In addition, the Commission created a "catch-all" category for any entities that are not specifically listed in the accredited investor definition.[\[15\]](#) To qualify as accredited investors, these entities must own investments[\[16\]](#) in excess of \$5 million and not be formed for the specific purpose of acquiring the securities being offered.

Amendments to the QIB Definition

Securities Act Rule 144A provides a non-exclusive safe harbor exemption from the Securities Act registration requirements for the resale of restricted securities[\[17\]](#) to QIBs. The current definition of QIB specifies the types entities that are eligible for that status if they meet the threshold of \$100 million in securities owned and invested.[\[18\]](#)

Largely as proposed, the Commission expanded the categories of entities that are eligible for QIB status to be consistent with its expansion of categories of entities eligible for accredited investor status.[\[19\]](#) Notably, a new "catch-all" category in Rule 144A(a)(1)(i)(j) will permit an entity that meets the definition of accredited investor to qualify as a QIB if it satisfies the \$100 million securities-owned threshold, even if the entity is not of a type otherwise specified in Rule 144A.

Consistent with ICI comments, the Commission also clarified that new Rule 144A(a)(1)(i)(j)

will not require that entities are “not formed for the specific purpose of acquiring the securities offered.”^[20] The Commission stated that it intends that eligible purchasers under Rule 144A will continue to include entities formed solely for the purpose of acquiring restricted securities under Rule 144A, provided that they satisfy the threshold for QIB status.^[21]

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endnotes

^[1] See *Amending the “Accredited Investor” Definition*, Securities Act Release No. 10824 (Aug. 26, 2020) (the “Release”), available at <https://www.sec.gov/rules/proposed/2019/33-10734.pdf>; see also proposing release (the “Proposal”) (Dec. 18, 2019), available at <https://www.sec.gov/rules/proposed/2019/33-10734.pdf>. The Institute submitted a comment letter in response to the Proposal, available at <https://www.sec.gov/comments/s7-25-19/s72519-6949729-212280.pdf>. The Proposal and Release builds on ideas discussed in a concept release that the Commission issued in June 2019. See *Concept Release on Harmonization of Securities Offering Exemptions*, Securities Act Release No. 10649 (June 18, 2019) (the “Concept Release”), available at <https://www.sec.gov/rules/concept/2019/33-10649.pdf>. See also the Institute’s comment letter in response to the Concept Release, available at <https://www.sec.gov/comments/s7-08-19/s70819-6190597-192465.pdf>.

^[2] Release at 26.

^[3] Securities Act Rule 501(a)(10), as adopted. The non-exclusive list of attributes are: (i) The certification, designation, or credential arises out of an examination or series of examinations administered by a self-regulatory organization or other industry body or is issued by an accredited educational institution; (ii) 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; (iii) 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; and (iv) An indication that an individual holds the certification or designation is either made publicly available by the relevant self-regulatory organization or other industry body or is otherwise independently verifiable.

^[4] See *Order Designating Certain Professional Licenses as Qualifying Natural Persons for Accredited Investor Status Pursuant to Rule 501(a)(1) under the Securities Act of 1933* (Aug. 26, 2020), available at <https://www.sec.gov/rules/other/2020/33-10823.pdf>.

^[5] The Commission declined to adopt an amendment to permit individuals to self-certify that they have the requisite financial sophistication to be an accredited investor. Release at 34.

^[6] See Securities Act Rule 501(a)(11), as adopted. Investment Company Act Rule 3c-5(a)(4) defines knowledgeable employees as (i) an executive officer, director, trustee,

general partner, advisory board member, or persons services in a similar capacity, of the private fund or an affiliated management person (as defined in Rule 3c-5(a)(1)) of the private fund; and (ii) an employee of the private fund or an affiliated management person of the 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 function or duties, participates in the investment activities of such private fund, or investment companies the investment activities of which are managed by such affiliated management person of the private fund, provided that such employee has been performing such functions and duties for or on behalf of the private fund or the affiliated management person of the private fund, or substantially similar functions or duties for or on behalf of another company for at least 12 months.

[7] The current income and net worth tests for individuals are: having a net worth exceeding \$1 million (excluding the value of the individual's primary residence), either alone or jointly with a spouse; or having an income exceeding \$200,000 in each of the two most recent years, or joint income with a spouse of \$300,000 in each of those years. See Securities Act Rule 501(a)(5)-(6). Individuals who are directors or officers of an issuer can also be accredited investors. Securities Act Rule 501(a)(4).

[8] The current financial thresholds for individuals are substantially identical to those the Commission adopted in 1982. The Commission adopted an update in 2011, when it kept the net worth standard at \$1 million but, as required by Dodd-Frank, excluded the value of the investor's primary residence when calculating net worth. See *Net Worth Standard for Accredited Investors*, Securities Act Release No. 9287 (Dec. 21, 2011), available at <https://www.sec.gov/rules/final/2011/33-9287.pdf>.

[9] Release at 71-75.

[10] Securities Act Rule 501(j), as adopted.

[11] Proposal at 83. The proposal notes that commenters to the Concept Release generally supported this idea, although others were opposed or expressed concern.

[12] "Exempt reporting advisers" are advisers who qualify for an exemption from registration as an investment adviser under Investment Advisers Act Section 203(l) or 203(m).

[13] See Consolidated Farm and Rural Development Act Section 384A. RBICs are companies approved by the Secretary of Agriculture and that enter a participation agreement with the Secretary. RBICs are intended to promote economic development and the creation of job opportunities for individuals living in rural areas.

[14] Investment Advisers Act Rule 202(a)(11)(G)-1 defines family office as a "company (including its directors, partners, members, managers, trustees, and employees acting with the scope of their position or employment that: (1) has no clients other than family clients; provided that if a person that is not a family client becomes a client of the family office as a result of the death of a family member or key employee or other involuntary transfer from a family member or key employee, that person shall be deemed a family client for purposes of this section for one year following the completion of the transfer of legal title to the assets resulting from the involuntary event; (2) is wholly owned by family clients and is exclusively controlled (directly or indirectly) by one or more family members and/or family entities; and (3) does not hold itself out to the public as an investment adviser."

[\[15\]](#) Securities Act Rule 501(a)(9).

[\[16\]](#) The definition of “investments” would be the same as that in Investment Company Act Rule 2a51-1(b).

[\[17\]](#) Restricted securities are generally securities acquired in an unregistered, private sale from the issuing company or from an affiliate of the issuer. See Securities Act Rule 144(a)(3).

[\[18\]](#) Rule 144A(a). There are exceptions. A registered dealer can be a QIB if it owns and invests in the aggregate at least \$10 million in securities, or if it is acting in a riskless principal transaction on behalf of a QIB. Banks and other specified financial institutions are subject to an additional minimum audited net worth requirement of \$25 million.

[\[19\]](#) The Commission did not address whether to permit regulated non-US funds to qualify as QIBs using the “family of investment companies” test.

[\[20\]](#) Release at 93.

[\[21\]](#) The Commission also noted that this clarification is in contrast to its amendments to the accredited investor definition in Rule 501(a)(3), which will continue to require that the entity not be formed for the specific purpose of acquiring the securities offered. Release at 93, note 315.