

SEC expands the definition of accredited investor



Brian D. Anhalt

414.287.9603
banhalt@gklaw.com



Dennis F. Connolly

414.287.9258
dconnolly@gklaw.com



C.J. Wauters

414.287.9663
cwauters@gklaw.com

On Aug. 26, 2020, the U.S. Securities and Exchange Commission (SEC) amended the definition of “accredited investor” in Rule 501(a) of Regulation D. Notably, the SEC did not amend the financial thresholds, even though those thresholds have been in place since 1982 and have not been adjusted for inflation. Rather, the amendments set forth new categories of accredited investors for individuals that are not based on financial thresholds, expand the list of entities qualifying as accredited investors and revise the rules related to calculating “joint net worth” and “joint income” by permitting “spousal equivalents” to pool finances. The SEC also made similar changes to the definition of “qualified institutional buyer.” These amendments will be effective 60 days after publication in the Federal Register.

Categories not based on financial thresholds

The amendments create new categories of accredited investors for individuals based on qualifications other than income and net worth:

- **Professional certifications, designations or credentials:** The definition of accredited investor now includes individuals who hold certain professional certifications, designations or credentials in good standing, including Series 7, 65 and 82 licenses. The SEC may expand by order this preliminary list of qualifying certifications, designations and credentials.
- **Knowledgeable employees:** The definition of accredited investor also now includes “knowledgeable employees” of a private fund (e.g., hedge funds, venture capital funds and private equity funds) investing in that private fund. “Knowledgeable employees,” pursuant to rules promulgated under the Investment Company Act of 1940, as amended, includes, among others, executive officers, directors, trustees, general partners, advisory board members or persons serving in a similar capacity, and certain other individuals participating in the investment activities of the fund. For a private fund that does not meet the financial thresholds (i.e., greater than \$5 million in assets) and instead qualifies as an accredited investor because its equity holders are accredited investors, the inclusion of “knowledgeable employees” allows employees who do not meet the financial thresholds to invest in the private fund without the fund losing its accredited investor status.

Additional entity types

The accredited investor definition enumerates several categories of entities that qualify as accredited investors. The recent amendments expand this list:

- **Catch-all category:** The amendments add a catch-all category for entities owning investments in excess of \$5 million and not formed for the specific purpose of acquiring the securities offered. It is intended to capture entity forms not explicitly listed in the accredited investor definition, such as Indian tribes and governmental bodies, as well as entity types that may be created in the future.

The information contained herein is based on a summary of legal principles. It is not to be construed as legal advice and does not create an attorney-client relationship. Individuals should consult with legal counsel before taking any action based on these principles to ensure their applicability in a given situation.

- **SEC- and state-registered investment advisors, and exempt reporting advisers.**
- **Rural Business Investment Companies:** Rural Business Investment Companies, as defined in the Consolidated Farm and Rural Development Act, as amended, are approved by the Secretary of Agriculture and are intended to promote economic development and the creation of wealth in rural areas and among individuals living in such areas.
- **Family offices:** Family offices with at least \$5 million in assets under management and their family clients, each as defined in the family office rule under the Investment Advisers Act of 1940, as amended.

Spousal equivalents

For purposes of calculating “joint net worth” under the asset test (currently, a \$1 million threshold), or “joint income” for the income test (currently, a \$300,000 threshold), individuals are now able to include income from or assets of “spousal equivalents” rather than merely “spouses.” Spousal equivalent is defined as a cohabitant occupying a relationship generally equivalent to that of a spouse.

Qualified institutional buyers

The SEC made similar changes to expand the definition of qualified institutional buyer, which relates to resales of restricted securities under Rule 144A. Pursuant to the amendments, that definition now includes:

1. Rural business investment companies and limited liability companies if they own and invest on a discretionary basis at least \$100 million in securities; and
2. Institutional accredited investors that do not otherwise qualify as a qualified institutional buyer if they own and invest on a discretionary basis at least \$100 million in securities.

Next steps

These amendments will impact form subscription documents, including investor questionnaires, as well as potentially impact the drafting of securities purchase agreements. Companies should take steps to review their form documents prior to the effective date of the amendments. Companies should further consider the expanded scope of potential investors in ongoing and future private offerings and their screening methods for such investors.

The SEC also noted that these amendments will provide a foundation for their ongoing efforts to assess whether the exempt offering framework is consistent, accessible and effective for both issuers and investors.

If you have any questions on the amendments, please contact a member of Godfrey & Kahn’s Corporate Practice Group.