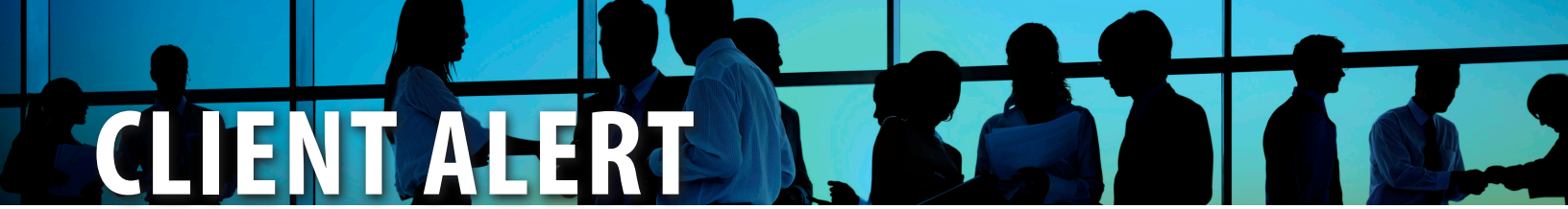


SEC EXPANDS ACCREDITED INVESTOR DEFINITION, GIVING IMPETUS TO PRIVATE MARKETS

by Rasika A. Kulkarni, Bradley J. Wyatt, William H. Dorton, and Julie D. Gulledge

Summary:

On August 26, 2020, the Securities and Exchange Commission (the "SEC") announced that it has adopted amendments to the definition of accredited investor under Regulation D of the Securities Act of 1933 (the "Securities Act"). The modified definition adds new categories of natural persons and entities who will become eligible to participate in exempt private offerings. Specifically, the amendments add new categories of natural persons that may qualify as accredited investors based on certain professional certifications or designations or other credentials, or their status as a private fund's "knowledgeable employee." They further expand the list of entities that may qualify as accredited investors, like entities owning $5 million in investments, family offices with at least $5 million in assets under management, and their family clients, and add the term "spousal equivalent" to the definition.

Natural Persons:

The amendments have added the following categories of natural persons to the definition of Accredited Investor:

- natural persons holding in good standing one or more professional certifications or designations or other credentials from an accredited educational institution that the SEC has designated as qualifying an individual for accredited investor status; and
- natural persons who are "knowledgeable employees," as defined in Rule 3c– 5(a)(4) under the Investment Company Act of 1940 (the "Investment Company Act"), of the private-fund issuer of the securities being offered or sold.

In conjunction with the adoption of the amendments, the SEC designated by order holders in good standing of the certifications or designations administered by the Financial Industry Regulatory Authority, Inc. (FINRA), including Licensed General Securities Representative (Series 7), Licensed Investment Adviser Representative (Series 65), and Licensed Private Securities Offerings Representative (Series 82), as qualifying natural persons. This approach provides the Commission with the flexibility to reevaluate or add certifications, designations, or credentials in the future.

Until now, accredited investors were defined solely by monetary metric: Only people with an annual income of at least $200,000 or with assets worth at least $1 million were included. The new rules expand the definition to those with knowledge of the financial markets, such as persons licensed in the above-mentioned capacities.

Similarly, current rule 501(a)(4) of Regulation D only limits directors, executive officers, or general partners of the issuer to participate in private offerings. With this amendment, the definition is extended to those employees of private funds who in connection with their regular functions or duties, have participated in investment activities of the fund for at least 12 months, including an affiliate of the managing entity of a private fund operating in a similar capacity. Whether any particular employee is one who participates in the investment activities of a fund is a determination that must be made on a case-by-case basis.

Lastly, the amendments add "spousal equivalent" to the accredited investor definition, so that spousal equivalents may pool their finances for the purpose of qualifying as accredited investors. The spousal equivalent would be defined as a cohabitant occupying a relationship generally equivalent to that of a spouse. The SEC has utilized this definition before under the Investment Advisors Act of 1940 in the context of defining family clients and under Regulation Crowdfunding in the context of defining family members of a purchaser.

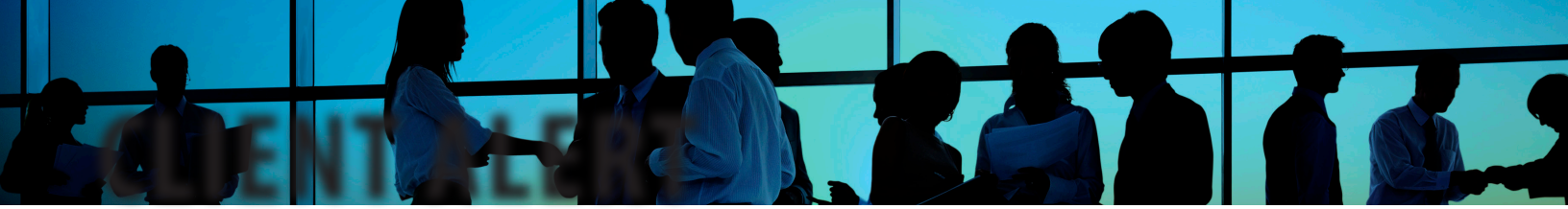
Entities:

The amendments added the following list of entities to the accredited investor definition:

- limited liability companies with $5 million dollars in assets. While it has been a long-standing practice of market participants and practitioners to include LLCs with $5 million in assets as accredited investors pursuant to Rule 501(a)(3) of Regulation D so long as they were not formed for purpose of investing, this addition adds a welcome clarification;
- SEC and state-registered investment advisers, exempt reporting advisers, and rural business investment companies (RBICs);
- entity, including Indian tribes, governmental bodies, funds, and entities organized under the laws of foreign countries, that own "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 Investment Advisers Act.

Modification to Institutional Buyer Definition in Rule 144A

The amendments expand the definition of "qualified institutional buyer" in Rule 144A to include limited liability companies and RBICs if they meet the $100 million in securities owned and invested threshold in the definition. The amendments also add to the list any institutional investors included in the accredited investor definition that are not otherwise enumerated in the definition of "qualified institutional buyer," provided they satisfy the $100 million threshold. In registered offerings under the Securities Act, issuers may engage in test-the-waters communications with qualified institutional buyers or institutional accredited investors to gauge their interest in a contemplated offering. These amendments will permit issuers to engage in test-the-waters communication with a larger set of investors, further facilitating capital formation.



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