

SEC Broadens Accredited Investor and Qualified Institutional Buyer Definitions

August 28, 2020

On August 26, 2020, the U.S. Securities and Exchange Commission (SEC) adopted amendments to the definitions of “accredited investor” and “qualified institutional buyer” (QIB) to bring additional categories of persons and entities within the scope of the definitions. The [adopting release](#) characterized these amendments as “part of a broader effort to simplify, harmonize, and improve the exempt offering framework under the Securities Act to promote capital formation and expand investment opportunities while maintaining and enhancing appropriate investor protections.” The amendments will take effect 60 days after publication in the *Federal Register*.

The vote in favor of these amendments was 3-2, with Chairman Jay Clayton and Commissioners Hester Peirce and Elad Roisman lauding the amendments for granting more investors access to a broader array of investments and Commissioners Allison Herren Lee and Caroline Crenshaw expressing concern about the risks to potentially vulnerable investors, particularly seniors. This divergence in perspectives may augur widely different approaches for the SEC’s rulemaking focus in the coming years, depending on the results of the presidential election and the appointment of a new SEC Chair.

The amendments to the accredited investor definition in Rule 501(a) under the Securities Act of 1933, as amended, add the following categories of persons and entities:

- natural persons with certain professional certifications, designations, or credentials or other credentials issued by an accredited educational institution, which the SEC may designate from time to time by order (including holders in good standing of the Series 7, Series 65, and Series 82 licenses);ⁱ
- natural persons who are “knowledgeable employees” of private funds (i.e., hedge funds, venture capital funds, and private equity funds excluded from the definition of “investment company” in Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act of 1940, as amended (Investment Company Act));
- limited liability companies with \$5 million in assets;
- SEC- and state-registered investment advisers, exempt reporting advisers, and rural business investment companies (RBICs);
- any entity, including American Indian tribes, governmental bodies, funds, and entities organized under the laws of foreign countries, that owns “investments,” as defined in Rule 2a51-1(b) under the Investment Company Act, in excess of \$5 million and was not formed for the specific purpose of investing in the securities offered;

- “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 of 1940, as long as such family office’s investments are directed by someone with “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,” and such family office was not formed for the specific purpose of acquiring the securities offered; and
- for the purposes of calculating joint income or determining net worth under Rules 501(a)(5) and (6), “spousal equivalents” — cohabitants occupying a relationship generally equivalent to that of a spouse.

The amendments also expand the definition of qualified institutional buyer in Rule 144A to include:

- limited liability companies and RBICs that, in the aggregate, own and invest on a discretionary basis at least \$100 million in securities of issuers that are not affiliated with such entity; and
- 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.

Private fund managers should review their offering memoranda, subscription agreements, and related offering documents to determine whether amendments are needed to incorporate the new accredited investor and, if applicable, QIB definitions.

While the amendments to the definition of qualified institutional buyer were largely uncontroversial, each of the Commissioners released a statement for or against the amendments to the definition of accredited investor. These statements are of interest as they illustrate a significant gap in perspective and priorities.

<u>Chairman Clayton:</u>	<u>Commissioners Lee and Crenshaw:</u>
<p>“The Commission’s use of income or wealth as the exclusive proxy for an individual’s financial sophistication and ability to assess and bear risk has long been unsatisfactory. Individual investors who do not meet the wealth tests, but who clearly are financially sophisticated enough to understand the risks of participating in unregistered offerings, are denied the opportunity to invest in our private markets. ... Moreover, businesses — particularly smaller and early stage businesses, those in geographic areas with lower concentrations of accredited investors, or founders without a wealthy friends-and-family network — are unable to seek investments from otherwise financially sophisticated individuals to access much needed seed and growth capital. ... [T]hese restrictions are limiting and almost certainly stifle opportunity.”</p>	<p>“The accredited investor definition is the single most important investor protection in the private market. Today’s amendments purport to ‘update’ that definition while leaving in place 38-year old wealth thresholds, declining to index the thresholds to inflation, and declining to provide economic analysis to show how the failure to index will affect American investors — the bulk of whom are seniors — going forward. With its actions today, the Commission continues a steady expansion of the private market, affording issuers of unregistered securities access to more and more investors without due regard for the risks they face, and without sufficient data or analysis to ensure that our policy choices are grounded in fact rather than supposition.”</p>

<u>Commissioner Roisman:</u>	<u>Commissioner Peirce:</u>
"[W]ealth is a crude measure of a person's ability to make financial decisions. ... I would have supported venturing further down this path of expanding the definition to include knowledge-based eligibility."	"Why shouldn't mom and pop retail investors be allowed to invest in private offerings? Why should I, as a regulator, decide what other Americans do with their money?"

¹ Note that persons who qualify as accredited investors under this provision must separately continue to satisfy the definition of "qualified client" under Rule 205-3 of the Investment Advisers Act of 1940 in order to invest in funds subject to performance fees.

If you have any questions regarding this Sidley Update, please contact the Sidley lawyer with whom you usually work, or

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