

August 31, 2020

SEC Finalizes Amendments to “Accredited Investor” Definition

Amendments Expand Persons and Categories of Entities That Qualify as Accredited Investors

SUMMARY

On August 26, 2020, the Securities and Exchange Commission adopted its previously proposed amendments to the definition of “accredited investor” in Rule 501(a) of Regulation D under the Securities Act of 1933. “Accredited investor” status is a prerequisite to participating in most investments in private companies and private funds in the United States. By expanding the definition, the SEC has broadened the categories of persons and entities able to participate in the private capital markets.¹ Our Memorandum to Clients, published on [January 7, 2020](#), summarized key aspects of the proposed rule; the amendments were adopted substantially as proposed with certain modifications.

The amendments will become effective 60 days after publication in the Federal Register.

AMENDMENTS TO ACCREDITED INVESTOR DEFINITION

Rule 506 of Regulation D under the Securities Act of 1933 establishes a safe harbor for private offers and sales or securities—usually referred to as “private placements”—that will be deemed not to involve a public offering within the meaning of the Securities Act. A company may therefore offer and sell its securities in such a private offering without registration under the Securities Act. In most cases, offers and sales in Rule 506 offerings are limited to “accredited investors” as defined in Rule 501(a) of Regulation D. The determination of whether a person or entity is an accredited investor is one of the principal tests for determining eligibility to participate in unregistered capital markets offerings. Chairman Clayton noted in his remarks that the accredited investor definition was being amended “for the first time in over 35 years” in light of the increased significance of the exempt securities markets in terms of both the absolute amount of

SULLIVAN & CROMWELL LLP

capital raised and relative to the public registered markets.² The amendments are intended to improve the definition to identify more effectively institutional and individual investors that have the knowledge and expertise to participate in private capital markets without the additional protections of registration under the Securities Act.

New Categories of Natural Persons Who Qualify as Accredited Investors

The amendments to the definition of “accredited investor” include the following two new categories of natural persons that will qualify as “accredited investors.”

1. Professional Certifications and Designations and Other Credentials

Under the final rule, the SEC may from time to time designate, by order, professional certifications and designations or other credentials (collectively, “credentials”) that meet certain criteria as qualifying an individual for accredited investor status. The SEC will consider the following non-exclusive list of factors in its analysis of particular credentials:

- the 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;
- 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;
- persons obtaining the 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
- an indication that an individual holds the credential is made publicly available by the relevant self-regulatory organization or other industry body or can be otherwise independently verifiable.

The SEC is including Licensed General Securities Representative (Series 7), Licensed Investment Adviser Representative (Series 65) and Licensed Private Securities Offerings Representative (Series 82) as qualifying credentials in the initial SEC order accompanying the final rule. The SEC also adopted a good standing requirement, but did not adopt a requirement that the individual holding a designated credential be required to practice in a field related to the credential in order to qualify as an accredited investor, in each case, consistent with the proposal.

2. “Knowledgeable Employees” of Private Fund Managers

Consistent with the proposal, the final rule also qualifies “knowledgeable employees” of a private fund manager as accredited investors for purposes of investments in the relevant managed fund or funds. “Knowledgeable employee” is defined in Rule 3c-5(a)(4) of the Investment Company Act of 1940, and generally includes directors and senior executives of the manager as well as individuals who directly participate in the investment activities of the private fund or funds.³ The SEC believes that, by virtue of their position, these persons are likely to be financially sophisticated and capable of fending for themselves in evaluating their investments in the fund, and that permitting them to invest may better align their interests

SULLIVAN & CROMWELL LLP

with those of other investors. Further, the SEC noted that it believes that it is appropriate to attribute a knowledgeable employee's accredited investor status to his or her spouse with respect to joint investments made by the knowledgeable employee and his or her spouse in a private fund.

3. New Categories of Entities That Qualify as Accredited Investors

The final rule also expands the current list of enumerated categories of entities that qualify as accredited investors under Rule 501(a). Specifically, the following entities will qualify as accredited investors under the final rule:

- SEC- or state-registered investment advisers, including exempt reporting advisers under Section 203(m) or Section 203(l) of the Advisers Act;
- rural business investment companies, as defined in Section 384A of the Consolidated Farm and Rural Development Act;⁴
- limited liability companies with total assets in excess of \$5 million and that were not formed for the specific purpose of acquiring the securities being offered;⁵
- “family offices” and their “family clients,” subject to certain criteria, which is intended to alleviate confusion that frequently arose under the existing “accredited investor” definition even for very large family offices;⁶ and
- any other entity owning investments in excess of \$5 million and that was not formed for the specific purpose of acquiring the securities being offered.⁷

The adopting release notes that the final category above is intended to capture any other undesignated entity type (e.g., Indian Tribes) or any new corporate form that might come into existence and gain acceptance but is not within the existing scope of Rule 501(a).

4. Permitting Spousal Equivalents to Pool Finances for Qualification as Accredited Investors

The final rule, which was adopted as proposed, will expand the “spousal” qualification for “accredited investor” status in order to allow persons to include joint income from, or the net worth of, “spousal equivalents” in these threshold calculations, with spousal equivalent defined as a cohabitant occupying a relationship generally equivalent to that of a spouse.

5. Amendments to the Definition of “Qualified Institutional Buyer” Under Rule 144A

Consistent with the proposal, the final rule expands the list of entities that are eligible for qualified institutional buyer status under Rule 144A to include, among others, RBICs, limited liability companies and any other institutional accredited investor as defined in proposed Rule 501(a) to the types of entities eligible for QIB status if they own and invest on a discretionary basis \$100 million in securities. The final rule also clarifies that the entity seeking qualified institutional buyer status may be formed for the purpose of acquiring the 144A securities being offered.

* * *

ENDNOTES

- 1 For the full text of the final rules, see “Amending the Accredited Investor Definition,” *available at* <https://www.sec.gov/rules/final/2020/33-10824.pdf>.
- 2 Commissioner Clayton’s remarks are available at <https://www.sec.gov/news/public-statement/clayton-accredited-investor-2020-08-26>.
- 3 Rule 3c-5(a)(4) under the Investment Company Act of 1940 defines a “knowledgeable employee” with respect to a private fund as: (i) an executive officer, director, trustee, general partner, advisory board member, or person serving in a similar capacity, of the private fund or an affiliated management person 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 functions or duties, participates in the investment activities of such private fund, other private funds 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.
- 4 Under Section 384A of the Consolidated Farm and Rural Development Act, a “rural business investment company” (“RBIC”) must be approved by the Secretary of Agriculture and enter into a participation agreement with the Secretary of Agriculture. To be eligible to participate as an RBIC, the company must be a newly formed for-profit entity or a newly formed for-profit subsidiary of such an entity, have a management team with experience in community development financing or relevant venture capital financing and invest in enterprises that will create wealth and job opportunities in rural areas, with an emphasis on smaller enterprises.
- 5 This amendment codifies a long-standing SEC staff interpretation that limited liability companies that satisfy the other requirements of the accredited investor definition are eligible to qualify as accredited investors under Rule 501(a)(3).
- 6 For a family office to qualify as an accredited investor under the new rule, it must have at least \$5 million in assets under management, the family office may not have been formed for the specific purpose of acquiring the securities being offered and its prospective investments must be directed by a person who has such knowledge and experience in financial and business matters that the family office would be capable of evaluating the merits and risks of the prospective investment criteria. For this purpose, “family office” and “family client” are as defined in Rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940. Generally, family offices are established by wealthy families to manage their wealth, plan for their families’ financial future and provide other services to family members. New investments by a family office—including one that may manage hundreds of millions or billions of dollars’ worth of securities investments—may frequently be made through newly formed or uncapitalized trusts or investment vehicles for tax- and estate-planning purposes. Such trusts and vehicles did not always clearly qualify as “accredited investors,” notwithstanding the wealth and sophistication of the family office operation, but will likely qualify in many cases under the amended definition.
- 7 For this purpose, “investments” is as defined in Rule 2a51-1(b) under the Investment Company Act of 1940.

SULLIVAN & CROMWELL LLP

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 875 lawyers on four continents, with four offices in the United States, including its headquarters in New York, four offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers listed below, or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by sending an e-mail to SCPublications@sullcrom.com.

CONTACTS

New York

Ari B. Blaut	+1-212-558-1656	blauta@sullcrom.com
Robert E. Buckholz	+1-212-558-3876	buckholzr@sullcrom.com
Catherine M. Clarkin	+1-212-558-4175	clarkinc@sullcrom.com
Donald R. Crawshaw	+1-212-558-4016	crawshawd@sullcrom.com
Robert G. DeLaMater	+1-212-558-4788	delamaterr@sullcrom.com
Robert W. Downes	+1-212-558-4312	downesr@sullcrom.com
John E. Estes	+1-212-558-4349	estesj@sullcrom.com
William G. Farrar	+1-212-558-4940	farrarw@sullcrom.com
Jared M. Fishman	+1-212-558-1689	fishmanj@sullcrom.com
Marion C. Leydier	+1-212-558-7925	leydierm@sullcrom.com
John P. Mead	+1-212-558-3764	meadj@sullcrom.com
Scott D. Miller	+1-212-558-3109	millersc@sullcrom.com
Robert W. Reeder III	+1-212-558-3755	reederr@sullcrom.com
Rebecca J. Simmons	+1-212-558-3175	simmonsr@sullcrom.com
William D. Torchiana	+1-212-558-4056	torchianaw@sullcrom.com
Benjamin H. Weiner	+1-212-558-7861	weinerb@sullcrom.com

Washington, D.C.

Robert S. Risoleo	+1-202-956-7510	risoleor@sullcrom.com
-------------------	-----------------	--

Los Angeles

Patrick S. Brown	+1-310-712-6603	brownp@sullcrom.com
Alison S. Ressler	+1-310-712-6630	resslera@sullcrom.com

SULLIVAN & CROMWELL LLP

Palo Alto

Sarah P. Payne	+1-650-461-5669	paynesa@sullcrom.com
John L. Savva	+1-650-461-5610	savvaj@sullcrom.com

London

Chris Beatty	+44-20-7959-8505	beatty@sullcrom.com
Kathryn A. Campbell	+44-20-7959-8580	campbellk@sullcrom.com
Oderisio de Vito Piscicelli	+44-20-7959-8589	devitopiscicelli@sullcrom.com
John Horsfield-Bradbury	+44-20-7959-8491	horsfieldbradburyj@sullcrom.com
John O'Connor	+44-20-7959-8515	oconnorj@sullcrom.com
Evan S. Simpson	+44-20-7959-8426	simpsons@sullcrom.com

Paris

William D. Torchiana	+33-1-7304-5890	torchianaw@sullcrom.com
----------------------	-----------------	--

Frankfurt

Krystian Czerniecki	+49-69-4272-5525	czernieckik@sullcrom.com
---------------------	------------------	--

Sydney

Waldo D. Jones Jr.	+61-2-8227-6702	jonesw@sullcrom.com
--------------------	-----------------	--

Tokyo

Keiji Hatano	+81-3-3213-6171	hatanok@sullcrom.com
--------------	-----------------	--

Hong Kong

Garth W. Bray	+852-2826-8691	brayg@sullcrom.com
Ching-Yang Lin	+852-2826-8606	linc@sullcrom.com
Chun Wei	+852-2826-8666	weic@sullcrom.com

Beijing

Gwen Wong	+86-10-5923-5967	wonggw@sullcrom.com
-----------	------------------	--
