

SEC Updates “Accredited Investor” Definition for 21st Century -- Rule Changes Offer Greater Flexibility for Private Investment Participants

Legal Alert
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After years of deliberation, the U.S. Securities and Exchange Commission (SEC) has adopted amendments to its “accredited investor” and “qualified institutional investor” definitions. These definitions have long been the main test for determining who is eligible to participate in private capital markets, which are exempt from the SEC registration process required for public securities offerings. Until now, income and net worth have been the key measures qualifying individuals to invest in a private placement: (i) income of more than \$200,000 annually for the past two years (or more than \$300,000 combined with a spouse) or (ii) a net worth greater than \$1 million (individually or combined with a spouse).

While retaining such financial tests, the just-announced SEC rule amendments (effective in October) will offer individuals not meeting the financial-means test with an alternate pathway into private investing. **Newly defined measures of professional certification, knowledge and experience can now be used to demonstrate the financial sophistication to qualify an individual to invest responsibly in privately placed securities.**

The amendments revise Rule 501(a), Rule 215 and Rule 144A of the Securities Act. The rules, as previously written, had drawn criticism for keeping private investment opportunities within wealthier circles. In response, the amendments widen the door to those who may not be independently wealthy, but who possess the demonstrable qualifications to assess the risks involved in private capital markets. The amendments are generally viewed as modernizing improvements, balancing the desire to expand investment and fundraising opportunities against the need to protect those at risk of misunderstanding the

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hazards involved in more opaque and riskier private investments.

The amendments to the accredited investor definition in Rule 501(a):

- Permit individuals to qualify as accredited investors based on certain professional certifications, designations or other credentials issued by an accredited educational source, which the SEC may designate from time to time. This category currently includes brokerage industry and investment adviser employees with Series 7, Series 65 and Series 82 licenses. For the SEC’s consideration, members of the public may propose additional certifications, designations or credentials to satisfy the attributes set out in the new rule;
- Permit individuals who are “knowledgeable employees” of a private fund (such as a private equity, hedge or venture capital fund) to invest in the securities offering of that fund;
- Clarify that limited liability companies with \$5 million in managed assets may be accredited investors;
- Add SEC- and state-registered investment advisers, exempt reporting advisers and rural business investment companies (RBICs) to the list of entities that may qualify for private placement investments;
- Allow private investments for any “entity,” including Indian tribes, governmental bodies and entities organized under the laws of foreign countries, that owns “investments” (as defined in Rule 2a51-1(b) of the Investment Company Act) in excess of \$5 million and that was not formed for the specific purpose of investing in the securities offered;
- Add “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; and
- Add the term “spousal equivalent,” so that spousal equivalents (as defined) may pool their finances for the purpose of qualifying as accredited investors, just as “spouses” had been permitted to do.

A related amendment to Rule 144A expands the definition of “qualified institutional buyer” to include limited liability companies and RBICs if they meet the threshold of \$100 million in securities owned and invested. The amendments also add to the qualifying list any institutional investors included in the accredited investor definition so long as they satisfy the \$100 million threshold. The SEC also adopted conforming amendments to Rule 163B (the “testing-the-waters” rule for IPOs) under the Securities Act and to Rule 15g-1 under the Exchange Act.

If you have any questions, please contact [Brooks Lindsay](#), [Zachary Dean](#), or [Sy Bucholz](#) for further information.