On August 26, 2020, the Securities and Exchange Commission (“SEC”) finalized changes to the definitions of “accredited investor” and “qualified institutional buyer” that will open private capital markets to new investors. As previewed in our earlier Viewpoints advisory, the SEC first proposed these changes in December 2019, and the final rule adopts changes to these definitions substantially as previously proposed. The changes will become effective 60 days after the final rule is published in the Federal Register.[1]

Under the final rule, the SEC updated Rule 501(a) to add the following categories of accredited investors:
individuals with certain professional certifications, such as a FINRA Series 7, 65 or 82 license;

with respect to investments in private funds, individuals who are “knowledgeable employee[s]” of the funds;

a “spousal equivalent” concept to the accredited investor definition, so that spousal equivalents may pool their finances for the purpose of qualifying as accredited investors;

limited liability companies that meet certain conditions, registered investment advisers and rural business investment companies (RBICs);

any entity, including Indian tribes, owning certain “investments” 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.”

These new categories are in addition to the existing categories of accredited investors, which already include (i) a person whose individual net worth exceeds $1,000,000 (excluding the value of that person’s primary residence), (ii) a person who had an individual income in excess of $200,000 in each of the two most recent years ($300,000 if combined with a spouse) and has a reasonable expectation of reaching the same income level in the current year and (iii) certain senior officers of the issuer.

The update also expands the entities included as “qualified institutional buyers” under Rule 144A, which generally provides a registration exemption for resales of securities by certain buyers. Under the new final rule, limited liability companies and RBICs are eligible for qualified institutional buyer status if they meet the $100 million in securities owned and investment threshold in the definition. Furthermore, the final rule creates a new catch-all category such that any entity type may qualify as an institutional buyer when it satisfies the $100 million threshold.

The definition of “accredited investor” has not been updated in more than 35 years, so any changes are noteworthy. Importantly, the changes described above illustrate a shift in policy from using wealth as a proxy for investor sophistication to more directly evaluating an investor’s knowledge of the private capital markets. SEC Commissioner Elad L. Roisman explained, “these changes are modest, but incremental” and that he “would have supported venturing further down this path of expanding the definition to include knowledge-based eligibility.” We may see further knowledge-based expansion of the “accredited investor” rules going forward, which, together with these recent amendments, will help to expand the pool of potential investors and enable private financing transactions.

**Endnotes**

[1] The changes are expected to become effective by the beginning of November 2020.