

## SEC Expands Access to Private Offerings

September 1, 2020

### New rules broaden definitions of “accredited investor” and “qualified institutional buyer”

On August 26, the Securities and Exchange Commission **expanded** the definitions of “accredited investor” in Regulation D and of “qualified institutional buyer” in Rule 144A, thereby allowing a larger pool of investors to have access to private investments, including in hedge funds, private equity funds and venture capital funds. While the previous definition of “accredited investor” relied on an individual’s net worth to reflect financial sophistication, the new rules reflect the SEC’s view that certain experience and knowledge may also demonstrate financial sophistication. The changes are part of the SEC’s effort to “simplify, harmonize and improve” the private offering framework and are substantially similar to those in the SEC’s December 2019 proposal, discussed [here](#).

The rules are effective 60 days after publication in the Federal Register.

#### Key takeaways:

- Adds new categories of “accredited investor” definition for natural persons to include:
  - Individuals with certain professional credentials
  - “knowledgeable employees” of private funds
- Expands list of entities that qualify as an “accredited investor” to include, among others, investment advisers registered under the Investment Advisers Act of 1940 and registered under state law, as well as exempt reporting advisers
- Expands list of entities that qualify as a “qualified institutional buyer” to include, among others, LLCs and rural business investment companies

### Expansion of “accredited investor” definition for individuals

The final rules expand the “accredited investor” definition to include individuals holding a professional credential issued by an institution designated as qualifying by the SEC. Prior to this change, an individual would have had to have a net worth exceeding \$1 million (excluding primary residence) or income exceeding \$200,000 (\$300,000 with spouse) in each of the two most recent years, or be a director, executive officer or general partner of the issuer to qualify as an “accredited investor.”

In determining which professional credentials qualify their holders for accredited investor status, the SEC will consider, among others, the following attributes:

- 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 demonstrate the individual’s comprehension and sophistication in the areas of securities and investing;
- individuals 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 either publicly available by the accrediting authority or is otherwise independently verifiable.

The SEC will provide an opportunity for public comment prior to designating any credentials as qualifying and will post qualifying credentials on its website. In connection with the final rule, the SEC has designated the FINRA Series 7, Series 65 and Series 82 licenses as credentials that qualify under the new rules. In a change from the proposed rule, the final rule requires that any credential be in good standing.

The final rules also modify certain of the calculations for the purposes of calculating net worth. The new rules add a concept of “spousal equivalent” (defined as “a cohabitant occupying a relationship generally equivalent to that of a spouse”) which may be included when calculating joint income or joint net worth for purposes of qualifying as an “accredited investor.” In addition, the rules clarify that the calculation of “joint net worth” can be the aggregate net worth of an investor and his or her spouse (or spousal equivalent) and that the securities being purchased by an investor relying on the joint net worth test need not be purchased jointly.

For private-fund offerings, the final rules include a new category of “accredited investor” based on the individual’s status as a “knowledgeable employee” of the fund. This change harmonizes Regulation D with rules under the Investment Company Act of 1940 (“the Investment Company Act”) that permit such employees to invest in private funds without regard to the 100-investor limit or “qualified purchaser” requirement for frequently-used exemptions under the Investment Company Act, and therefore allows such employees to invest in private funds even if they do not meet current accredited-investor standards. Knowledgeable employees include senior officers of a private fund’s manager and certain other employees who, in connection with their regular duties, have participated in the investment activities of the manager’s funds for at least 12 months.

## **Expansion of “accredited investor” definition for entities**

The SEC also amended the accredited investor definition to include investment advisers registered under the Investment Advisers Act of 1940 and registered under state law. In a modification from the SEC’s original proposal, the final rule also expands the definition of accredited investor to include exempt reporting advisers. The SEC stated that advisers registered with the SEC and with the states, as well as exempt reporting advisers, have the financial sophistication needed to conduct meaningful investment analyses, a hallmark of financial sophistication..

In addition, the final rule expands the definition to include any “family office” with at least \$5 million in assets under management, as well as its “family clients” as defined under the Investment Advisers Act.

## **Expansion of “qualified institutional buyer” definition**

Rule 144A provides a safe harbor from registration under the Securities Act of 1933 for resales of securities to “qualified institutional buyers;” generally speaking, institutions that own and invest on a discretionary basis at least \$100 million in securities of non-affiliates. The SEC views such investors as sophisticated enough to not need the protections of registration under the Securities Act of 1933.

The current definition of “qualified institutional buyer” contains a list of the legal entities that can qualify that excludes some commonly used entity types. The final rules add limited liability companies and rural business investment companies to the current entities, and also add a catch-all category that would permit institutional accredited investors of an entity type not already included in the “qualified institutional buyer” definition when they satisfy the \$100 million threshold. (In practice, this change will have limited impact, as many capital markets participants have always presumed that such entities are “qualified institutional buyers.”)

---

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your usual Davis Polk contact.

<b>Maurice Blanco</b>	212 450 4086	<a href="mailto:maurice.blanco@davispolk.com">maurice.blanco@davispolk.com</a>
<b>Joseph A. Hall</b>	212 450 4565	<a href="mailto:joseph.hall@davispolk.com">joseph.hall@davispolk.com</a>
<b>Michael Kaplan</b>	212 450 4111	<a href="mailto:michael.kaplan@davispolk.com">michael.kaplan@davispolk.com</a>
<b>Leor Landa</b>	212 450 6160	<a href="mailto:leor.landa@davispolk.com">leor.landa@davispolk.com</a>
<b>James C. Lin</b>	+852 2533 3368	<a href="mailto:james.lin@davispolk.com">james.lin@davispolk.com</a>
<b>Emily Roberts</b>	650 752 2085	<a href="mailto:emily.roberts@davispolk.com">emily.roberts@davispolk.com</a>
<b>Richard D. Truesdell, Jr.</b>	212 450 4674	<a href="mailto:richard.truesdell@davispolk.com">richard.truesdell@davispolk.com</a>
<b>Aaron Gilbride</b>	202 962 7179	<a href="mailto:aaron.gilbride@davispolk.com">aaron.gilbride@davispolk.com</a>
<b>Elizabeth Weinstein</b>	212 450 3889	<a href="mailto:elizabeth.weinstein@davispolk.com">elizabeth.weinstein@davispolk.com</a>

---

© 2020 Davis Polk & Wardwell LLP | 450 Lexington Avenue | New York, NY 10017

This communication, which we believe may be of interest to our clients and friends of the firm, is for general information only. It is not a full analysis of the matters presented and should not be relied upon as legal advice. This may be considered attorney advertising in some jurisdictions. Please refer to the firm's [privacy notice](#) for further details.