CLIENT ALERT

SEC Finalizes Amendments to the Definitions of Accredited Investor and Qualified Institutional Buyer

Aug.27.2020

On August 26, 2020, the U.S. Securities and Exchange Commission (**SEC**) announced that it has finalized amendments to the definitions of accredited investor under Rule 501 of Regulation D and qualified institutional buyer (**QIB**) under Rule 144A of the Securities Act of 1933, as amended (the **Securities Act**). The SEC originally proposed the amendments on December 18, 2019, and the final version is largely consistent with the SEC's proposed version. The amendments will be effective 60 days after publication in the Federal Register.

The amendments expand the scope of individuals and entities that may participate in private offerings of securities as accredited investors and QIBs, which the SEC expects will increase access to private capital markets. The amendments were approved by a 3-2 vote of the SEC, with both SEC commissioners filling Democratic seats on the SEC dissenting. Among other reasons for their dissent, the dissenting commissioners objected to the SEC's decision not to include an adjustor in the wealth thresholds in the definitions to reflect the effects of future inflation.

The key changes to these definitions are discussed below. Private companies engaging in fundraising and investment funds should review their subscription documents to ensure that they properly reflect investors who may now qualify as accredited investors and QIBs.

Amendments to the Accredited Investor Definition

Individuals

Generally, to qualify as an accredited investor, an individual previously had to have a net worth of at least $1,000,000 (excluding the value of his or her primary residence) or income of at least $200,000 (or $300,000 if married) and the expectation to earn the same amount in the current year. Once effective, the amendments will modify this definition such that individuals with certain professional certifications or credentials which demonstrate financial sophistication, such as Series 7, Series 65 and Series 82 licenses, will also qualify as accredited investors. New certifications may be added by the SEC at a later date. The net effect is that personal wealth is no longer the sole proxy for accredited investor status. Rather, wealth or financial sophistication will now suffice for purposes of qualifying as an accredited investor and being permitted to participate in private securities offerings like venture capital financings or digital assets offerings.

In addition, "spousal equivalents" may now pool assets for purposes of meeting the definition of accredited investor, with a spousal equivalent meaning a cohabitant occupying a generally equivalent relationship to that of a spouse. Additionally, "knowledgeable employees" of private equity, venture capital or hedge funds may now qualify as accredited investors for purposes of investing in their employer's fund.

Entities

Generally, to qualify as an accredited investor, an entity previously had to be owned by accredited investors or be a corporation, partnership, trust or similar entity with more than $5,000,000 of assets. The final rule expands the types of entities that are deemed accredited investors to include (1) SEC and state registered investment advisors, (2) rural business investment companies, (3) family offices with $5,000,000 in assets under management and their clients and (4) and a catch-all category for other entities that own "investments" of at least $5,000,000 (as defined in the Investment Company Act) and were not formed for the specific purpose of acquiring the securities being offered, which will pick up, among others, foreign entities.

Amendments to the QIB Definition

Until now, the definition of QIB under Rule 144A has specified certain categories of entities that are eligible for QIB status if they meet the $100 million in securities owned and invested threshold. In its amendments, the SEC expanded the QIB definition to include rural business investment companies and limited liability companies. The SEC also created a catch-all category, thereby enabling investors that meet the $100 million threshold to qualify as QIBs even if not otherwise listed in the enumerated categories of entities in QIB definition. This latter change enables investors that meet the $100 million threshold in securities owned and invested to qualify as QIBs regardless of their legal form of organization.

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More information on the changes to the definitions of accredited investor and qualified institutional buyer can be found in the summary from the SEC available here. Under the Dodd-Frank Act, the SEC is required to review the definition of accredited investor every four years; the next review will take place in 2023.

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