
Hughes Hubbard & Reed

SEC Adopts Final Changes to Accredited Investor Definition

Client Advisories

Hughes Hubbard & Reed LLP • A New York Limited Liability Partnership
One Battery Park Plaza • New York, New York 10004-1482 • +1 (212) 837-6000

Attorney advertising. Readers are advised that prior results do not guarantee a similar outcome. No aspect of this advertisement has been approved by the Supreme Court of New Jersey. For information regarding the selection process of awards, please visit <https://www.hugheshubbard.com/legal-notice-methodologies>.

September 3, 2020 - On August 26, 2020, the Securities and Exchange Commission (the "Commission" or "SEC") adopted final rules amending the definition of "accredited investor" in Rule 501 under the Securities Act of 1933, as amended (the "**Securities Act**"),¹ to expand the classes of persons qualifying to participate in private placements, which do not have the rigorous disclosure and procedural protections provided by securities registration. The Commission seeks to expand access to exempt offerings because "the significance of the exempt securities markets has increased both in terms of the absolute amount raised and relative to the public registered markets."² The Commission also amended the definition of "qualified institutional buyer" ("**QIB**") in Rule 144A to align with the changes to Rule 501.

Issuers will now be able to rely on alternative indicators of financial sophistication and risk tolerance, such as professional certifications or other credentials or, with respect to investment in a private fund, an investor's status as a "knowledgeable employee." Previously, accredited investor status relied on wealth as the sole yardstick of financial sophistication. The changes acknowledge other factors sufficient to signify an investor's ability to analyze the risks and rewards, to allocate investments to mitigate or avoid risk of unsustainable loss, to access information about an issuer or opportunity, and to bear the risk of loss.

The Release is available [here](#). The amendments will be effective 30 days after the Release is published in the Federal Register. (All Rule and Section references refer to the Securities Act unless otherwise stated.)

A. New Categories for Natural Persons

The final rules add the following types of natural persons to the definition of accredited investor:

1. Credentialed Natural Persons. Under new Rule 501(a)(10), accredited investors include natural persons holding, in good standing, one or more professional certifications, designations or other credentials that the Commission designates as qualifying for accredited investor status.³ To fulfill the good standing requirement, individuals must demonstrate that they have passed the required exams and maintain active certification or

designation, though they are not required to be actively practicing the profession related to the credential. It is not sufficient for individuals to self-certify as to financial sophistication.

Professional credentials recognized by the Commission will be posted on the SEC website. The initial credentials recognized, by separate Commission order, available [here](#), are persons who have passed certain FINRA Exams and possess the following licenses: General Securities Representatives who passed the Series 7; Private Securities Offerings Representatives who passed the Series 82; and state-registered Investment Adviser Representatives who passed the Series 65.

2. Knowledgeable Employees. New Rule 501(a)(11) adds natural persons who are “knowledgeable employees,” with respect to a private fund⁴ that is the issuer of the securities offered or sold as accredited investors admissible in such offers or sales. The Commission noted that it is not modifying the existing definition of knowledgeable employee in Rule 3c-5(a)(4) under the Investment Company Act of 1940, as amended (the “**Company Act**”).

B. New Categories for Entities

The final rules add the following types of entities to the definition of accredited investor:

1. Registered and Exempt Reporting Advisers. The Release adds to Rule 501(a)(1) all SEC- and state-registered investment advisers, including sole proprietorships, plus investment advisers qualifying as exempt reporting advisers under the Investment Advisers Act of 1940, as amended (the “**Advisers Act**”).⁵

2. RBICs. The Release adds to Rule 501(a)(1) rural business investment companies (RBICs), approved by the Secretary of Agriculture to promote economic development and wealth and job creation in rural areas.

3. LLCs. Rule 501(a)(3) will now list limited liability companies (LLCs) as a type of entity that can be an accredited investor if it has total assets in excess of \$5 million and is not formed for the specific purpose of acquiring the securities offered. The Commission also confirmed its view that managers of LLCs, whether managing members or third-party managers, perform policy making functions for the issuer such that they are the equivalent of executive officers of the issuer and therefore qualify as accredited investors under Rule 501(f).

4. Family Offices and Family Clients. New rules that add certain single family offices and family clients as accredited investors rely, in part, on definitions in Rule 202(a)(11)(G)-1 under the Advisers Act (the “**Family Office Rule**”). Under new Rule 501(a)(12), a family office, as defined in the Family Office Rule, will be accredited if it has at least \$5 million in assets under management, is not formed for the specific purpose of acquiring the securities offered, and has its investment in the offered securities directed by a person who has such knowledge and experience in financial and business matters that such family office is capable of evaluating the merits and risks of the prospective investment. Under new Rule 501(a)(13), a family client, as defined in the Family Office Rule, will be accredited if such client’s prospective investment in the issuer is directed by an accredited investor family office. The new rules also follow the Family Office Rule in treating certain family client beneficiaries who would not otherwise qualify as accredited investors as family clients—and hence, accredited investors—for one year.

5. Other Entities. New Rule 501(a)(9) adds an omnibus category for entities, not otherwise covered in Rule 501, that own in excess of \$5 million in investments (as defined in Rule 2a51-1(b) under the Company Act) and were not formed for the specific purpose of acquiring the securities offered. The purpose of this new category is to extend accreditation to all existing entity forms not already covered, such as Indian tribes, government bodies, labor unions, and foreign entities, as well as any new entity types created in the future.

C. Other Rules and Interpretations Promoting Consistency

The Commission adopted a handful of other changes for consistency among federal securities laws and ease of application. First, natural persons will now be allowed to consider income and assets from spousal equivalents when determining joint income and net worth requirements under Rule 501(a)(5) and Rule 501(a)(6). The term “spousal equivalent” will have the same definition as it does under other federal securities laws.⁶

The Commission also added certain interpretive notes to Rule 501. A note to Rule 501(a)(5) clarifies that a person aggregating net worth with a spouse or spousal equivalent can include assets not held jointly and that a person can rely on the joint net worth test even if not purchasing the offered securities jointly. A new note to Rule 501(a)(8) clarifies that an entity looking through to its equity owners to determine their accredited investor status may look through any equity owner that is another entity to its natural person owners. The Release asserts the Commission’s view that Rule 501(a)(8) applies to entities that are 100% owned by accredited investors and that, for this purpose, it does not matter whether such ownership is direct or indirect.⁷

In the Release, the SEC also adopted aligning changes to Rule 215 and Rule 163B under the Securities Act and to Rule 15g-1 under the Securities Exchange Act of 1934, as amended.

D. New Categories for QIBs

The Commission added a new section to Rule 144A, Rule 144A(a)(1)(i)(J), which states that any institutional accredited investor defined in Rule 501(a) not otherwise captured by the other subsections of Rule 144A(a)(1)(i), can be a QIB if it meets the QIB criteria.⁸ To avoid confusion, the Commission added an interpretive note to Rule 144A(a)(1)(i)(J) to confirm that, unlike institutional accredited investors under Rule 501, QIBs may be formed for the purpose of acquiring the offered securities.⁹

¹ *Amending the “Accredited Investor” Definition*, Release Nos. 33- 10824; 34-89669 (August 26, 2020) (the “Release”).

² Release, 5.

³ The new rule provides non-exclusive criteria by which the Commission will determine which professional certifications, designations, or credentials are appropriate to evolving markets and industry practices. The Commission will consider, among other things, credentials that result from an examination administered by a self-regulatory organization (“SRO”) or other industry body, which exam is designed to reliably and validly demonstrate an individual’s comprehension and sophistication in areas of securities and investing; are issued by an accredited educational institution; that are reasonably expected to evidence sufficient knowledge and experience in financial and business matters to evaluate the merits and risks of a prospective investment; and that are made publicly available by an SRO or other examining body or is otherwise independently verifiable.

⁴ “Private funds are pooled investment vehicles that are excluded from the definition of investment company under the Investment Company Act of 1940 by section 3(c)(1) or 3(c)(7) of that Act. The term private fund generally includes funds commonly known as hedge funds and private equity funds.” Private Fund Adviser Overview, U.S. Securities and Exchange Commission, modified October 21, 2016, available [here](#).

⁵ Release, 45. Exempt reporting adviser refers to an investment adviser that would be required to register, but for the exemptions in Sections 203(m) and 203(l) of the Advisers Act.

⁶ Release, 65.

⁷ Release, 67.

⁸ Namely, it must be an entity, acting for its own account or the accounts of other QIBs, that in the aggregate owns and invests on a discretionary basis at least \$100 million in securities of issuers that are not affiliated with the entity. Rule 144A(a)(1)(i).

⁹ Release, 93.

Related People



Alexandra Poe



Charles A. Samuelson



Gary J. Simon



Javad Husain

Related Areas of Focus

Corporate

Securities & Capital Markets

Private Funds and Asset Management