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SEC Proposes Updated Accredited Investor and Qualified Institutional Buyer Standards

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On December 18, 2019, the U.S. Securities and Exchange Commission (the "SEC") proposed to broaden and update the categories of natural persons and entities that qualify as "accredited investors" for Regulation D under the Securities Act of 1933 (the "Securities Act") and "qualified institutional buyers" for Rule 144A under the Securities Act. If adopted, the amended definition of (1) accredited investor would expand the pool of investors eligible to participate in, and provide capital to, the Regulation D private placement market commonly used by private funds and portfolio companies, and (2) qualified institutional buyers would expand the types of entities that could meet the qualified institutional buyer test for purposes of the private resale safe harbor under Rule 144A used by many issuers to allow private resales to large institutional investors following a private placement transaction.

Proposed Accredited Investor Changes

Background. Regulation D under the Securities Act provides an exemption from registration for certain private offerings of securities and is the most commonly used exemption by private funds and other issuers. Under Regulation D, offerings may be made to accredited investors (as defined in Regulation D) and a limited number of non-accredited investors. If securities are sold to non-accredited investors, Regulation D requires a specific form of disclosure, so many Regulation D offerings are limited to only accredited investors.

Natural Persons. The proposed rule adds two new non-financial categories for natural person accredited investors, including natural persons:

- holding certain professional certifications or designations or other credentials as designated from time to time by order of the SEC and initially expected to include

Series 7, 65 and 82 licenses[1]; and
- meeting "knowledgeable employee" status (i.e., a high-level executive or qualifying investment personnel) for a private fund[2] and investing in such private fund.

These new categories would in effect qualify natural persons based on professional knowledge and experience in addition to the current use of net worth and income levels.

The SEC did not propose any updates to the current accredited investor net worth or income aggregate dollar standards, but would allow natural persons to include joint net worth from "spousal equivalents," meaning a cohabitant occupying a relationship generally equivalent to that of a spouse. In addition, the proposal defines joint net worth as "aggregate" net worth and clarifies that qualifying under the joint net worth standard does not require owning the securities jointly.

Entities. The proposed rule also adds new categories of entity accredited investors, including:

- SEC and state registered investment advisers;
- rural business investment companies ("RBICs");
- limited liability companies with total assets in excess of $5 million that are not formed for the specific purpose of acquiring the securities being offered[3];
- any form of entity not covered under the current rule[4] (e.g., Native American tribal entities, non-U.S. pension plans or sovereign wealth funds) owning "investments[5]" in excess of $5 million that is not formed for the specific purpose of acquiring the securities being offered;
- "family offices" (as defined in the family office rule under the Investment Advisers Act of 1940 (the "Advisers Act"))[6] with at least $5 million in assets under management that are not formed for the specific purpose of acquiring the securities offered and whose prospective investment is directed by a person who has such knowledge and experience in financial and business matters that such family offices are capable of evaluating the merits and risks of the prospective investment; and
- "family clients[7]" of a "family office" qualifying as an accredited investor.[8]

The proposal to add any form of entity with at least $5 million of investments to the list of accredited investors would be beneficial to private funds and other issuers that have potential investors that are large sophisticated institutions but that technically do not qualify as accredited investors.

Proposed Qualified Institutional Buyer Changes

Background. Rule 144A under the Securities Act allows the private resale of securities offered in a private placement to large "qualified institutional buyers" ("QIBs") without registration. QIBs generally are certain classes of institutional investors that own and invest on a discretionary basis at least $100 million in securities of non-affiliated issuers. Many institutional private placements (e.g., debt or asset-backed securities) are structured to comply with Rule 144A, and many buyers of such securities (e.g., private funds) seek to meet the qualified institutional buyer definition.

Proposed Amendments to QIB Definition. The SEC proposes to expand the definition of qualified institutional buyer in order to avoid inconsistencies between the entity types that are eligible for accredited investor status and QIB status. The proposed rule would expand the definition of QIB to include the following types of institutional investors meeting the $100 million of securities test:

- limited liability companies and RBICs; and
- any entity not covered under the current accredited investor rule (as described above), such as sovereign wealth funds, Native American tribal entities and non-U.S. plans.

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The proposed rules will be subject to public comment until 60 days after publication in the Federal Register and are not effective until final rules are issued.

If you have any questions about the topics discussed in this *KirklandPEN*, please contact the authors listed below or your regular Kirkland contact.

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1. These are licenses required for broker-dealer representatives or certain investment adviser representatives dealing with retail investors.↩

2. A "private fund" is an issuer qualifying for the exemption from investment company status under Investment Company Act Section 3(c)(1) — 100-or-fewer beneficial owners — or 3(c)(7) — solely qualified purchaser owners.↩

3. This codifies a longstanding SEC no-action position.↩

4. The current accredited investor definition includes traditional U.S. entities such as corporations, partnerships and limited liability companies, and state and local benefit plans, ERISA plans and trusts.↩

5. For purposes of determining accredited investor status, the term "investments" would use the definition under the Investment Company Act for purposes of determining an investor's "qualified purchaser" status under the Investment Company Act. That definition focuses on assets held for investment (net of debt used for investment purposes) and also includes capital commitments, which are not included under current total asset tests.↩

6. Rule 202(a)(11)(G)-1 under the Advisers Act.↩

7. "Family clients" generally are family members, former family members and certain key employees of the family office, as well as certain of their charitable organizations, trusts and other types of entities. "Family members" include "all lineal descendants (including by adoption, stepchildren, foster children, and individuals that were a minor when another family member became a legal guardian of that individual) of a common ancestor (who may be living or deceased), and such lineal descendants' spouses or spousal equivalents; provided that the common ancestor is no more than 10 generations removed from the youngest generation of family members."↩

8. For additional information on family offices and family clients under the Advisers Act, see *Kirkland Alert*.↩

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