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SEC Adopts Updated Accredited Investor and Qualified Institutional Buyer Standards

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On August 26, 2020, the U.S. Securities and Exchange Commission (the "SEC") adopted amendments to broaden and update the categories of natural persons and entities qualifying 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 substantially in the form proposed in December 2019.[1] The amended definition of (1) accredited investor expands 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 buyer expands the types of entities eligible to participate in 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.

The amendments are not effective until 60 days following formal publication in the Federal Register, so the new categories are likely effective only for closings in early November 2020 and later.

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 amended rule adds two new non-financial categories for natural person accredited investors, including natural persons:

- holding certain professional certifications or designations or other credentials designated from time to time by order of the SEC and held in good standing[2] — the SEC has initially designated Series 7, 65 and 82 licenses[3]; and
- meeting "knowledgeable employee" status (i.e., a high-level executive or qualifying investment personnel) for a private fund[4] and investing in such private fund.

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

The SEC did not update the current accredited investor net worth or income aggregate dollar standards, but did adopt an amendment that allows 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 amendments define 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 amended rule also adds new categories of entity accredited investors, including:

- SEC- and state-registered investment advisers, as well as venture capital or mid-sized private fund exempt reporting advisers under the Investment Advisers Act of 1940 (the "Advisers Act")[5];
- 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[6];
- any form of entity not covered under the current rule[7] (e.g., Native American tribal entities, non-U.S. pension plans or sovereign wealth funds) owning "investments[8]" 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 Advisers Act) [9] 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[10]" of a "family office" qualifying as an accredited investor, whose prospective investment is directed by such family office.[11]

As expected, the amendment adding any form of entity with at least $5 million of investments to the list of accredited investors is beneficial to private funds and other issuers that have potential investors that are large sophisticated institutions that historically did not meet the technical requirements to qualify as accredited investors.

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 QIB definition.

Amendments to QIB Definition. The SEC is expanding the definition of QIB in order to avoid inconsistencies between the entity types that are eligible for

accredited investor status and QIB status. The final rules 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.[12]

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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. For information on the SEC's amendment proposal, see our prior *Kirkland Alert*.↩

2. The "good standing" requirement does not require that the individual practice in the fields related to the certification, designation or credential. However, in order to qualify under this prong of the definition, the individual may be required to pass examinations, affiliate with regulated firms and/or maintain active certifications, designations or licenses.↩

3. Concurrently with the adoption of the amended rules, the SEC issued a separate order designating Series 7, 65 and 82 licenses as qualifying natural persons for accredited investor status. These are licenses required for broker-dealer representatives or certain investment adviser representatives dealing with retail investors.↩

4. 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.↩

5. Venture capital and mid-sized private fund exempt reporting advisers were not included in the proposed rule, but were added to the final rule.↩

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

7. The historical accredited investor definition includes traditional U.S. entities such as corporations and partnerships, as well as state and local benefit plans, ERISA plans and trusts.↩

8. For purposes of determining accredited investor status, the term “investments” uses 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.↩

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

10. “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.”↩

11. For additional information on family offices and family clients under the Advisers Act, see our prior *Private Investment & Family Office Insights* newsletter.↩

12. The SEC is also adding a note to this part of the QIB definition to clarify that the entity seeking QIB status may be formed for the purpose of acquiring the 144A securities being offered. For additional information regarding QIB status, see our prior *Kirkland Alert*.↩

Authors

Scott A. Moehrke, P.C.

Partner / Chicago

Josh Westerholm, P.C.

Partner / Chicago

Christopher J. Scully

Partner / Chicago

Timothy D. Nolan

Associate / Chicago

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