

**SEPTEMBER 15, 2020**

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SEC Opens Private Capital Markets to New Investors by Expanding Accredited Investor Definition

On August 26, 2020, the Securities and Exchange Commission (SEC) adopted an expanded definition of “accredited investor” in Rule 501(a) under the Securities Act of 1933, as amended (Securities Act).

Part of an effort “to promote capital formation and expand investment opportunities while maintaining...investor protections”,¹ the move allows (i) individual investors with measurable indicators of financial sophistication to participate in exempt offerings irrespective of their net worth or income and (ii) a wider range of entities who meet minimum assets or investments tests to take part in such transactions.

Correspondingly, the amendment expands the definition of “qualified institutional buyer” (QIB) in Rule 144A under the Securities Act to include a broader class of entities which may be eligible to participate in the resale of privately placed securities under the private resale safe harbor under Rule 144A.

Set to take effect 60 days after publication in the Federal Register, the rulemaking will afford previously ineligible investors access to private capital markets.²

KEY OVERVIEW

In key part, the new rule amends the term “accredited investor” to include:

- individuals who hold certain professional certifications, designations or credentials issued by an accredited educational institution, which the SEC may designate from time to time by order. Together with the adoption of the amendment, the SEC designates holders of Series 7, Series 65 and Series 82 licenses as qualifying for accredited investor status;
- with respect to investments in a private fund, “knowledgeable employees” (as such term is defined in Rule 3c-5(a)(4) of the Investment Company Act of 1940, as amended (Investment Company Act)) of the fund;



- individuals who are “spousal equivalents”, so that such persons may pool their finances to meet the joint net worth test for qualifying as accredited investors;
- SEC- and state-registered investment advisers, limited liability companies and rural business investment companies (RBICs) with total assets in excess of \$5 million;
- any entities, including Indian tribes, governmental bodies, funds and foreign incorporated entities, not formed for the specific purpose of acquiring the securities offered, with investments (as such term is defined in Rule 2a51-1(b) under the Investment Company Act) in excess of \$5 million; and
- “family offices,” not formed for the specific purpose of acquiring the securities offered, with assets under management in excess of \$5 million and whose prospective investment is directed by an individual with sufficient knowledge and experience to evaluate its risk, and their “family clients” (as each term is defined in the Investment Advisers Act of 1940, as amended).

The amendment also moves to conform the list of investors that can qualify as a QIB to match the types of entities that can qualify as “accredited investors”, so long as they meet the threshold of \$100 million in owned and invested securities under Rule 144A.

IMPLICATIONS

Private funds will now be able to target a broader pool of investors in certain offerings. Additionally, fund sponsors may also expand employee participation in fund offerings to a potentially wider range of investment professionals than before.

Finally, on a practical note, private funds should update their subscription process and documentation to reflect the Rule amendments once effective.

Read the SEC Press Release and access the Final Rule [here](#).

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¹ Amending the “Accredited Investor” Definition, Release Nos. 33-10824; 34-89669 (Aug. 26, 2020), available at <https://www.sec.gov/rules/final/2020/33-10824.pdf>.

² As of the date of this alert, the rule has yet to be published in the Federal Register.