Leah Neumann

Of Counsel
303.295.8046
Denver
lmneumann@hollandhart.com

Amy Bowler

Partner
303.290.1086
Denver
abowler@hollandhart.com

Ryan Nichols

Partner
303.295.8298
Boulder, Denver
rlnichols@hollandhart.com

SEC Expands Pool of Eligible Private Offering Participants

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On August 26, 2020, the Securities and Exchange Commission (the "SEC") adopted amendments to update and expand the definitions of "accredited investor" and "qualified institutional buyer." As a result of the new categories of investors who qualify as accredited investors and qualified institutional buyers ("QIBs"), more investors will be eligible to participate in private capital markets. The amendments are part of the SEC's stated effort to "simplify, harmonize, and improve the exempt offering framework" to promote capital formation and expand investment opportunities, while maintaining and enhancing appropriate investor protections.

Background

Under existing SEC rules, those who qualify as accredited investors may participate in privately offered investment opportunities that are not generally available to the public and are regarded as involving greater risk than publicly registered offerings. Issuers engaged in private offerings frequently restrict investment to accredited investors in order to rely on certain exemptions from federal and state securities registration requirements. Prior to the amendments, accredited investor status for individuals was based primarily on income or net worth, rather than financial sophistication.

Investors, issuers, and regulators have previously observed that the income and net worth thresholds used to determine accredited investor status do not capture many investors who have sufficient knowledge and expertise to evaluate and invest in private offerings, without the need for protections afforded by registration. As SEC Chairman Jay Clayton noted in a statement accompanying the release, "for the first time, individuals will be permitted to participate in our private capital markets not only based on their income or net worth, but also based on established, clear measures of financial sophistication."

Accredited Investors

The amendments broaden the definition of "accredited investor" to include the following:

- **Natural Persons:**
    - **Persons Holding Certain Professional Certifications** – holders in good standing of a general securities representative license (Series 7), investment adviser representative license (Series 65), private securities

offerings representative license (Series 82) or such other certifications that demonstrate expertise in the areas of securities and investing that the SEC may designate in the future;

- **"Knowledgeable Employees" of Private Funds** – "knowledgeable employees," as defined under the Investment Company Act of 1940, as amended (the "Investment Company Act"), solely for investments in funds with respect to which they are knowledgeable employees; and
- **Spousal Equivalents** – spousal equivalents, who may pool their finances for the purpose of qualifying as accredited investors, whether or not they are purchasing securities jointly.

- **Entities:**
  - **Registered Investment Advisers** – SEC- and state-registered investment advisers and exempt reporting advisers, as each is defined under the Investment Advisers Act of 1940, as amended (the "Investment Advisers Act");
  - **Rural Business Investment Companies** – rural business investment companies ("RBICs"), as defined under the Consolidated Farm and Rural Development Act;
  - **Limited Liability Companies** – limited liability companies with $5 million in assets, not formed for the specific purpose of acquiring the securities offered (which codifies prior SEC guidance);
  - **Certain Family Offices and Family Clients** – "family offices" with at least $5 million in assets under management and their "family clients," as each is defined under the Investment Advisers Act; and
  - **Other Entities Meeting an Investments-Owned Test** – any entity, including Indian tribes, governmental bodies, funds, and entities organized under the laws of foreign countries, that owns "investments," as defined under the Investment Company Act, in excess of $5 million and that was not formed for the specific purpose of investing in the securities offered.

The amendments also codify the following SEC interpretations:

- **Calculation of Joint Net Worth without Joint Purchase Required** – The calculation of "joint net worth" for purposes of satisfying exemptions based on net worth is the aggregate net worth of an investor and the investor's spouse, or spousal equivalent, but securities being purchased by an investor relying on joint net worth need not be purchased jointly.
- **Indirect Ownership by Accredited Investors** – For purposes of determining whether an entity qualifies as an accredited investor because all of the equity owners of that entity are accredited, in instances where an equity owner of an entity is another entity that

does not itself qualify as an accredited investor, the issuer may look through such entity (or entities) to the natural persons who are the ultimate owners. If the ultimate owners of the investing entity are accredited investors, the investing entity is accredited.

Qualified Institutional Buyers

Rule 144A provides a safe harbor exemption from securities registration requirements for resales of certain restricted securities to QIBs. The SEC's amendments expand the list of entities eligible for QIB status to be consistent with the amendments to the accredited investor definition, while maintaining the requirement that such entities own and invest on a discretionary basis $100 million in securities. Provided that such entities hold investments of at least $100 million, entities that qualify as institutional accredited investors, including Indian tribes, governmental bodies, RBICs, LLCs, and other entities, will qualify as QIBs.

The amendments will become effective 60 days after publication in the Federal Register.

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