



Oct 16, 2020

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It's Time to Update Your Accredited Investor Questionnaires

The Securities and Exchange Commission (SEC) adopted final amendments to the definition of “accredited investor” on August 26, 2020, significantly altering the definition for the first time since the 1980s. Qualifying as an accredited investor is in many ways a threshold qualification for participation in the private capital markets through investment in hedge funds, private equity funds, and, notably, all securities offerings conducted pursuant to Rules 506(b) and 506(c) of Regulation D under the Securities Act of 1933. Many state registration exemptions utilize the accredited investor standard as well. Pursuant to the final amendments, clearly defined categories of individuals and entities will now qualify as accredited investors under this expanded definition.

The SEC simultaneously adopted amendments to the definition of “qualified institutional buyer” (QIB) under Rule 144A. This amendment similarly expands the list of entities that qualify as QIBs, and, thereby, expands the potential participants in Rule 144A offerings, which, generally, involve the resale of securities to QIBs.¹

The final amendments to the accredited investor definition include the following significant changes:

- Certain knowledgeable employees of a private fund, as defined in Rule 3c-5(a)(4) under the Investment Company Act of 1940, qualify as accredited investors with respect to investment in that private fund. These employees are not required to meet the other income requirements under the accredited investor definition but must have participated in the private fund’s investment activities as part of their regular duties for at least 12 months. Such private funds will not lose accredited investor status by allowing such knowledgeable employees to invest.
- Any natural persons who currently hold one or more valid professional certifications, designations or other credentials

that have been designated by the SEC will qualify as accredited investors. To qualify, individuals holding such designated certifications must demonstrate that they have passed the required examinations and the certifications are active. Currently, the SEC has designated Series 7, Series 82, and Series 65 as qualifying credentials, and additional qualifying professional certifications, designations and credentials may be designated by the SEC in the future.

- Certain “family offices” with at least \$5 million in assets under management qualify as accredited investors, provided that any such family office is not formed for the specific purpose of acquiring the offered securities, and that the purchase of the securities is directed by a person who has knowledge and experience in financial and business matters such that the family office is capable of evaluating the merits and risks of the prospective investment. As a related change, family clients of such family offices, including family members, key employees and certain other entities, e.g., trusts, would also be accredited investors if they have at least \$5 million in assets under management, are not formed for the specific purpose of acquiring the offered securities and the purchase of the securities is directed by a qualified family office.
- Rural business investment companies, which are defined under the Consolidated Farm and Rural Development Act as a company that is approved by the Secretary of Agriculture and that has entered into a participation agreement with the Secretary, qualify as accredited investors, provided that they meet the other requirements for all entities, which include (1) having total assets in excess of \$5 million and (2) that such entity is not formed for the specific purpose of acquiring the securities being offered.
- All investment advisers either registered with the SEC, registered with a state, or exempt from registration under the Investment Advisers Act as exempt reporting advisers qualify as accredited investors.
- A “catch-all” is included, and any entity that (a) owns investments in excess of \$5 million (b) is not formed for the

specific purpose of acquiring the securities and (c) otherwise is not covered by the current accredited investor definition now qualifies as an accredited investor.

The amendment also codifies certain SEC interpretations:

- Individuals can include joint income from “spousal equivalents” when calculating the joint income thresholds. “Spousal equivalent” is defined as “a cohabitant occupying a relationship generally equivalent to that of a spouse.”
- Securities purchased based on the joint net worth test may be purchased by an individual investor, and such securities are not required to be purchased jointly with the spouse or the “spousal equivalent.”
- Although not previously included in the list of entities that qualify for investor status if they have total assets in excess of \$5 million and were not formed for the specific purpose of acquiring the securities being offered, limited liability companies continue to qualify as accredited investors, provided that they meet the other requirements of Rule 501(a)(3).

The final changes expand the definition of “qualified institutional buyer” to include limited liability companies and rural business investment companies, provided that such entities meet the threshold of at least \$100 million in securities owned and invested. The amendment also adds a “catch-all” category, whereby institutional investors that meet the definition of accredited investor in Rule 501(a) qualify as qualified institutional buyers, provided they satisfy the \$100 million threshold.

The final rule becomes effective on December 8, 2020. Issuers conducting securities offerings that rely on a registration exemption utilizing the accredited investor or qualified institutional buyer standards should update their accredited investor questionnaires, offering memoranda, subscription agreements and other relevant documentation no later than the effective date of the final rule.

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[1] Section 4(a)(7) of the Securities Act of 1933 also exempts certain resales of securities to accredited investors.

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