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[SEC Proposes Amendments To Reflect Dodd-Frank's Definition Of "Accredited Investor"](#)

On January 25, 2011, the SEC proposed new amendments to conform the definition of “accredited investor” under Rule 215 of the Securities Act of 1933 and Rule 501 of Regulation D to requirements imposed by Congress under the [Dodd-Frank Wall Street Reform and Consumer Protection Act](#) (“Dodd-Frank”). Various exemptions for private or other limited offerings of securities under the Securities Act of 1933 and state “blue sky” laws depend on whether participants are “accredited investors.” Non-accredited investors who participate in private offerings under Rule 505 or Rule 506 of Regulation D must receive financial and other information that is not required to be given to accredited investors.

Dodd-Frank required that the “net worth” test for natural persons exclude the value of the person’s primary residence, without specifying how such value would be calculated. Under the SEC’s proposals, a person’s net worth would exclude “the value of the primary residence” calculated by subtracting from the estimated fair market value of the property the amount of debt secured by the property, up to the estimated fair market value of the property. The SEC’s proposed rule change is substantially similar to the Staff guidance published shortly after the enactment of Dodd-Frank.

Background

As we previously commented (see our blogs [“Legal Update: Dodd-Frank Redefines “Accredited Investor”](#)“ from July 23, 2010 and [“Legal Update: Dodd-Frank Redefines “Accredited Investor” and the SEC Provides New Guidance”](#) from September 3, 2010), prior to the enactment of Dodd-Frank, the definition of an “accredited investor” under Rule 215 of the Securities Act of 1933 and Rule 501 of Regulation D included a natural person with a net worth of at least \$1 million, either individually or jointly with the investor’s spouse, and the value of such investor’s primary residence was included in the calculation of his or her net worth for purposes of determining “accredited investor” status. Section 413(a) of Dodd-Frank amended the definition of “accredited investor” to exclude the value of an investor’s primary residence from the \$1 million net worth calculation. The amendment was effective immediately.

Section 413(a) of Dodd-Frank does not define the term “value,” and it does not address the treatment of mortgage and other indebtedness secured by the person’s primary residence for purposes of the net worth calculation. In response to this lack of clarity and because Dodd-Frank’s amendment became effective immediately, the SEC released guidance regarding the definition of the term “value” in the form of Division of Corporation Finance, Compliance and Disclosure Interpretations, Q. 179.01 on July 23, 2010. Pursuant to this SEC guidance, pending implementation of SEC rule changes mandated by Dodd-Frank, the amount of indebtedness secured by the primary residence up to its fair market value was permitted to be excluded together with the value of the person’s primary residence. The guidance also stated that where the indebtedness secured by the residence exceeds the value of the home, the excess should be considered a liability and deducted from the investor’s net worth.

What changes now?

Nothing yet.

On January 25, 2011, the SEC proposed the awaited amendments which would conform the definition of “accredited investor” in SEC rules to the definition as amended by Dodd-Frank. In addition to adopting Dodd-Frank’s definition, the SEC’s proposed amendments codify its earlier guidance on the treatment of indebtedness secured by the residence in the net worth calculation. The amendments, as proposed, provide that the value of the primary residence is determined by subtracting from the estimated fair market value of the property the amount of debt secured by the property, up to the estimated fair market value of the property. As such, for the purposes of determining whether an investor is accredited, net worth will be reduced by the amount of value that the primary residence would have contributed to net worth if the residence were not required to be excluded.

The Commission is seeking public comments on the proposed rules through March 11, 2011.

What could change?

The SEC has requested comments on several issues, including whether it would be more appropriate to exclude the entire fair market value of the residence from net worth, without netting out any associated debt. If the rules were to exclude the entire fair market value of the residence from net worth, without netting out any associated debt, the level of wealth, other than home equity, required to be an “accredited investor” would, in many cases, be significantly increased beyond the already heightened requirements of Dodd-Frank.

What should you do now?

Issuers and agents should make the appropriate adjustments to their subscription documents and investor questionnaires if they have not already done so, as suggested in our prior posting on this subject.

What if you have questions?

For any questions or more information on these or any related matters, please contact any attorney in the firm’s [corporate practice group](#).

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