

Congress Changes the "Accredited Investor" Calculation - Effective Immediately

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[Shane B. Hansen](#)

Broker-dealers handling private offerings on behalf of securities issuers need to know that **the calculation of an accredited investor's net worth was materially changed by Congress, effective immediately**, with no transition period. A natural person may no longer include the value of his or her primary residence in the \$1 million net worth test. The change was made in Section 413 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law by President Obama today, July 21, 2010.

The SEC staff's position is that the exclusion of a primary residence from an investor's net worth is effective upon enactment of the law – today. Securities issuers relying on the definition of "accredited investor" in SEC Rule 501(a)(5) of Regulation D or SEC Rule 215 under the Securities Act of 1933 should consider immediately revising their disclosure and subscription documents before proceeding with the offering. Broker-dealers handling these private distributions should re-examine subscriptions in offerings that have not yet closed to determine whether each investor still meets the accredited investor definition without counting the current fair market value of their residence.

Informally, the SEC staff has indicated their belief that the amount of any mortgage or other indebtedness secured by an investor's primary residence may be netted against the current fair market value of the residence. Indebtedness secured by the primary residence does not need to be deducted from an investor's net worth unless the outstanding debt exceeds the value of the residence and the investor is personally liable to the lender for any deficiency. If, however, the investor's mortgage is "underwater," then the excess liability must be deducted from the investor's net worth.

The other provisions of the accredited investor definition, including the net income test for natural persons, remain unchanged for now. In the new law, Congress directed the SEC to review the accredited investor definition and make appropriate adjustments, though it may not raise the \$1 million net worth threshold for the next four years. Further, the U.S. Comptroller General must conduct a study to assess the financial thresholds and other criteria used to qualify for accredited investor status and eligibility to invest in private funds. The report to Congress must be made within three years from today.

If you have questions or need assist to deal with this change, please do not hesitate to contact a member of our BD-IA team.