

Corporate & Financial Weekly Digest

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SEC Proposes Rules to Amend Net Worth Standard for Accredited Investor Definition

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On January 25, the Securities and Exchange Commission proposed rules amending the accredited investor standards under the Securities Act of 1933 to reflect the requirements of Section 413(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The proposed rules would amend Rules 215 and Rule 501(a)(5) of the Securities Act to exclude the value of a person's primary residence from the \$1 million net worth (or joint net worth) test for determining whether a person is an "accredited investor" under Regulation D. The proposed rules would also amend Rules 215 and Rule 501(a)(5) to clarify that net worth is calculated by excluding only the investor's net equity in its primary residence by adding the phrase "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." While this clarification (as well as the technical and conforming amendments referenced below) supplements Section 413(a) of the Dodd-Frank Act, the exclusion itself was effective upon enactment of the Dodd-Frank Act.

Under the proposed rules, an investor who loses his or her "accredited" status as a result of the new net worth standard would not be allowed to make a subsequent investment in a company or a fund that the investor had previously invested in through a prior Regulation D offering. At the January 25 SEC Open Meeting, Commissioner Troy Paredes, while supporting the proposed amendments to the accredited investor standards, noted that an investor could be disadvantaged by the change in status, as an investor's economic interest could be diluted if he or she cannot participate in a subsequent round of financing, or an investor could be frustrated in exercising certain contractual rights that he or she enjoys as an existing investor. Commissioner Paredes also stated that issuers could be disadvantaged by a change in an investor's accredited status, as it could be more difficult or costly for a company or fund to raise capital if certain current investors cannot invest in future offerings. Commissioner Paredes stated that he hoped commentators would address whether the SEC should "grandfather" an investor's accredited status for the focused purpose of allowing an investor who does not satisfy the new net worth standard to make follow-on investments in a company or a fund in which the investor is already invested.

The proposed rules also make certain technical and conforming amendments to Rule 501(e)(1)(i) of the Securities Act to revise the reference of "principal residence" to "primary residence" and

to revise the references to former Section 4(6) of the Securities Act to Section 4(5) in Rules 144(a)(3)(viii), 155(a) and 500(a)(1) of the Securities Act, Rule 17j-1(a)(8) of the Investment Company Act of 1940 and Rule 204A-1(e)(7) of the Investment Advisers Act of 1940. Section 944 of the Dodd-Frank Act deleted the former Section 4(5) of the Securities Act and renumbered the former Section 4(6) of the Securities Act as Section 4(5).

Comments should be received on or before March 11.

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