

**DODD-FRANK ACT MODIFIES “ACCREDITED INVESTOR” DEFINITION AND CREATES  
ADDITIONAL BAD BOY DISQUALIFICATION FOR REGULATION D OFFERINGS**

**July 28, 2010**

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act”)<sup>1</sup>, signed into law last week, will impact not only financial institutions and public companies generally<sup>2</sup>, but also companies seeking to privately sell securities under the exemptions from registration found in Regulation D, adopted under the Securities Act of 1933, as amended (the “Securities Act”). In particular, the Act modifies the definition of “accredited investor” in a manner that may make it more difficult for individuals to qualify as accredited investors and requires the Securities and Exchange Commission (the “SEC”) to adopt rules restricting certain “bad actors” from selling securities under Regulation D.

The changes to the “accredited investor” definition are effective immediately, so public and private companies raising -- or planning to raise -- capital in Regulation D offerings should immediately (i) revise their subscription and disclosure documents and (ii) take appropriate additional steps to ensure that any individual investors purchasing securities based on an exemption that relies on accredited investor status meet the revised standards, since failure to comply with the new requirement could result in the loss of the company’s registration exemption. The remainder of this client alert summarizes these two changes to Regulation D offerings.

**Accredited Investor**

Offerings to accredited investors are provided special treatment under Regulation D, which provides safe harbor exemptions from registration under the Securities Act designed to enable companies to conduct private placements and other limited offerings of securities without registration with the SEC. Companies making offers to accredited investors are subject to less stringent requirements regarding the number of purchasers and required disclosures under certain Regulation D exemptions.

Accredited investors include natural persons with individual (or joint, with the person’s spouse) net worth in excess of \$1,000,000.<sup>3</sup> In the past, the SEC Staff has indicated that the fair market value of an

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<sup>1</sup> The final version of the Act can be found at: <http://www.gpo.gov/fdsys/pkg/BILLS-111hr4173ENR/pdf/BILLS-111hr4173ENR.pdf>. See Title IV, Section 413 for the changes to the definition of “accredited investor” and Title IX, Subtitle B, Section 926 for the disqualification requirement.

<sup>2</sup> See our client alert regarding the Act’s corporate governance and executive compensation provisions at: <http://www.wcsr.com/resources/pdfs/cs072210.pdf>.

<sup>3</sup> The term “accredited investor” is defined in Rule 501(a) under Regulation D, and may be found at: <http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=20c66c74f60c4bb8392bcf9ad6fcea3&rgn=div5&view=text&node=17:2.0.1.1.12&idno=17#17:2.0.1.1.12.0.43.174>. A natural person may also be treated as an accredited investor if he had individual income in

investor's primary residence could be included in net worth.<sup>4</sup> However, the Act may make it more difficult for individuals to qualify as accredited investors since it requires the SEC to adjust any definition of "accredited investor" to exclude the value of the primary residence of an investor from the calculation of net worth.

In response to the Act, on July 23, 2010, the SEC published new staff guidance (C&DI 179.01 and identical C&DI 255.47), clarifying that the value of an individual's primary residence must be excluded when determining net worth for accredited investor purposes. In addition, the Staff indicated that, pending future SEC rulemaking, the related amount of any mortgage or other indebtedness secured by an investor's primary residence also may be excluded up to the residence's fair market value. Any indebtedness secured by the residence in excess of the home's value should be considered a liability and deducted from the investor's net worth.<sup>5</sup>

The Act also permits the SEC to undertake a review of the definition of "accredited investor" as it relates to individuals and make changes "for the protection of investors, in the public interest, and in light of the economy" (other than to the new requirement to exclude the value of a primary residence). The Act also requires the SEC to undertake a review every four years of the definition to determine whether it should be modified on the same grounds.

### **Bad Boy Provisions**

The Act also requires the SEC to issue rules within the next year disqualifying certain "bad actors" from reliance on the Rule 506 safe harbor exemption under Regulation D.<sup>6</sup> The SEC rules must disqualify offerings or sales of securities by any issuer if the issuer (or certain affiliates) have been the subject of certain proceedings under federal and state laws, including proceedings that bar the person from engaging in certain securities, insurance, banking, savings association or credit union activities and certain proceedings involving fraudulent conduct.

### **Contact Information**

We will continue to monitor SEC rulemaking in this area and the Act's impact on private and public company corporate and securities matters in general. If you have any questions regarding the effect of the Act on Regulation D offerings, please contact Shandra N. Stout (<http://www.wcsr.com/ShandraStout>), the principal drafter of this client alert, or you may contact the Womble Carlyle attorney with whom you usually work or one of our Corporate and Securities attorneys at the following link: <http://www.wcsr.com/profSearch?team=corporateandsecurities>.

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excess of \$200,000 (or joint income with his spouse in excess of \$300,000) in each of the two most recent years and has a reasonable expectation of reaching the same income level in the current year. This income test was not changed as a result of the Act.

<sup>4</sup> Former SEC Staff Compliance and Disclosure Interpretation ("C&DI") 255.13 was withdrawn on Thursday, July 22, 2010.

<sup>5</sup> New C&DI 179.01 and C&DI 255.47 may be found at: <http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm>.

<sup>6</sup> Rule 506 of Regulation D exempts offers of an unlimited dollar amount as long as offers are made to an unlimited number of accredited investors and no more than 35 additional (unaccredited) investors and the other requirements of the rule are met.

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