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SEC PROPOSES RULE TO AMEND “ACCREDITED INVESTOR” DEFINITION TO CONFORM WITH DODD-FRANK ACT

February 3, 2011

Last week, the Securities and Exchange Commission (the “SEC”) proposed a rule to amend the definition of “accredited investor” under the Securities Act of 1933, as amended (the “Securities Act”), to exclude the value of a person’s primary residence from their net worth for purposes of determining whether the person is an “accredited investor” under the Securities Act rules applicable to private and other limited offerings.¹ To the extent companies have not already done so, public and private companies raising -- or planning to raise -- capital in Regulation D or other limited offerings should (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.

This proposed rule reflects a requirement that became effective last summer in connection with enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “DFA”) and is intended only to reflect the new standard, clarify how it is to be applied and make certain technical corrections. The SEC is seeking comment on the proposed rule through March 11, 2011.

The proposed rule would codify the DFA requirement that the value of a person’s primary residence be excluded for purposes of determining whether the person qualifies as an accredited investor. The proposed rule also would provide that the value of the primary residence of an individual is 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. This calculation to exclude only an individual’s net equity from the determination of net worth is consistent with staff guidance released after the DFA became effective.²

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. The rule proposals also affect offerings under Section 4(5) of the Securities Act (formerly Section 4(6)), which provides an exemption from registration for certain limited offerings to accredited investors if there is no advertising or public solicitation

¹ Net Worth Standard for Accredited Investors, SEC Release No. 33-9177 (January 25, 2011), available at: <http://www.sec.gov/rules/proposed/2011/33-9177.pdf>. Our earlier client alert on the DFA “accredited investor” requirement may be found at: <http://www.wcsr.com/resources/pdfs/cs072810.pdf>.

² SEC Staff Compliance and Disclosure Interpretation (“C&DI”) 179.01 and C&DI 255.47 may be found at: <http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm>.

by the issuer. Accredited investors include natural persons with individual (or joint, with the person's spouse) net worth in excess of \$1,000,000.³ Under the previous standard, individuals qualified as accredited investors if they had a net worth of more than \$1,000,000, including the value of the primary residence.

The DFA requires that the revised net worth standard remain in place until July 21, 2014, four years after enactment of the DFA. Beginning in 2014 and every four years thereafter, the SEC will be required to review the definition of "accredited investor" and make appropriate changes.

Contact Information

We will continue to monitor SEC rulemaking concerning the "accredited investor" standard. If you have any questions regarding the proposed rule, 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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³ 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=20c66c74f60c4bb8392bcf9ad6fccea3&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 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.