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[Legal Update: Dodd-Frank Redefines "Accredited Investor"](#)

Background

Prior to the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law by President Obama on July 21, 2010, 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.

What changes now?

Section 413(a) of the act amends the definition of "accredited investor" to exclude the value of an investor's primary residence from the \$1 million net worth calculation. The other provisions of the "accredited investor" definition, including the net income test for natural persons, remain unchanged.

What could change next?

During the first four years following enactment of the act, the Securities and Exchange Commission is authorized to further revise the definition of "accredited investor" as such term applies to natural persons but may not adjust the \$1,000,000 net worth threshold. Effective four years after enactment, the SEC's definition must change to increase the net worth threshold to an amount greater than \$1,000,000. Congress does not specify what the amount should be. Thereafter, the SEC must review the definition of "accredited investor" as such term applies to natural persons at least once every four years. Upon completion of each such review, the SEC is authorized to make such adjustments to the definition as it deems appropriate for the protection of investors, in the public interest, and in light of the economy, including the adjustment of the minimum net worth for natural persons in its discretion. It appears that the net worth amount must remain in excess of \$1 million following any such adjustment.

Additionally, the Comptroller General of the United States must conduct a study on the appropriate criteria for determining the financial thresholds or other criteria needed to qualify for "accredited investor" status and eligibility to invest in private funds and must report the results of such study not later than three years after the enactment of the act. Congress is not required to take any action in response to such study, but Congress might pass additional legislation

in response to the study further amending the definition of the “accredited investor,” and could do so prior to the SEC adopting any regulations responsive to Section 413(a).

What should you do now?

Be aware that the act's modification of the "accredited investor" definition will render some individuals and entities who formerly were eligible to invest in private entities ineligible to invest in them going forward. The actual impact may be attenuated because of the significant decline in residential real estate values over the past three years, which had already reduced the ability of individual investors to meet the net worth standard through equity in their primary residences.

Entities affected by this change include those that avail themselves of Rule 215(h) promulgated under the Securities Act of 1933, which provides that an entity is an "accredited investor" if all of its equity owners are themselves accredited in their own right.

Issuers relying on the former definition of "accredited investor" in connection with ongoing private offerings that could possibly be affected by the change should revise disclosure and investment documents to reflect the act's alteration of the net worth test. Particular attention should be given to current shareholders who may no longer be eligible to make additional purchases under the applicable exemption from the registration requirements of the Securities Act of 1933 due to the change in the "accredited investor" definition. To the extent investor materials have already been received from investors in potentially affected ongoing private offerings, issuers should consider obtaining updated accredited investor representations to ensure the continued availability of the applicable exemption.

When is the new law effective?

The alteration to the definition of "accredited investor" pursuant to the act is effective now.

What if you have questions?

For any questions or more information on these or any related matters, please contact [Louis Lehot](#), [John Tishler](#), [Camille Formosa](#) or any attorney in the firm's corporate practice group.

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