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SECURITIES ALERT
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SEC Adopts Amendments to the Definition of an Accredited Investor

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On December 21, 2011, the Securities and Exchange Commission ("SEC") adopted amendments to the "accredited investor" definitions in Regulation D and Rule 215 under the Securities Act of 1933 (the "1933 Act") to exclude the value of a person's primary residence from the net worth calculation and clarify the treatment of borrowing secured by a primary residence for purposes of the net worth calculation.

Regulation D is a private placement safe harbor adopted by the SEC, which is commonly used by issuers of securities to avoid the registration requirements under the 1933 Act. From a regulatory perspective, Regulation D provides small to mid-market businesses one of the most efficient means by which to raise equity capital. Under Rule 506 of Regulation D, an issuer of securities in a private placement may sell its securities to an unlimited number of "accredited investors," with no prescribed information disclosure requirements (other than what may apply under the anti-fraud provisions of the federal securities laws), and straightforward, relatively inexpensive state blue sky law compliance through notice filing thanks to federal preemption.

Among other tests, an individual investor's net worth, or joint net worth with that person's spouse, needs to exceed $1 million for that investor to qualify as an "accredited investor." The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") requires that the value of a person's primary residence be excluded from the net worth calculation used to determine the person's "accredited investor" status. In addition, the Dodd-Frank Act also required the SEC to revise its 1933 Act rules to reflect the new standard. The amended rules are the result of such requirement.

Under the amended rules, the value of an individual's primary residence will not count as an asset when calculating net worth to determine "accredited investor" status. The amendments also clarify the treatment of borrowing secured by a primary residence for purposes of the net worth calculation. In addition, the amendments permit individuals who qualified as accredited investors under the pre-Dodd-Frank Act definitions of net worth to continue to use that prior net worth standard for certain statutory or contractually required follow-on investments.

Under the amended net worth calculation, indebtedness secured by the person's primary residence, up to the estimated fair market value of the primary residence, is not treated as a liability, unless the borrowing occurs in the 60 days preceding the purchase of securities in the private placement and is not in connection with the acquisition of the primary residence. In such cases, the debt secured by the primary residence must be treated as a liability in the net worth calculation. This is intended to prevent manipulation of the net worth standard, by eliminating the ability of individuals to artificially inflate net worth under the new definitions by borrowing against home equity shortly before participating in a private placement. In addition, any indebtedness se-

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cured by a person's primary residence in excess of the property's estimated fair market value is treated as a liability under the new definitions.

The Dodd-Frank Act provides that the SEC may not modify the net worth requirement during the four years following the enactment of the Dodd-Frank Act. However, once this four-year period has passed, the SEC is required to review, at least once every four years, the accredited investor definition as it applies to individuals, including both the net worth and income tests, and make adjustments to the accredited investor definition as the SEC deems appropriate.

The amended net worth standard will take effect 60 days after publication in the Federal Register.

In light of the above, companies in discussions with potential investors about private offerings will need to confirm that such investors qualify as "accredited" under the new net worth standard or under one of the other standards, such as the income tests, which remain unchanged. ◆

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