ALERTS AND UPDATES

SEC Amends Accredited Investor Net Worth Standards per Dodd-Frank

December 28, 2011

The accredited investor standard has been revised to exclude the equity value of the investor's primary residence from the $1 million net worth threshold for individuals.[1] The Amendments will be effective 60 days after publication in the *Federal Register*.[2]

The Amendments provide that a person's primary residence may not be included as an asset in calculating that person's net worth. Likewise, debt secured by an investor's primary residence is not included as a liability in the net worth calculation.[3] Nevertheless, indebtedness secured by a primary residence that exceeds the estimated fair market value of the primary residence (that is, when the primary residence is underwater) will be included as a liability in the net worth calculation.

The Amendments[4] set the same standard under both Rule 501(a)(5) of Regulation D and Rule 215(e) under the Securities Act for individuals to qualify as accredited investors on the basis of net worth.[5] Depending on an individual's personal situation, these Amendments may make it easier or more difficult to garner accredited investor status for a particular private placement.

To prevent investors from artificially inflating their net worth by increasing cash or other assets by securing additional debt on their primary residence, the SEC added a 60-day look-back provision. Under this provision, any increase in the amount of debt secured by a primary residence in the 60 days prior to the sale of securities will be included as a liability, even if the estimated fair market value of the primary residence exceeds the amount of debt secured by the primary residence.[6]

Recognizing that applying the new accreditation standards to investors who had a preexisting relationship with a specific issuer could present an unnecessary hardship, the SEC included a "grandfathering" provision in the new rules. If, as of July 10, 2010, an investor (i) had a right to purchase securities in the issuer, (ii) qualified as an accredited investor on the basis of net worth at the time the person acquired such right, and (iii) held securities of the same issuer, other than such a right, the new accreditation standards will not apply to the investor.

About Duane Morris

Duane Morris has an online **Financial Services Reform Center**—www.duanemorris.com/FinancialReform—which includes the firm's comprehensive series of Alerts analyzing the provisions of the Dodd-Frank Act and emerging policies, as well as videos and links to relevant government websites. Duane Morris' attorneys are monitoring the rules and regulations released under the Dodd-Frank Act, as well as the regulatory agencies' interpretive guidance, and continuously update the Financial Services Reform Center.

For Further Information

If you have any questions regarding the Regulations discussed above, please contact Laurence Lese, Richard Silfen, Robert Bramnik, David Kaufman, Joel Ephross, Michael Schwamm, Maria Granholm, Joseph Machi, any member of the Securities

Law Practice Group, any member of the Broker-Dealer and Securities Regulation Practice Group or the lawyer with whom you are regularly in contact.

Notes

1. The amendments ("Amendments") were adopted on December 21, 2011, by the U.S. Securities and Exchange Commission (the "SEC") under the Securities Act of 1933 (the "Securities Act"). The Amendments reflect the requirements of Section 413(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Section 413(a) changed the net worth standard for accredited investors and required the SEC to revise the Securities Act rules to conform to the new standard. *See* SEC Release No. 33-9287, *available at* http://www.sec.gov/rules/final/2011/33-9287.pdf.
2. The change to the net worth standard became effective upon enactment of the Dodd-Frank Act. The Dodd-Frank Act requires the SEC to review the definition of "accredited investor" every four years, beginning four years after enactment of the Dodd-Frank Act.
3. The SEC states that net worth will be calculated only once, at the time of the sale of securities. As a result, consideration should be given as to the timing of the investor questionnaire, and, if there is a delay between the execution of the questionnaire and closing, whether the representations that are made in the questionnaire will still be valid at closing.
4. Under the new net worth standard, an accredited investor is "[a]ny person whose individual net worth, or joint net worth with that person's spouse, exceeds $1,000,000," calculated by:
    - excluding the value of the person’s primary residence as an asset;
    - excluding the indebtedness secured by the person's primary residence, up to the fair market value of the primary residence at the time of the sale of securities, as a liability (except that if the amount of such indebtedness outstanding at the time of the sale of securities exceeds the amount outstanding 60 days before such time, other than as a result of the acquisition of the primary residence, the amount of such excess shall be included as a liability); and
    - including the indebtedness secured by the person's primary residence in excess of the estimated fair market value of the primary residence at the time of the sale of securities.
5. The accredited investor standards, which are set forth in Rules 215 and 501 under the Securities Act, are used in determining the availability of certain exemptions from Securities Act registration for private and other limited offerings. Section 4(5) of the Securities Act exempts from registration transactions involving offers or sales by an issuer solely to one or more accredited investors, if the aggregate offering price does not exceed $5 million, there is no advertising or public solicitation in connection with the transaction, and the issuer files a notice with the SEC.
6. The SEC indicates, however, that it does not intend the 60-day look-back provision to address debt secured by a primary residence that is incurred in connection with the acquisition of a primary residence within the 60-day period.