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SEC Adopts Amendments to Net Worth Standards for Accredited Investors

Introduction

On December 21, 2011 the United States Securities and Exchange Commission (“SEC”) adopted amendments to the accredited investor standards set forth in the rules under the Securities Act of 1933, as amended (the “Securities Act”). The amendments, which were required by Section 413(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”), modify the definition of “accredited investor” under the Securities Act to exclude the value of a person’s primary residence for purposes of determining whether the person qualifies as an “accredited investor” on the basis of having a net worth in excess of US\$1 million. The amendments become effective on February 27, 2012.¹

Overview of Amended Rules

Issuers that sell securities in the United States often take advantage of the safe harbor provided by Rule 506 of Regulation D under the Securities Act by selling to “accredited investors”. The definition of “accredited investor” includes persons who come within any of eight listed categories.² The US\$1 million individual net worth standard is one such category.

Previously, the US\$1 million individual net worth standard permitted the person’s primary residence to be included in the calculation of net worth. Under the new rules, the person’s primary residence can no longer be included as an asset for the purposes of such calculation.

Treatment of Mortgage Debt

Under the new rules, indebtedness that is secured by the person’s primary residence, up to the estimated fair market value of the primary residence, is not generally included as a liability when calculating net worth.

However, any excess of indebtedness secured by the primary residence over the estimated fair market value of the residence is considered a liability for purposes of calculating net worth (whether or not the lender can seek repayment from other assets in default). Furthermore, incremental debt secured by the primary residence that is incurred in the 60 days before the sale of securities will also be included as a liability, even if the estimated value of the primary residence exceeds the aggregate amount of debt secured by such primary residence.

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¹ Though these specific Securities Act rule amendments become effective on February 27, 2012, the change to the net worth standard became effective upon enactment of Section 413(a) of Dodd-Frank.

² See Rules 501 and 215 of the Securities Act.

Grandfathering Provision

The final rules contain a provision under which the former accredited net worth test will apply to purchases of securities in accordance with a right to purchase such securities so long as (i) the right was held by a person on July 20, 2010 (the day before the enactment of Dodd-Frank), (ii) the person qualified as an accredited investor on the basis of net worth at the time the right was acquired; and (iii) the person held securities of the same issuer, other than the right, on July 20, 2010.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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