

SECURITIES INDUSTRY PRACTICE

ALERT

NEW PROPOSED ACCREDITED INVESTOR STANDARD FOR THE SEC

On January 25, 2011, the Securities and Exchange Commission (SEC) submitted proposed amendments to the Accredited Investor standard as a result of Section 413(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). A copy of the complete proposed amendment proposal may be found at <http://www.sec.gov/rules/proposed/2011/33-9177.pdf>. If adopted, these proposed amendments would have a significant impact on who would be considered an Accredited Investor and able to participate in certain private placements.

By way of background, for eligibility to participate in certain private placements, an investor must meet the criteria set forth in the Accredited Investor standard found in the Securities Act of 1933 Regulation D Rule 501. If the investor does not meet this specific criteria based on the investor's (and his or her spouse, if any) net worth, then he or she may not participate in the private placement.

This alert will explain the current standard for the dollar threshold amount of the SEC's Accredited Investor standard, differentiate the new standard described in the SEC's proposed amendments and examine the significance of these proposed amendments if adopted.

Current Standard for Dollar Threshold

Rule 501 defines an Accredited Investor as "any natural person whose individual net worth, or joint net worth with that person's spouse, at the time of his purchase exceeds \$1,000,000," otherwise known as the

Net Worth Test. To determine if an investor qualifies as an Accredited Investor, his or her total liabilities are subtracted by the total assets to calculate the person's net worth. If the net worth is greater than \$1 million, the person qualifies as an Accredited Investor under Rule 501 and may participate in certain private placements.

New Proposed Standard for Dollar Threshold

Section 413(a) of the Dodd-Frank Act requires the SEC's rules pertaining to the net worth standards for Accredited Investors be adjusted to remove the value of the primary residence of a person for purposes of calculating the Net Worth Test. Specifically, the Dodd-Frank Act requires the SEC to adjust the net worth standards that apply to a natural person individually, or jointly with his or her spouse, to "more than \$1,000,000 ... excluding the value of the primary residence of such natural person." This means that when determining a person's net worth, the net value of the person's primary residence must be excluded from the calculation. Under the current Accredited Investor standard, the Net Worth Test would consider that if a person's home had a market value of \$500,000 and a mortgage of \$200,000, then the person could include \$300,000 toward the calculation of the Net Worth Test. The proposed standard would exclude this \$300,000 in the net worth calculation.

Significance of New Proposed Standard

The change in standard is important to small corporations and funds that rely on Accredited Investors to raise capital as well as to current and potential

Accredited Investors. According to footnote 31 in the SEC's proposed amendments, the SEC used data from the 2007 Federal Reserve Board Survey of Consumer Finances (the latest date available) to calculate that approximately 9.04 percent of U.S. households would qualify for Accredited Investor status on the basis of the net worth standard before it was modified by Section

413(a) of the Dodd-Frank Act. Following the adoption of the SEC's proposed amendments, the SEC calculated that approximately only 6.55 percent of U.S. households would qualify. This is a reduction of 28 percent of the U.S. households eligible to participate in these private placements.

At Fox Rothschild, we remain ready to assist you in assessing the impact of the SEC's proposed rule on your business. If you have any questions regarding the information in this alert, please contact:

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