Dodd-Frank Act Changes Definition of Accredited Investor for Private Placements of Securities

The passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") into law on July 21, 2010, changes the test for determining a natural person's accredited investor status for private placements of securities under Section 501(a)(5) of Regulation D of the Securities Act of 1933. Effective July 21, 2010, a natural person qualifies as an "accredited investor" under Section 501(a)(5) of the Regulation D if such person's individual net worth, or joint net worth with that person's spouse, at the time of his purchase exceeds $1,000,000, but only if the net worth threshold can be met without including the value of the person's primary residence. Previously, the value of the investor's primary residence was included in the investor's net worth calculation.

The SEC has indicated that in applying the $1,000,000 net worth test, it will allow investors to exclude any mortgage and other debt secured by the investor's primary residence if the amount of such debt is less than the fair market value of the residence. If the amount of any mortgage or debt secured by a primary residence exceeds the fair market value of the residence and the lender has recourse to the investor personally for the excess, then such excess amount shall be deducted from the investor's net worth.

The Dodd-Frank Act does not require any other immediate changes Section 501 of Regulation D and, accordingly, a natural person continues to qualify as an "accredited investor" under:

- Section 501(a)(4) if such person is a director, executive officer or general partner of the issuer or a director, executive officer or general partner of the general partner of the issuer; or

- Section 501(a)(6) if such person had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year.

There is no transition period nor grandfathering provision for this change so issuers in the process of conducting a private placement relying on the definition of "accredited investor" in Regulation D, should revise their disclosure and subscription documents and reassess the accredited investor status of investors under the amended net worth test.

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