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SEC ADOPTS FINAL RULE ON NET WORTH STANDARD IN ACCREDITED INVESTOR DEFINITION

On December 21, 2011, the SEC adopted a final rule ("Final Rule") to amend the net worth standard in the definition of "accredited investor" under the Securities Act of 1933 to conform the definition to the requirements of Section 413(a) of the 2010 Dodd-Frank Wall Street Reform and Consumer Act. Since July 21, 2010, Dodd-Frank has required that a person's primary residence be excluded when calculating whether the \$1 million net worth standard has been met. The Final Rule formally revises the SEC's accredited investor definition and clarifies how debt secured by a person's primary residence will be treated.

Under the Final Rule, for the purposes of calculating net worth:

- the value of a person's primary residence must not be included as an asset;
- indebtedness secured by a person's primary residence that exceeds the property's estimated fair market value is treated as a liability; and
- indebtedness secured by a person's primary residence, up to its estimated fair market value, is not treated as a liability, unless (i) the borrowing occurred in the 60 days preceding the purchase of securities in the exempt offering and (ii) not in connection with the acquisition of the primary residence. If these two conditions are met, this increased debt secured by the person's primary residence must be treated as a liability. This rule was intended to prevent individuals from inflating net worth to qualify as an accredited investor by changing home equity into a qualifying asset.

A person may rely on the prior "accredited investor" definition in connection with a purchase of securities under a previously acquired right to purchase such securities, if a person:

- held a right to purchase securities of an issuer and also held other securities of the same issuer on or before July 20, 2010; and
- qualified as an "accredited investor" on the basis of net worth at the time he or she acquired such right.

The Final Rule will take effect on February 27, 2012. Both private and public companies raising funds pursuant to an exemption from registration will want to revise their subscription documents to reflect the specifics of the Final Rule.



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