

SPECIAL REPORT

Presented by the Securities Team of Whyte Hirschboeck Dudek S.C.



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SEC Issues New Rules on Net Worth Standard for Accredited Investors

by Lisa R. Lange

The adoption of Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) in July 2010 required that the definition of "accredited investor" under Regulation D of the Securities Act (relating to private placements of securities) 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 \$1 million. This change was effective upon enactment of Dodd-Frank.

The Securities and Exchange Commission (SEC) in its Release No. 33-9287 issued December 21, 2011 has adopted rules effective February 27, 2012 implementing this change in the rule and making other clarifying changes.

Treatment of Mortgage Debt

The elimination of the investor's primary residence from the calculation of net worth will exclude only the positive equity the investor has in the residence. Any mortgage debt on the property up to the property's fair market value will be excluded as a liability when calculating net worth (except certain debt incurred within 60 days of the investment as discussed below). Any mortgage debt in excess of the estimated fair market value

The SEC has adopted rules effective February 27, 2012 which implement the change in the net worth standard for accredited investors and make other clarifying changes.

of the residence (e.g., negative equity if the property is underwater) must be included as a liability in the calculation of net worth.

In addition, any indebtedness secured by the primary residence which at the time of the sale of securities exceeds the amount outstanding 60 days prior to the sale (other than as a result of the acquisition of the primary residence), the amount of such excess shall be included as a liability. The purpose of this provision is to prevent investors from trying to prop up their net worth by incurring additional indebtedness secured by their primary residence to purchase other assets.

Grandfathering for Limited Follow-on Investments

The rules also address the situation involving follow-on investments for those accredited investors who may cease to be accredited investors as a result of the changes to the net worth requirement under Dodd-Frank. The new rule allows limited grandfathering under the old definition in connection with investors' exercise of certain pre-existing rights to acquire securities, such as pre-emptive rights.

The exclusion of primary residence and new rule regarding treatment of mortgage debt will not apply to any calculation of a person's net worth in connection with the purchase of securities in accordance with a right to purchase securities, provided that the person qualified as an accredited investor on the basis of net worth at the time the person acquired such right; such right was held by the person on July 20, 2010 (day prior to date of enactment of Dodd-Frank); and the person held securities of the same issuer, other than such right, on July 20, 2010.

Changes to Subscription Documents

Since adoption of Dodd-Frank, most issuers of securities have updated the language in their subscription documents excluding the value of the investor's primary residence from the calculation of net worth. Prior to February 27, 2012, issuers should make additional clarifying changes to incorporate the treatment of mortgage debt and other changes under the new rules.



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Future Changes to Who Qualifies as an Accredited Investor

Beginning in 2014, and every four years thereafter, Dodd-Frank requires the SEC to review the accredited investor definition in its entirety and to engage in further rulemaking to the extent it deems appropriate.

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