

# Akerman Practice Update

CORPORATE

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## Dodd-Frank Act Changes Definition of Accredited Investor

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank” or the “Act”). The Act will be implemented in significant part through the studies and rulemaking activities it enables.

Akerman Senterfitt is publishing a series of updates to apprise our clients of the salient features of Dodd-Frank in specific areas. This update addresses the Act’s immediate impact on certain private placements.

### “Accredited Investor” Definition

Regulation D provides a safe harbor exemption from registration under the Securities Act of 1933 for the private placement of securities to accredited investors. One provision of Dodd-Frank that became effective immediately upon the Act’s enactment is a modified definition of the term “accredited investor” under Rule 501 of Regulation D and Rule 215 of the Securities Act of 1933. The new definition excludes the value of a primary residence for purposes of calculating a natural person’s net worth. On July 23, 2010, the SEC issued a Compliance and Disclosure Interpretation (the “Interpretation”) in which it clarified how such value should be calculated pending official amendment to its rules.

Prior to the enactment of Dodd-Frank, the term “accredited investor” included any natural person whose net worth, either individually or jointly with his or her spouse, exceeded one million dollars (\$1,000,000), including the value of the investor’s primary residence. Section 413(a) of Dodd-Frank amends this definition to exclude the value of the investor’s primary residence. If an investor



has, for example, \$1.2 million in total net worth, including a \$500,000 residence with no mortgage, under the new law, that investor will no longer qualify as an “accredited investor” as the value of the residence must be excluded, leaving a net worth of \$700,000 in this example. The amended definition does not apply to investors that are legal entities, which will still be permitted to count the value of their real estate holdings in determining whether they qualify as an “accredited investor”.

The SEC’s Interpretation states that pending implementation of the changes to the SEC’s rules required by the Act, the amount of mortgage debt secured by an investor’s primary residence should be deducted from the fair market value of the residence to calculate the amount excluded from the investor’s net worth. However, the amount of mortgage debt secured by the residence in excess of the value of the home should be considered a liability and deducted from the investor’s net worth. For example, if an investor’s primary residence has a fair market value of \$500,000 but the investor has a mortgage of \$750,000 on that residence, then \$250,000 in excess mortgage debt needs to be subtracted from the investor’s other assets in calculating the investor’s net worth.

### **Future Modifications Authorized**

During the first four years following enactment of the Act, the SEC is authorized to review and modify the definition of the term accredited investor, but may not change the \$1 million net worth threshold (excluding the value of the investor’s residence). Not less than four years after the date of enactment, and once every four years thereafter, the SEC is required to review the definition of accredited investor in its entirety and is authorized to modify the term in any way it deems appropriate, including adjustment of the net worth threshold. As the \$1 million net worth standard has not changed in about 30 years, it is widely anticipated that the SEC will revise the “accredited investor” net worth standard, perhaps increasing it to \$2.5 million, in 2014.

### **Action Items**

In light of these changes, issuers presently engaged in or contemplating a private placement of securities to accredited investors are advised to immediately revise their subscription and disclosure documents to ensure compliance with the Act. Additionally, any issuer currently conducting a private placement should reassess the eligibility of all accredited investors prior to closing. **These changes, however, do not apply retroactively so it is**

not necessary to ask individual investors who purchased securities prior to July 21, 2010 to confirm they are accredited investors under the amended definition.

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The summary set forth herein is intended to be general in nature and does not constitute legal advice with respect to any particular situation. No legal or business decision should be based solely on its contents. For more information, please contact a member of our Corporate practice.

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