

SEC Issues Final Rules On The “Accredited Investor” Net Worth Standard

By Joe Wallin on December 31, 2011



The [Securities Exchange Commission \(SEC\)](#) has now issued the final amendments to the [accredited investor](#) standards that were prompted by the [Dodd-Frank Wall Street Reform and Consumer Protection Act](#). Dodd-Frank required the SEC to revise its rules to 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 \$1M.

Because the [Dodd-Frank Act](#) required that the value of an investor’s primary residence be excluded from net worth, questions arose about how debt on a primary residence should be treated. For example, should debt on a primary residence be included in the net worth calculation, even if the total value of the residence was excluded?

The SEC’s proposed rules adopted a pragmatic, common sense approach. Net worth must exclude the value of a primary residence as an asset, can exclude debt on such residence up to the FMV of the primary residence, but must take into account the debt on the primary residence in excess of such FMV.

The final rules are substantially similar to the proposed rules, with one twist. The final rules say that debt secured by the primary residence, up to the estimated fair market value of the primary residence, doesn’t count against net worth—except for increases in primary residence debt incurred within 60 days of the sale of the securities. If you increase your debt secured by your primary residence within 60 days prior to purchasing securities, such increase must be counted as a liability.

In summary, in determining an investor's net worth (assets over liabilities):

1. **Exclude** an investor's primary residence as an asset;
2. **Exclude** debt secured by the primary residence, up to the estimated fair market value of the residence;
3. **Include** the amount of any increase on the debt secured by the primary residence incurred within 60 days prior to the purchase of the securities (unless related to the acquisition of the primary residence); and
4. **Include** debt in excess of the fair market value of the primary residence.

You see, wasn't that easy?

The rules are effective February 27, 2012.

The final amendments are as follows:

(a) * * *

(5) Any natural person whose individual net worth, or joint net worth with that person's spouse, exceeds \$1,000,000.

(i) Except as provided in paragraph (a)(5)(ii) of this section, for purposes of calculating net worth under this paragraph (a)(5):

(A) The person's primary residence shall not be included as an asset;

(B) Indebtedness that is secured by the person's primary residence, up to the estimated fair market value of the primary residence at the time of the sale of securities, shall not be included as a liability (except that if the amount of such indebtedness outstanding at the time of sale of securities exceeds the amount outstanding 60 days before such time, other than as a result of the acquisition of the primary residence, the amount of such excess shall be included as a liability); and

(C) Indebtedness that is secured by the person's primary residence in excess of the estimated fair market value of the primary residence at the time of the sale of securities shall be included as a liability;

(ii) Paragraph (a)(5)(i) of this section will not apply to any calculation of a person's net worth made in connection with a purchase of securities in accordance with a right to purchase such securities, provided that

- (A) Such right was held by the person on July 20, 2010;
- (B) The person qualified as an accredited investor on the basis of net worth at the time the person acquired such right; and
- (C) The person held securities of the same issuer, other than such right, on July 20, 2010.

For More Information About SEC Rules:

- [SEC PROPOSED "BAD ACTOR" RULES: HARD ON STARTUPS AND EARLY STAGE COMPANIES](#)
- [MORE ON THE NEW ACCREDITED INVESTOR REGULATIONS](#)
- [NEW ACCREDITED INVESTOR DEFINITION SOON TO BE IN EFFECT](#)

Disclaimer

This advisory is a publication of Davis Wright Tremaine LLP. Our purpose in publishing this advisory is to inform our clients and friends of recent legal developments. It is not intended, nor should it be used, as a substitute for specific legal advice as legal counsel may only be given in response to inquiries regarding particular situations.