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Dodd-Frank Act Amends the Definition of Accredited Investor for Private Offerings

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On July 21, President Obama signed into law the [Dodd-Frank Wall Street Reform and Consumer Protection Act](#) (“Dodd-Frank Act”). Section 413(a) of the Dodd-Frank Act revised the definition of “accredited investor” under the Securities Act of 1933 and Regulation D promulgated thereunder. This amendment takes effect immediately and may have implications for banks and bank holding companies currently engaged in private placements/offerings.

Revisions to Accredited Investor Definition

Many banks and bank holding companies raising capital in private offerings rely on an exception from registration with the Securities and Exchange Commission (“SEC”) under Regulation D. In a private offering under Regulation D, the offering is limited to 35 sophisticated purchasers and an unlimited number of “accredited investors.” The definition of accredited investor contained in Rule 215 and Regulation D currently includes, among other categories, any natural person:

- who had an individual income in excess of \$200,000 in each of the two most recent years or joint income with his or her 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; or
- whose individual net worth, or joint net worth with his or her spouse, at the time of his or her purchase exceeds \$1 million (such calculation includes the value of an investor’s primary residence).

The Dodd-Frank Act revises the accredited investor definition as it pertains to natural persons to exclude the value of a person’s primary residence from the \$1 million net worth test. This change effectively increases the net worth requirement for many investors that are natural persons. The \$200,000 income threshold remains unchanged at this time.

Section 413(a) of the Dodd-Frank Act does not define the term “value,” nor does it address the treatment of mortgage and other indebtedness secured by the residence for purposes of the net worth calculation. As required by Section 413(a), the SEC will issue amendments to its rules to conform them to the adjustment to the accredited investor net worth standard made by the Dodd-Frank Act. Pending implementation of the changes to the SEC’s rules, the SEC Staff advised that the related amount of indebtedness secured by the primary residence up to its fair market value may also be excluded. Indebtedness 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.

Effective Date of the Amendment

The revision to the accredited investor definition discussed above appears to be effective immediately, with no transition period or grandfathering for currently outstanding private offerings. As such, banks and bank holding companies currently engaged in private offerings should consider revising disclosure and subscription documents now to reflect this modification of the net worth test. To the extent subscription materials have already been received from investors who are natural persons, such banks or holding companies should consider whether new accredited investor representations are required to ensure the availability of the Regulation D exemption.

Additional Changes to Regulation D

The Dodd-Frank Act also requires the SEC to review Regulation D to evaluate whether additional changes are necessary or warranted. To that end, the SEC is authorized to review the definition of accredited investor as it applies to natural persons and make adjustments, by notice and comment rulemaking, as it deems appropriate to ensure adequate investor protection and to account for economic factors. Also, beginning July 21, 2014, and at least every four years thereafter, the SEC must review the accredited investor definition as it applies to natural persons, including both the net worth and income tests, and may make such adjustments, as it deems appropriate to ensure adequate investor protection and to account for economic factors.

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