

Richer Accredited Investors

If, as expected, President Obama signs the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") into law, one provision that will go into effect immediately upon enactment and with no notice period affects all those issuing securities in private placements in the United States in reliance on Regulation D, by effectively raising the accredited investor net worth standard for natural persons.

The Act will immediately **exclude** the value of a natural person's primary residence in determining whether the individual net worth of that person (or joint net worth with the spouse of that person) exceeds the \$1 million test for being an accredited investor under Regulation D. Previously, the value of the person's primary residence was **included** in the calculation of net worth to satisfy the \$1 million minimum.

Issuers should immediately revise their offering documents to reflect the change to the accredited investor standard and, if in the process of an offering, ensure that investors who buy securities on or after enactment of the Act meet the new standard.

In addition, Section 413 of the Act requires the Securities and Exchange Commission to adjust the \$1 million net worth test four years after the enactment of the Act. The requirement is similar to a proposal¹ made by the SEC in 2007 that would have adjusted, effective in 2012, the \$1 million standard set back in 1982, to reflect inflation. The SEC also remarked at the time on the huge increase in value of personal residences over their value in 1982 that in and of itself may have qualified many individuals as accredited investors.

If the SEC does no more than the minimum required of it, the impact in the case of many hedge funds and other private investment pools may be marginal. Many private placements that rely on Regulation D, including private placements for funds that are structured to not require registration under the Investment Company Act of 1940 (the "1940 Act") by reason of Section 3(c)(1) of the 1940 Act, have sufficiently high minimum subscription requirements as to make it unlikely that an investor with net assets of \$1 million in today's dollars could come up with the necessary cash, even counting a primary residence. Other private investment vehicles rely on the even more stringent standard of requiring that individual investors meet the definition of a qualified purchaser by owning a minimum of \$5 million in investments in order to be excluded from the requirement to register under the 1940 Act by reason of Section 3(c)(7) of the 1940 Act.

The change in the \$1 million net worth test will make it harder for small businesses to raise smaller sums of money from individual investors, including "angel rounds" of venture capital, in reliance on Regulation D. In addition, if, for example, the SEC adjusts the \$1 million floor for inflation since 1982, the \$1 million floor would, based on 2009 calculations, grow to \$2.2 million. Although issuers raising money in private placements can fall

¹ Release No. 33-8828; IC-27922, Fed. Reg. Vol. 72, No. 154, August 10, 2007.

back on Section 4(2) of the Securities Act of 1933, a court could conclude, based upon the fact that Regulation D is a Section 4(2) safe harbor, that the statutory exemption has within it an element of requiring that investors be able to fend for themselves economically within the meaning of the seminal *Ralston Purina* Supreme Court case and that the Regulation D stated criteria are relevant to a Section 4(2) determination.

Under Section 413 of the Act, the SEC could also adjust for inflation the alternative income test for accredited investors and raise the minimum income requirement for individuals from \$200,000 (or \$300,000 in joint income with a spouse) in the two most recent years. In its 2007 proposal, the SEC made just this suggestion. However, the SEC could choose to time any such adjustment to synchronize with an adjustment of the \$1 million net worth test.

Section 415 of the Act also requires the Comptroller General of the United States to conduct a study of the “appropriate criteria” for determining the financial thresholds or other criteria needed to qualify for accredited investor status and eligibility to invest in private Section 3(c)(1) and 3(c)(7) funds. On the face of the Section, there is no carve out for private funds, such

as venture capital funds. This measure may lead the SEC on its own volition to broadly revisit the net worth/income minima for individuals investing in Section 3(c)(1) funds, as well as increasing the \$5 million minimum in investments required of Section 3(c)(7) individual investors. In its 2007 proposal, the SEC suggested that the definition of accredited investor for the purposes of investing in Section 3(c)(1) funds, other than venture capital funds, also require that the investor own individually or jointly with a spouse not less than \$2.5 million in investments.² A formulation of this sort, post-Madoff, may be thought to provide a valuable additional criterion because of its focus on an individual’s experience in making investment decisions of some magnitude.

■ ■ ■

This update was written by Margaret A. Bancroft (+1 212 698 3590; margaret.bancroft@dechert.com), Jennifer Wood (+44 20 7184 7403; jennifer.wood@dechert.com), and Christopher G. Karras (+1 215 994 2412; christopher.karras@dechert.com).

² *Ibid.*

Practice group contacts

For more information, please contact the authors, one of the attorneys listed, or any Dechert attorney with whom you regularly work. Visit us at www.dechert.com/financialservices.

If you would like to receive any of our other *DechertOnPoints*, please [click here](#).

Karen L. Anderberg
London
+44 20 7184 7313
karen.anderberg@dechert.com

David L. Ansell
Washington, D.C.
+1 202 261 3433
david.ansell@dechert.com

Margaret A. Bancroft
New York
+1 212 698 3590
margaret.bancroft@dechert.com

Sander M. Bieber
Washington, D.C.
+1 202 261 3308
sander.bieber@dechert.com

Stephen H. Bier
New York
+1 212 698 3889
stephen.bier@dechert.com

Thomas C. Bogle
Washington, D.C.
+1 202 261 3360
thomas.bogle@dechert.com

Julien Bourgeois
Washington, D.C.
+1 202 261 3451
julien.bourgeois@dechert.com

Kevin F. Cahill
Orange County
+1 949 442 6051
kevin.cahill@dechert.com

Christopher D. Christian
Boston
+1 617 728 7173
christopher.christian@dechert.com

Elliott R. Curzon
Washington, D.C.
+1 202 261 3341
elliott.curzon@dechert.com

Carl A. de Brito
New York
+1 212 698 3543
carl.debrito@dechert.com

Douglas P. Dick
Washington, D.C.
+1 202 261 3305
douglas.dick@dechert.com

Ruth S. Epstein

Washington, D.C.
+1 202 261 3322
ruth.epstein@dechert.com

Joseph R. Fleming

Boston
+1 617 728 7161
joseph.fleming@dechert.com

Brendan C. Fox

Washington, D.C.
+1 202 261 3381
brendan.fox@dechert.com

Robert M. Friedman

New York
+1 212 649 8735
robert.friedman@dechert.com

David M. Geffen

Boston
+1 617 728 7112
david.geffen@dechert.com

David J. Harris

Washington, D.C.
+1 202 261 3385
david.harris@dechert.com

Christopher P. Harvey

Boston
+1 617 728 7167
christopher.harvey@dechert.com

Robert W. Helm

Washington, D.C.
+1 202 261 3356
robert.helm@dechert.com

Richard M. Hervey

New York
+1 212 698 3568
richard.hervey@dechert.com

Richard Horowitz

New York
+1 212 698 3525
richard.horowitz@dechert.com

Jane A. Kanter

Washington, D.C.
+1 202 261 3302
jane.kanter@dechert.com

Christopher G. Karras

London, Philadelphia
London: +44 20 7184 7412
Philadelphia: +1 215 994 2412
christopher.karras@dechert.com

Geoffrey R.T. Kenyon

Boston
+1 617 728 7126
geoffrey.kenyon@dechert.com

Matthew Kerfoot

New York
+1 212 641 5694
matthew.kerfoot@dechert.com

Robert H. Ledig

Washington, D.C.
+1 202 261 3454
robert.ledig@dechert.com

George J. Mazin

New York
+1 212 698 3570
george.mazin@dechert.com

Jack W. Murphy

Washington, D.C.
+1 202 261 3303
jack.murphy@dechert.com

John V. O'Hanlon

Boston
+1 617 728 7111
john.ohanlon@dechert.com

Reza Pishva

Washington, D.C.
+1 202 261 3459
reza.pishva@dechert.com

Edward L. Pittman

Washington, D.C.
+1 202 261 3387
edward.pittman@dechert.com

Jeffrey S. Puretz

Washington, D.C.
+1 202 261 3358
jeffrey.puretz@dechert.com

Jon S. Rand

New York
+1 212 698 3634
jon.rand@dechert.com

Robert A. Robertson

Orange County
+1 949 442 6037
robert.robertson@dechert.com

Keith T. Robinson

Hong Kong
+1 852 3518 4705
keith.robinson@dechert.com

Alan Rosenblat

Washington, D.C.
+1 202 261 3332
alan.rosenblat@dechert.com

Alison C. Ryan

Orange County
+1 949 442 6006
alison.ryan@dechert.com

Kevin P. Scanlan

New York
+1 212 649 8716
kevin.scanlan@dechert.com

Jeremy I. Senderowicz

New York
+1 212 641 5669
jeremy.senderowicz@dechert.com

Frederick H. Sherley

Charlotte
+1 704 339 3100
frederick.sherley@dechert.com

Stuart Strauss

New York
+1 212 698 3529
stuart.strauss@dechert.com

Patrick W. D. Turley

Washington, D.C.
+1 202 261 3364
patrick.turley@dechert.com

Thomas P. Vartanian

Washington, D.C.
+1 202 261 3439
thomas.vartanian@dechert.com

Brian S. Vargo

Philadelphia
+1 215 994 2880
brian.vargo@dechert.com

Jennifer Wood

London
+44 20 7184 7403
jennifer.wood@dechert.com

Anthony H. Zacharski

Hartford
+1 860 524 3937
anthony.zacharski@dechert.com

