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### SEC Accredited Investor Rules Spark Debate

When are you "wealthy enough" to invest in private placements? Section 413(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd Frank Act") changed the definition of "accredited investor" in the Securities Act to exclude the value of a person's primary residence for purposes of determining whether a person qualifies as an "accredited investor" on the basis of having a net worth in excess of \$1,000,000. On January 25, 2011, the Securities and Exchange Commission ("SEC") provided proposed rules to clarify the interpretation of the Dodd-Frank Act. The SEC's proposed interpretation of Section 413(a) of the Dodd Frank Act excludes the "net equity value" of a person's residence from his net worth calculation. Net equity is calculated by taking the value of the residence, less the accumulated debt, to determine the net equity value. The net equity value is then deducted from your net worth. The SEC is now soliciting comments to their proposed interpretation which can be sent to [rule-comments@sec.gov](mailto:rule-comments@sec.gov).

Steven J. Thayer, an attorney with Handler Thayer, LLP, recently submitted comments to the SEC in which he agreed with the SEC's interpretation of the "net equity" approach, but also suggested that further rules be adopted to exclude existing accredited investors from the new rules to the extent that they had already made an investment in a company or fund. Stating simply that "these rules should not apply to existing fund and company investors," Mr. Thayer pointed out that "shareholder agreements and other investor rights agreements could be materially impacted" if the proposed rules applied to investors who had already made investments in companies and funds. Mr. Thayer further stated that "instead of helping investors, which is the point of the new rule, the rules will hurt existing investors" as well as the companies they invested in. The rules will otherwise imply that investors are no longer "wealthy enough" to invest in the company or fund to which they had already committed investment capital. Mr. Thayer argued in his comments to the SEC that very few companies will rely upon broader Section 4(2) exemptions to allow investors to continue to make investments that are exempt, because the information requirements are too burdensome. Fund managers and companies will instead tell investors who no longer meet the new requirements that they are no longer eligible to make an investment in the fund or company. This could potentially put the new law into direct conflict with existing contracts and subscription agreements.

Mr. Thayer also agreed with the SEC's comments that the new rules could allow investors to manipulate their net worth calculation by borrowing against their home. Although the SEC is soliciting comments on whether to close this apparent loop hole, Mr. Thayer argued against it, stating that "investors should be able to choose whether or not to have investments in securities or homes."

The SEC expressed concern that unscrupulous brokers would arrange for people to borrow against their homes to make inappropriate private placement investments. The real question, Mr. Thayer, pointed out, is in a free society "how far do you want to go to protect people from their own decisions?"

The SEC is also soliciting comments on whether or not to include excess debt on a principal residence in the net worth calculation requiring investors to reduce their net worth to the extent that their home is under water. Mr. Thayer agreed with the SEC's initial interpretation to exclude excess debt stating that "home values are too speculative" especially now that appraisers "include foreclosure sales and short sales in home appraisals." It is also noteworthy that this proposal comes at a time when accredited investors have seen the value of their primary and secondary residences drop to their lowest values in recent years.

Although Mr. Thayer generally agreed with the SEC's approach to their interpretation of the Dodd Frank Act, he separately stated that "the Dodd Frank Act will have a negative impact on the ability of small companies to raise capital." Mr. Thayer further remarked that small companies are already facing one of the worst markets ever for raising investment capital and the pool of qualified investors just got smaller.

#### **About Handler Thayer, LLP**

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