

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR PARTS 230, 239, 270, and 275**

**Release Nos. 33-9287; IA-3341; IC-29891; File No. S7-04-11**

**RIN 3235-AK90**

**NET WORTH STANDARD FOR ACCREDITED INVESTORS**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule.

**SUMMARY:** We are adopting amendments to the accredited investor standards in our rules under the Securities Act of 1933 to implement the requirements of Section 413(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 413(a) requires the definitions of “accredited investor” in our Securities Act 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 \$1 million. This change to the net worth standard was effective upon enactment by operation of the Dodd-Frank Act, but Section 413(a) also requires us to revise our current Securities Act rules to conform to the new standard. We also are adopting technical amendments to Form D and a number of our rules to conform them to the requirements of Section 413(a) and to correct cross-references to former Section 4(6) of the Securities Act, which was renumbered Section 4(5) by Section 944 of the Dodd-Frank Act.

**DATES:** Effective Date: [insert date 60 days after publication in Federal Register].

**FOR FURTHER INFORMATION CONTACT:** Anthony G. Barone, Special Counsel; Karen C. Wiedemann, Attorney Fellow; or Gerald J. Laporte, Chief, Office of Small Business Policy, Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F

Street, NE, Washington, DC 20549-3628, (202) 551-3460.

**SUPPLEMENTARY INFORMATION:** We are adopting amendments to Rule 144(a)(3)(viii),<sup>1</sup> Rule 155(a),<sup>2</sup> Rule 215,<sup>3</sup> and Rule 501(a)(5)<sup>4</sup> and 501(e)(1)(i) of Regulation D<sup>5</sup> of our general rules under the Securities Act of 1933 (“Securities Act”)<sup>6</sup>; Rule 500(a)(1)<sup>7</sup> of our Securities Act form rules; Form D<sup>8</sup> under the Securities Act; Rule 17j-1(a)(8)<sup>9</sup> under the Investment Company Act of 1940;<sup>10</sup> and Rule 204A-1(e)(7)<sup>11</sup> under the Investment Advisers Act of 1940.<sup>12</sup>

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<sup>1</sup> 17 CFR 230.144(a)(3)(viii).

<sup>2</sup> 17 CFR 230.155(a).

<sup>3</sup> 17 CFR 230.215.

<sup>4</sup> 17 CFR 230.501(a)(5).

<sup>5</sup> 17 CFR 230.501 through 230.508.

<sup>6</sup> 15 U.S.C. 77a *et seq.*

<sup>7</sup> 17 CFR 239.500(a)(1).

<sup>8</sup> 17 CFR 239.500.

<sup>9</sup> 17 CFR 270.17j-1(a)(8).

<sup>10</sup> 15 U.S.C. 80a-1 *et seq.*

<sup>11</sup> 17 CFR 275.204A-1(e)(7).

<sup>12</sup> 15 U.S.C. 80b-1 *et seq.*

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### **I. Background and Summary**

On January 25, 2011, we proposed amendments to the accredited investor standards in our rules under the Securities Act of 1933<sup>13</sup> to implement the requirements of Section 413(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).<sup>14</sup> The accredited investor standards, which are set forth in Rules 215 and 501 under the Securities Act, are used in determining the availability of certain exemptions from Securities Act registration for private and other limited offerings. Section 4(5) of the Securities Act exempts transactions involving offers or sales by an issuer solely to one or more accredited investors, if the aggregate offering price does not exceed \$5,000,000, there is no advertising or public solicitation in connection with the transaction, and the issuer files a notice with the Commission. Pursuant to Regulation D under the Securities Act, an issuer conducting a limited offering of securities pursuant to the safe harbor of Rule 505 or 506 does not have to comply with the

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<sup>13</sup> See *Net Worth Standard for Accredited Investors*, Release No. 33-9177 (Jan. 25, 2011) [76 FR 5307] (the “Proposing Release”).

<sup>14</sup> Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

information requirements of Rule 502(b) if sales are made only to accredited investors; and sales to accredited investors do not count towards the 35-purchaser limits under Rules 505 and 506.<sup>15</sup> Moreover, accredited investor status obviates the sophistication requirement that Rule 506 imposes on non-accredited investors.<sup>16</sup> One purpose of the accredited investor concept is to identify persons who can bear the economic risk of an investment in unregistered securities, including the ability to hold unregistered (and therefore less liquid) securities for an indefinite period and, if necessary, to afford a complete loss of such investment.<sup>17</sup>

Section 413(a) of the Dodd-Frank Act requires us to adjust the accredited investor net worth standard that applies to natural persons individually, or jointly with their spouse, to “more than \$1,000,000 . . . excluding the value of the primary residence.”<sup>18</sup> Previously, this standard required a minimum net worth of more than \$1,000,000, but permitted the primary residence to be included in calculating net worth.<sup>19</sup> Under Section 413(a), the change to remove the value of the primary residence from the net worth calculation became effective upon enactment of the Dodd-Frank Act. As discussed in detail below, we are adopting amendments to our rules to conform them to the new standard.

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<sup>15</sup> See note 26 below.

<sup>16</sup> Under Rule 506, each purchaser who is not an accredited investor must, either alone or with a purchaser representative, have such knowledge and experience in financial and business matters that he or she is capable of evaluating the merits and risks of the prospective investment. 17 CFR 230.506(b)(2)(ii).

<sup>17</sup> See, Release No. 33-5487 [39 FR 15261] (1974), at 15264 (discussing the previous safe harbor for private placements under Rule 146), and Release No. 33-6339 [46 FR 41791] (1981), at 41793 (noting that the accredited investor concept was intended to “eliminat[e] the need for subjective judgments by the issuer about . . . suitability”, because investors that met the definition of accredited investor would be “presumed to meet the purchase qualifications”).

<sup>18</sup> The text of Section 413(a) states that: “The Commission shall adjust any net worth standard for an accredited investor, as set forth in the rules of the Commission under the Securities Act of 1933, so that the individual net worth of any natural person, or joint net worth with the spouse of that person, at the time of purchase, is more than \$1,000,000 (as such amount is adjusted periodically by rule of the Commission), excluding the value of the primary residence of such natural person, except that during the 4-year period that begins on the date of enactment of this Act, any net worth standard shall be \$1,000,000, excluding the value of the primary residence of such natural person.” *Id.*

<sup>19</sup> See 17 CFR 230.215(e) and 230.501(a)(5) (2010).

In the Proposing Release, we requested comment in nine specific areas. We received 43 comment letters in response.<sup>20</sup> In addition, we received 15 letters commenting on Section 413(a) of the Dodd-Frank Act before the publication of the Proposing Release.<sup>21</sup> These two sets of letters came from a variety of groups and constituencies, including state regulators, professional and trade associations, individual investors, broker-dealers and investment advisers, fund managers, consultants, academics and lawyers. Most comment letters expressed general support for the proposed amendments and the objectives that we articulated in the Proposing Release but suggested modifications to the proposals. The final rules reflect changes made in response to these comments, as well as other clarifying changes. As described in detail in the release, the most significant revisions from the proposal include the addition of (1) a grandfathering provision that permits the application of the former accredited investor net worth test in certain limited circumstances and (2) a provision addressing the treatment of incremental debt secured by the primary residence that is incurred in the 60 days before the sale of securities to the individual. Finally, the language of the proposed rules has been revised to make them clearer and easier to apply.

Section 413(b) specifically authorizes us to undertake a review of the definition of the term “accredited investor” as it applies to natural persons, and requires us to undertake a review of the definition in its entirety every four years, beginning four years after enactment of the Dodd-Frank Act. We are also authorized to engage in rulemaking to make adjustments to the

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<sup>20</sup> The comment letters we received on the Proposing Release are available on our website at <http://www.sec.gov/comments/s7-04-11/s70411.shtml>. In this release, we refer to these letters as the “comment letters” to differentiate them from the “advance comment letters” described in footnote 21.

<sup>21</sup> To facilitate public input on its Dodd-Frank Act rulemaking before issuance of rule proposals, the Commission provided a series of e-mail links, organized by topic, on its website at <http://www.sec.gov/spotlight/regreformcomments.shtml>. In this release, we refer to letters we received in response to this invitation as “advance comment letters.” The advance comment letters we received in anticipation of this rule proposal are available at <http://www.sec.gov/comments/df-title-iv/accredited-investor/accredited-investor.shtml>.

definition after each such review. Section 415 of the Dodd-Frank Act requires the Comptroller General of the United States to conduct a “Study and Report on Accredited Investors” examining “the appropriate criteria for determining the financial thresholds or other criteria needed to qualify for accredited investor status and eligibility to invest in private funds.”<sup>22</sup> The study is due three years after enactment of the legislation. We expect that the results of this study will be taken into account in any rulemaking that takes place in this area after the study is completed. Accordingly, we did not propose, and we are not adopting, any amendments to the definitions of “accredited investor” that are not related to Section 413(a) of the Dodd-Frank Act at this time.

In addition to the changes to the definition of “accredited investor” to implement the requirements of Section 413(a), we are also adopting today technical amendments to update cross-references that have changed as a result of the deletion of former Section 4(5) of the Securities Act and the renumbering of former Section 4(6) as Section 4(5).<sup>23</sup>

## **II. Discussion**

### **A. Net Worth Standard for Accredited Investors**

#### **(1) Overview of the Amended Rules**

As discussed above, Section 413(a) of the Dodd-Frank Act requires us to adjust the accredited investor net worth standard<sup>24</sup> that applies under our Securities Act rules to natural persons individually, or jointly with their spouse, to “more than \$1,000,000 . . . excluding the value of the primary residence.” Previously, the standard required a minimum net worth of more

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<sup>22</sup> Pub. L. No. 111-203, § 415, 124 Stat. 1376, 1578 (to be codified at 15 U.S.C. 80b-18c).

<sup>23</sup> Pub. L. No. 111-203, § 944, 124 Stat. 1376, 1897 (renumbering Securities Act Section 4(6), 15 U.S.C. 77d(6) (2006), as Section 4(5), 15 U.S.C. 77d(5)). Former Section 4(5) exempted transactions involving mortgages with a minimum aggregate sales price per purchaser of \$250,000, as well as the resales of those securities. 15 U.S.C. 77d(6) (2006).

<sup>24</sup> Neither the Securities Act nor our rules promulgated under the Securities Act define the term “net worth.” The commonly understood, or basic, meaning of the term is the difference between the value of a person’s assets and the value of the person’s liabilities. See, e.g., *Barron’s Financial Guides*, Dictionary of Finance and Investment Terms, at 457 (7<sup>th</sup> ed. 2006).

than \$1,000,000, but permitted the primary residence to be included in calculating net worth.

The relevant rules are Securities Act Rules 501 and 215.<sup>25</sup> Rule 501 defines the term “accredited investor” for purposes of non-public and limited offerings under Rules 504(b)(1)(iii), 505 and 506 of Regulation D.<sup>26</sup> The definition of “accredited investor” includes persons who come within any of eight listed categories, or whom the issuer reasonably believes come within one of those categories, at the time of the sale of securities to that person.<sup>27</sup> The \$1 million individual net worth standard is one such category.<sup>28</sup>

Rule 215 defines the term “accredited investor” under Section 2(a)(15) of the Securities Act.<sup>29</sup> Section 2(a)(15) and Rule 215 set the standards for accredited investor status under Section 4(5) of the Securities Act, formerly Section 4(6), which permits offerings solely to accredited investors of up to \$5 million, subject to certain conditions.<sup>30</sup> While Regulation D is frequently relied upon,<sup>31</sup> exclusive reliance on Section 4(5) is rare.<sup>32</sup>

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<sup>25</sup> 17 CFR 230.501(a)(5) and 230.215(e).

<sup>26</sup> Under Regulation D, issuers are subject to fewer regulatory requirements when the purchasers of their securities are accredited investors. Both Rule 505 and Rule 506 require that there be no more than, or the issuer reasonably believe there are no more than, 35 purchasers of securities in the offering. 17 CFR 230.505(b)(2)(ii) and 230.506(b)(2)(i). However, Rule 501(e) provides that accredited investors are not counted as purchasers for that purpose, with the result that an unlimited number of accredited investors may participate in an offering under Rule 505 or 506, provided that the other requirements of the rules are satisfied. Further, specific information requirements apply to issuers in Rule 505 and Rule 506 transactions if they sell to non-accredited investors, but not if they sell only to accredited investors. 17 CFR 230.502(b)(1). Thus, issuers in offerings under Rule 505 or 506 generally seek to establish that potential purchasers in the offering are accredited investors. In addition, Rule 504(b)(1)(iii) exempts offerings from the manner of offering and resale restrictions that generally apply under Rule 504, if they are made in accordance with certain state law exemptions from registration that limit sales to accredited investors. 17 CFR 230.504(b)(1)(iii).

<sup>27</sup> 17 CFR 230.501(a).

<sup>28</sup> Other categories include certain regulated financial institutions; certain entities with total assets in excess of \$5 million; directors, executive officers and general partners of the issuer or its general partner; and natural persons who had an income of at least \$200,000 in each of the two most recent years (or \$300,000 together with their spouse) and have a reasonable expectation of reaching the same income level in the current year. *Id.*

<sup>29</sup> 15 U.S.C. 77b(a)(15).

<sup>30</sup> 15 U.S.C. 77d(5). As discussed above, former Section 4(6) of the Securities Act was renumbered Section 4(5) by Section 944 of the Dodd-Frank Act.

<sup>31</sup> In fiscal year 2010, we received 16,856 initial filings on Form D notifying us of claims of exemption under Rules 504(b)(1)(iii), 505 and 506, 17 CFR 230.504(b)(1)(iii), 230.505 and 230.506, the three exemptive provisions

Historically, the accredited investor standards under Rule 215 and Rule 501 have been identical. We are adopting identical language in the amendments to Rule 501 and Rule 215, so the two rules will implement Section 413(a) of the Dodd-Frank Act in the same way. As amended, the new individual net worth standard in the accredited investor definition is:

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

(1) Except as provided in paragraph (2) of this section, for purposes of calculating net worth under this paragraph:

- (i) The person's primary residence shall not be included as an asset;
- (ii) 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 the 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
- (iii) 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.

(2) Paragraph (1) 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:

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

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in Regulation D where accredited investor status affects the availability of an exemption. This represented 96% of the 17,593 initial Form D filings we received for that year.

<sup>32</sup> In fiscal year 2010, we received 900 initial filings on Form D notifying us of a claim of exemption under Section 4(5), formerly Section 4(6), representing 5% of the 17,593 initial Form D filings we received for that year. Only 66 of those filings, or less than 0.4% of total initial Form D filings, claimed the Section 4(5) exemption exclusively. The other 834 of these Form D filings indicated that both Section 4(5) and a Regulation D exemption were being relied upon.

The final accredited investor definition is consistent with the approach taken in the Proposing Release with respect to the basic treatment of the primary residence and indebtedness secured by the primary residence.<sup>33</sup> We have revised the language of this provision to make it easier for issuers, investors and other market participants to apply the new net worth standard.<sup>34</sup> We have also included a provision addressing the treatment of incremental debt secured by the primary residence that is incurred in the 60 days before the sale of securities to the individual, and have revised the proposal so that that the prior accredited investor net worth test will apply in connection with the exercise of rights to acquire securities, so long as the rights were in existence on July 20, 2010, the day before enactment of the Dodd-Frank Act, the investor qualified as an accredited investor on the basis of net worth at the time the rights were acquired, and the investor held securities of the same issuer, other than the rights, on July 20, 2010.

## **(2) Treatment of Mortgage Debt**

Under the final rules, as in the Proposing Release, individuals' net worth will be calculated excluding any positive equity they may have in their primary residence.<sup>35</sup> As we discussed in the Proposing Release, we believe this approach is the most appropriate way to conform our rules to Section 413(a). It reduces the net worth measure by the net amount that the

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<sup>33</sup> It is also consistent with the staff's initial analysis of Section 413(a). *See* Securities Act Rules Compliance & Disclosure Interpretation, Question No. 255.47 (July 23, 2010) (available at <http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm#255.47>).

<sup>34</sup> We have also deleted a reference to measuring net worth at the time of the investor's purchase, as all standards under the accredited investor definition are measured "at the time of the sale of securities to that person." 17 CFR 230.501(a).

<sup>35</sup> Thus, for example, if an investor with a net worth of \$2 million (calculated in the conventional manner before the enactment of Section 413(a)—that is, by subtracting from the investor's total assets, including primary residence, the investor's total liabilities, including indebtedness secured by the residence) has a primary residence with an estimated fair market value of \$1.2 million and a mortgage loan of \$800,000, the investor's net worth for purposes of the new accredited investor standard is \$1.6 million. Before enactment of Section 413(a), the primary residence would have contributed a net amount of \$400,000 to the investor's net worth for purposes of the accredited investor net worth standard—the value of the primary residence (\$1.2 million) less the mortgage loan (\$800,000). Under the amendments, exclusion of the value of the primary residence would reduce the investor's net worth by the same \$400,000 amount.

primary residence contributed to net worth before enactment of Section 413(a), which we believe is what is commonly meant by “the value of a person’s primary residence.” Most comment letters supported defining “excluding the value of the primary residence” in this way.<sup>36</sup>

Three letters supported excluding the fair market value of the primary residence from net worth without excluding any associated debt.<sup>37</sup> This group of letters argued that our proposal to “net out” any associated debt from the fair market value of the primary residence misinterprets the plain language of Section 413(a), and incentivizes investors to increase the amount of debt secured by their primary residence to acquire other assets for the purpose of inflating their net worth as calculated under our rules. As we stated in the Proposing Release, we believe that reducing an investor’s net worth by the value of the primary residence without also excluding associated indebtedness would not accord with the manner in which net worth reflected home equity before enactment of Section 413(a); excluding the residence alone would reduce net worth by more than the amount the residence contributes. We believe the approach in the final rule is the most appropriate approach and is consistent with Section 413(a).<sup>38</sup>

Five comment letters advocated excluding from the net worth calculation both the fair market value of the primary residence and all indebtedness secured by the primary residence, regardless of whether such indebtedness exceeds the fair market value of the primary

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<sup>36</sup> See, e.g., comment letters from Business Law Section of the American Bar Association (“ABA”), Cornell Securities Law Clinic (“Cornell”), Investment Adviser Association (“IAA”), Managed Funds Association, North American Securities Administrators Association (“NASAA”), Public Investors Arbitration Bar Association and Sullivan & Cromwell LLP (“S&C”).

<sup>37</sup> See comment letters from Secretary of the Commonwealth of Massachusetts (“Massachusetts Securities Division”), Professors Manning G. Warren and Marc I. Steinberg; and David A. Marion.

<sup>38</sup> New paragraph (ii) of the final rule, discussed in Part I.A.2 below, prohibits excluding incremental indebtedness secured by the primary residence that is incurred in the 60 days before the sale of securities. We believe this provision will mitigate incentives to increase debt secured against the residence solely for purposes of qualifying as an accredited investor.

residence.<sup>39</sup> Several of these commentators disagreed with our proposal on the basis that the proposal would require an estimate of the fair market value of the primary residence which, in their view, would make the net worth calculation problematic and uncertain and would force investors to incur additional expense to obtain a third party appraisal of their residence. These commentators argued that excluding both the value of the primary residence and all indebtedness secured by the primary residence would simplify and provide greater certainty regarding the net worth calculation.

We disagree with this view, as did many commentators.<sup>40</sup> In the first instance, estimating the value of the primary residence did not appear to cause problems before the Dodd-Frank Act, when that value was included in net worth for purposes of the definition of accredited investor. The rules did not then, and the rules we adopt today do not now, require a third party opinion on valuation, either for the primary residence or for any other assets or liabilities. All that is required is an estimate of fair market value.<sup>41</sup> Further, as we explained in the Proposing Release, if the amount of mortgage debt exceeds the value of the primary residence (*i.e.*, an underwater mortgage), excluding the entire debt from net worth for purposes of the accredited investor definition would result in a higher net worth than under a basic net worth calculation that takes into account all assets and all liabilities. Net worth would be effectively increased by the amount by which the mortgage exceeds the value of the primary residence, because that excess amount is treated as a liability in a basic net worth calculation but would be excluded under the standard

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<sup>39</sup> See comment letters from Welton E. Blount, Investment Program Association (“IPA”), Real Estate Investment Securities Association (“REISA”), Steven J. Thayer and Georg Merkl. See also advance comment letters from April Hamlin and Michael Scillia.

<sup>40</sup> See, *e.g.*, letters from Massachusetts Securities Division, Cornell, International Association of Small Broker Dealers and Advisors, NASAA and the Public Investors Arbitration Association.

<sup>41</sup> See, *e.g.*, Release No. 33-6455 (Mar. 3, 1983) at Question 21 (confirming that, under the net worth standard in effect at the time, “the estimated fair market value” of a primary residence could be considered as an asset) and Question 45 (individual statement of net worth reflects estimated value of assets and liabilities).

proposed by these commentators. We do not believe it would be appropriate for us to implement Section 413(a) in a way that results in increased net worth compared to a basic calculation for individuals with underwater mortgages.<sup>42</sup>

Three comment letters argued that mortgage debt in excess of the value of the primary residence should be excluded from the net worth calculation if the borrower would not be subject to personal liability by reason of contractual terms or state anti-deficiency statutes or similar laws.<sup>43</sup> In these situations, indebtedness in excess of the value of the residence may not be legally collectible, either because the loan by its terms provides recourse only to the underlying asset, the residence, or because applicable law bars a lender from obtaining a judgment for the shortfall when the fair market value of the residence (or the price obtained in a foreclosure sale) is less than the loan amount.<sup>44</sup>

Under the final rules, any excess of indebtedness secured by the primary residence over the estimated fair market value of the residence is considered a liability for purposes of

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<sup>42</sup> Where the amount of debt secured by the primary residence exceeds the estimated value of the residence, the new rules will not trigger any adjustment to net worth as calculated before the enactment of Section 413(a). In a pre-Section 413(a) basic net worth calculation involving an underwater mortgage, the fair market value of the residence and the amount of the mortgage up to that fair market value are included in the calculation but net to zero, and the excess of the amount of the mortgage over the fair market value of the primary residence is included as a liability. Under the final rules, the fair market value of the residence and the amount of the mortgage up to that fair market value are excluded from the calculation, and the excess of the amount of the mortgage over the fair market value of the primary residence is included as a liability. In both cases, the overall impact on net worth is a reduction equal to the underwater amount (*i.e.*, the excess of the amount of the mortgage over the fair market value of the residence). Take, for example, an investor whose primary residence has an estimated fair market value of \$1.2 million, with a mortgage of \$1.4 million. The excess of mortgage loan over the fair market value of the primary residence (in this case, \$200,000) would be taken into account as a liability and serve to reduce net worth both under a conventional net worth calculation and under the accredited investor definition adopted today. If, on the other hand, all debt secured by the primary residence were excluded, including debt in excess of the estimated fair market value of the residence, the investor's net worth would be \$200,000 higher than under a conventional calculation because the mortgage debt in excess of the value of the primary residence would not be treated as a liability.

<sup>43</sup> See comment letters from ABA and IPA and advance comment letter from Keith P. Bishop.

<sup>44</sup> See Ghent, Andra C. and Kudlyak, Marianna, "Recourse and Residential Mortgage Default: Theory and Evidence from U.S. States," (February 25, 2011), Federal Reserve Bank of Richmond Working Paper No. 09-10R. Available at SSRN: <http://ssrn.com/abstract=1432437>. In their Appendix A, the authors provide a summary of mortgage foreclosure procedures and anti-deficiency statutes in the 50 states and the District of Columbia. They classify 11 states (Alaska, Arizona, California, Iowa, Minnesota, Montana, North Carolina (for purchase mortgages only), North Dakota, Oregon, Washington and Wisconsin) as non-recourse states.

determining accredited investor status on the basis of net worth, whether or not the lender can seek repayment from other assets in default. In our view, the full amount of the debt incurred by the investor is the most appropriate value to use in determining accredited investor status. That is the basis on which interest accrues under the mortgage and the amount that third parties would look to in assessing creditworthiness. We do not believe that the treatment of a mortgage should vary solely because of state laws that limit the rights of the lender in an action to enforce the borrower's promise to repay. Such laws vary significantly in scope and procedural requirements, and their operation is often contingent on the specific foreclosure process chosen by the lender and other factors beyond the borrower's control.<sup>45</sup> We believe it would add substantial complexity to the rule if market participants were called upon to determine how an anti-deficiency statute would operate in the individual circumstances of each prospective investor. Moreover, the data available to us suggest that there would be no material difference in the number of households that qualify as accredited investors if we were to allow special treatment of non-recourse mortgages.<sup>46</sup> Accordingly, the final rules specify that debt secured against the primary residence in excess of the estimated fair market value of the primary residence must be treated as a liability in the net worth calculation.

### **(3) Increases in Mortgage Debt in the 60 Days Before Sale of Securities**

We also solicited comment on whether the amendments should contain a timing

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<sup>45</sup> *See id.*

<sup>46</sup> Using data from the 2007 Federal Reserve Board Survey of Consumer Finances, staff from our Division of Risk, Strategy and Financial Innovation estimate that in 2007 the same number of U.S. households (approximately 7.6 million) would have qualified for accredited investor status on the basis of net worth under our amendments and under an alternative net worth calculation that excluded both the fair market value of the primary residence and all indebtedness secured by the residence, even indebtedness in excess of the fair market value of the residence. Based on discussions with staff economists at the Federal Reserve Board, estimates derived from their unpublished 2009 supplemental update of the 2007 survey are qualitatively similar. For both 2007 and 2009, the data suggest that the number of households nationwide that qualify as accredited investors is not affected by whether the net worth calculation includes or excludes the underwater portion of debt secured by the primary residence.

provision to prevent investors from artificially inflating their net worth by incurring incremental indebtedness secured by their primary residence, thereby effectively converting their home equity—which is excluded from the net worth calculation under the rules adopted today—into cash or other assets that would be included in the net worth calculation. As an example, we indicated that the amendments could provide that the net worth calculation must be made as of a date 30, 60, or 90 days before the sale of the securities, as well as at the time of sale.

State securities regulators strongly supported this approach, noting that it would make the practice of advising investors to use equity in their primary residence to purchase securities less attractive, thereby helping to ensure that unregistered securities are not sold to investors with limited assets other than their homes, who may not be able to fend for themselves without the protections afforded by registration.<sup>47</sup> On the other hand, many commentators opposed having special rules for debt secured by a primary residence incurred close in time to the sale of securities, asserting that imposing such a timing provision would unduly complicate the calculation of net worth.<sup>48</sup> Some were particularly concerned that the date when accredited investor status has to be determined may not be known sufficiently in advance to permit a full net worth calculation 30, 60, or 90 days ahead of time, or that such a requirement would force delays in capital raising efforts.<sup>49</sup> We agree that we should avoid adding undue complexity in the process for determination of accredited investor status; however, we believe that the rule should address potential incentives for individuals to incur debt secured by a primary residence

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<sup>47</sup> Comment letter from NASAA. The other supporter of a timing provision was the Cornell Securities Law Clinic. *See* comment letter from Cornell (“The Clinic believes that a timing rule should not require the ‘60 day’ calculation to be performed on the date 60 days before the purchase date; rather, the calculation should occur on the intended purchase date, and estimate the investor’s net worth as it was on the date 60 days before the intended purchase date.”).

<sup>48</sup> *See* letters from ABA, Robert Edgerton, Georg Merkl, REISA and S&C.

<sup>49</sup> *See* comment letters from ABA and Robert Edgerton.

for the purpose of inflating their net worth to qualify as accredited investors. If the rule does not address that issue, the population Congress intended to protect—individuals whose net worth is below \$1 million unless their home equity is taken into account—may be incentivized (or urged by unscrupulous salespeople) to take on debt secured by their homes for the purpose of qualifying as accredited investors and participating in investments without the protection to which they are entitled.

We believe we have addressed this concern in a manner that manages the complexities noted by commentators that could arise from a requirement to calculate net worth far in advance of a possible sale of securities or to calculate net worth twice. The final rule provides a specific provision addressing the treatment of incremental debt secured by the primary residence that is incurred in the 60 days before the sale of securities.<sup>50</sup> As described above, debt secured by the primary residence generally will not be included as a liability in the net worth calculation under the rule, except to the extent it exceeds the estimated value of the primary residence. Under the final rule, any increase in the amount of debt secured by a primary residence in the 60 days before the time of sale of securities to an individual generally will be included as a liability, even if the estimated value of the primary residence exceeds the aggregate amount of debt secured by such primary residence.<sup>51</sup> Net worth will be calculated only once, at the time of sale of securities (the same time as under current rules). The individual's primary residence will be excluded from

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<sup>50</sup> *See, e.g.*, New Rule 501(a)(i)(B).

<sup>51</sup> The fair market value of the primary residence is determined as of the time of sale of securities, even if the investor has changed his or her primary residence during the 60-day period. The rule provides an exception to the 60-day look-back provision for increases in debt secured by a primary residence where the debt results from the acquisition of the primary residence. Without this exception, an individual who acquires a new primary residence in the 60-day period before a sale of securities may have to include the full amount of the mortgage incurred in connection with the purchase of the primary residence as a liability, while excluding the full value of the primary residence, in a net worth calculation. The 60-day look-back provision is intended to address incremental debt secured against a primary residence that is incurred for the purpose of inflating net worth. It is not intended to address debt secured by a primary residence that is incurred in connection with the acquisition of a primary residence within the 60-day period.

assets and any indebtedness secured by the primary residence, up to the estimated value of the primary residence at of that time, will be excluded from liabilities, except if there is incremental debt secured by the primary residence incurred in the 60 days before the sale of securities. If any such incremental debt is incurred, net worth will be reduced by the amount of the incremental debt. In other words, the only additional calculation required by the 60-day look-back provision is to identify any increase in mortgage debt over the 60-day period preceding the purchase of securities.

This approach will make it more difficult for individuals to manipulate their net worth as calculated under our rules by borrowing against their primary residence shortly before seeking to qualify as an accredited investor, to take advantage of any positive equity in the primary residence. It should, therefore, significantly reduce the incentive for individuals to try to “game” the accredited investor net worth standard or for salespeople to attempt to induce individuals to take on incremental debt secured against their homes to facilitate a near-term investment in an offering. The new provision may impose additional costs and burdens on investors who increase the indebtedness secured by their primary residence shortly before seeking to invest in a Rule 506 offering if the proceeds of such refinancing are invested in the primary residence or are otherwise disposed of without acquiring an asset that is included in the net worth calculation, because in such circumstances the amount of such additional borrowing will be treated as a liability, but the proceeds will not be treated as an asset. If such an increase in liabilities causes an individual not to meet the \$1,000,000 net worth test, and he or she does not otherwise qualify as an accredited investor, the individual may be excluded from investment opportunities if issuers are unable or unwilling to permit the participation of non-accredited investors. However, our approach should not present the same practical difficulties as requiring a full net worth

calculation as of a date 30, 60, or 90 days before securities are sold to an investor, in which all assets and liabilities of the investor would have to be taken into account based on their values as of the specified date.

We have included a 60-day look-back period for this purpose because we believe a 60-day period is long enough to decrease the likelihood that parties will attempt to circumvent the standard by taking on new debt and waiting for the look-back period to expire, while minimizing the potential burden on investors who increase their mortgage debt for other reasons. Both letters that commented favorably on the possible requirement to calculate net worth as of a specified date before the sale of securities supported a 60-day look-back period.<sup>52</sup> Another alternative to address this practice would have been to provide that any debt secured by a primary residence that was incurred after the original date of purchase of the primary residence would have to be counted as a liability, whether or not the fair market value of the primary residence exceeded the value of the total amount of debt secured by the primary residence. We believe that such a standard would be overly restrictive and not provide for ordinary course changes to debt secured by a primary residence, such as refinancing and drawings on home equity lines.

#### **(4) Transition Rules**

We did not propose any rules for transition to the new accredited investor net worth standards. In the Proposing Release, we questioned whether any transition relief would be necessary or appropriate because the new standards became effective upon enactment of the Dodd-Frank Act on July 21, 2010. We did, however, solicit comment on whether we should adopt provisions to permit investors who ceased to qualify as accredited investors as a result of

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<sup>52</sup> See comment letters from Cornell (suggesting a 60-day period) and NASAA (suggesting a 60- or 90-day period).

the changes effected by Section 413(a) to be treated as accredited for purposes of certain subsequent or “follow-on” investments.

Commentators generally supported a provision that would allow investors in that situation to participate in certain types of follow-on investments.<sup>53</sup> Some letters argued that such a provision would be appropriate to permit investors to protect their proportionate interest in an issuer or to exercise rights associated with an existing investment on the basis originally bargained for.<sup>54</sup> Others argued more broadly that investors should be permitted to maintain existing investment plans to avoid adverse tax or other consequences.<sup>55</sup> Commentators expressed a concern that issuers may be unwilling or unable to provide the information required to be provided to non-accredited investors under Rule 501(b)(1) of Regulation D,<sup>56</sup> and may simply exclude individuals from participating in securities offerings who no longer qualify as accredited investors.<sup>57</sup>

We are not persuaded that grandfathering or other transition provisions would be appropriate in all circumstances urged by commentators. In cases where securities would be purchased based on an investment decision made before enactment of the Dodd-Frank Act (for example, a capital call that is not subject to conditions under the investor’s control, under an

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<sup>53</sup> See comment letters from ABA, Robert Edgerton, IAA, IPA, Georg Merkl, REISA, S&C, Sutherland Asbill & Brennan (“Sutherland”) and Steven J. Thayer. Only one comment letter objected to a transition provision, arguing that Congressional intent is evident from the fact that Section 413(a) was effective immediately upon enactment of the Dodd-Frank Act and that investors who no longer qualify as accredited investors under Section 413(a) may participate in follow-on offerings as non-accredited investors. See letter from Cornell.

<sup>54</sup> Comment letters identified rights such as pre-emptive rights, rights of first refusal and buy-sell agreements, as well as provisions that impose dilution or other adverse consequences on investors who do not invest in future rounds of financing.

<sup>55</sup> See, e.g., comment letters from REISA (roll over of real estate investments) and Sutherland (roll over of private placement insurance contracts).

<sup>56</sup> 17 CFR 230.501(b)(1).

<sup>57</sup> Several letters also argued that issuers would not attempt to rely on the broader Section 4(2) exemption because it would create unnecessary legal risk related to the offering process. See, e.g., comment letters from Sutherland and Steven J. Thayer.

agreement entered into before enactment of the Dodd-Frank Act), accredited investor status would have been determined at the time of the investment decision. A subsequent change in the investor's accredited status would not be relevant, so special accommodation would not be needed. With respect to new investment decisions, some situations for which commentators requested special treatment could raise significant investor protection concerns. For example, certain rights to acquire securities in existence before the enactment of the Dodd-Frank Act could involve different issuers than the original investment. In such circumstances, an investor may not have been sufficiently familiar with, or had an opportunity to conduct diligence with respect to, such different issuers at the time the investor met the accredited investor net worth standard and received such rights.

We note also that the change in the accredited investor net worth standard took effect in July 2010, upon enactment of Section 413(a) of the Dodd-Frank Act. No grandfathering or transition provisions were included in Section 413(a), so market participants have been operating under the new standard for over a year. In particular, where existing rights (for example, under derivative instruments such as options, warrants and convertibles) give rise to a continuous offering of the underlying securities, because no grandfathering was provided by statute, issuers have already had to address any concerns that arose upon the change in the accredited investor net worth standard.

We do believe, however, that limited grandfathering would be appropriate in connection with investors' exercise of certain pre-existing rights to acquire securities. The final rules, therefore, contain a provision under which the former accredited investor net worth test will apply to purchases of securities in accordance with a right to purchase such securities,<sup>58</sup> so long

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<sup>58</sup> The grandfathering provision applies to the exercise of statutory rights, such as pre-emptive rights arising under state law; rights arising under an entity's constituent documents; and contractual rights, such as rights to

as (i) the right was held by a person on July 20, 2010, the day before the enactment of the Dodd-Frank Act; (ii) the person qualified as an accredited investor on the basis of net worth at the time the right was acquired; and (iii) the person held securities of the same issuer, other than the right, on July 20, 2010. For example, if an investor who qualified as accredited based on net worth at the time of her original investment owned common stock of an issuer on July 20, 2010, and on that date had pre-emptive rights to acquire additional common stock of that issuer, then when the issuer makes an offering of common stock that triggers the pre-emptive rights, the investor's net worth will be calculated as it was before enactment of the Dodd-Frank Act. Likewise, if the same investor owned Series A preferred stock of an issuer on July 20, 2010 and on that date had a right of first offer to purchase any equity securities offered by the issuer in a future sale, and the issuer proposed to sell Series B preferred stock at a future date, then the investor's net worth will be calculated as it was before enactment of the Dodd-Frank Act for purposes of exercising the right of first offer to purchase Series B preferred stock from the issuer. The provision is limited to persons who qualified as accredited investors on the basis of net worth at the time the relevant rights were originally acquired, and who held securities of the issuer other than the rights on July 20, 2010. We believe this approach strikes an appropriate balance between preserving investors' ability to exercise previously bargained-for rights, which otherwise may have been impaired by the change in accredited investor definition, and maintaining the investor protection benefits that Section 413(a) seeks to achieve.

#### **(5) Other Issues Considered**

In our Proposing Release, we requested comment on two additional issues discussed below, which we determined do not require any change in our rules.

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acquire securities upon exercise of an option or warrant or upon conversion of a convertible instrument, rights of first offer or first refusal and contractual pre-emptive rights.

**Defining “Primary Residence.”** We solicited comment on whether we should define the term “primary residence” for purposes of the rules we are amending. Our proposal did not contain a definition, consistent with our past policies in this area<sup>59</sup> and in an attempt to avoid unnecessary complexity in a rule that is intended to be straightforward in application.

Several comment letters agreed with us that the term “primary residence” is well understood, and does not require a legal definition.<sup>60</sup> Two comment letters advocated adoption of a legal definition, but did not agree on what definition should apply.<sup>61</sup>

We believe that “primary residence” has a commonly understood meaning as the home where a person lives most of the time. Consistent with the approach in Regulation D to reduce unnecessary complexity, we are not adopting a definition of the term “primary residence.”

**Proceeds of Debt Secured by Primary Residence Incurred to Invest in Securities.** We solicited comment on whether the accredited investor definition should contain special provisions addressing the treatment of debt secured by a primary residence where the proceeds of the debt are used to invest in securities. Under the rules we are adopting today, debt secured by the primary residence will generally be excluded from the calculation of net worth to the extent of the estimated fair market value of the primary residence. NASAA had urged in an advance comment letter that netting of such debt not be permitted if proceeds of the debt were

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<sup>59</sup> None of our three other rules that use the term “primary residence” have a definition of the term. *See* 17 CFR 240.17a-3(a)(17)(i)(A), 17 CFR 247.701(d)(1)(A) and 17 CFR 210.2-01(c)(1)(ii)(A)(4). Regulation D also did not define the similar term “principal residence,” as used in Rule 501(e)(1)(i) of Regulation D. 17 CFR 230.501(e)(1)(i). Until now, Regulation D used the term “principal residence” to exclude any purchasers who are relatives or spouses of the purchaser and who share the same principal residence as the purchaser for purposes of calculating the number of purchasers in a Regulation D offering. As explained below, we are adopting amendments to change this reference from “principal residence” to “primary residence” so that it conforms to the terminology of the Dodd-Frank Act. *See* text accompanying note 66 below.

<sup>60</sup> *See, e.g.,* comment letters from ABA, S&C and Steven J. Thayer.

<sup>61</sup> *See* comment letter from Cornell (suggesting the definition in Internal Revenue Code § 121). A comment letter from an individual suggested that the Commission use the definition of the term “primary residence” of the Organization for Economic Cooperation and Development, at least for non-U.S. investors. *See* letter from Georg Merkl.

used to invest in securities. NASAA's concern was that, without such a rule, we would create an incentive for unscrupulous salespeople to induce investors with significant equity in their home to borrow against their home for the purpose of investing in unsuitable unregistered offerings.<sup>62</sup>

NASAA made this suggestion again in its comment letter on the Proposing Release, which was the only comment letter supporting this idea.<sup>63</sup> The other comment letters that addressed this issue opposed it.<sup>64</sup> Critics asserted that such a change would add substantial complexity to the compliance process because of the difficulties of tracing loan proceeds, and suggested that the concerns articulated by NASAA could be better and more effectively addressed through enforcement of existing Securities Act and broker-dealer rules. After reviewing all the comment letters and further considering the issue, we have included the 60-day look-back provision discussed in Part II.A.3 above rather than a tracing provision. We believe that requiring incremental debt secured by the primary residence to be treated as a liability in the net worth calculation for 60 days after it is incurred will be a substantial disincentive to inappropriate sales practices, and will be much simpler and more certain in application than a tracing rule.<sup>65</sup>

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<sup>62</sup> Advance comment letter from NASAA.

<sup>63</sup> See letter from NASAA.

<sup>64</sup> See, e.g., letters from ABA, REISA, S&C, Robert G. Edgerton, Georg Merkl and Steven J. Thayer.

<sup>65</sup> The standards governing broker-dealer sales practices will also apply in relation to the activities of broker-dealer personnel. NASD (now known as FINRA) Rule 2310 requires registered representatives of broker-dealers to make only suitable recommendations to their customers. See Financial Industry Regulatory Authority, NASD Rule 2310: Recommendations to Customers (Suitability) (2010) (available at [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=3638](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3638)). Depending on the facts and circumstances, such behavior may also rise to the level of fraud under Section 17(a) of the Securities Act, 15 U.S.C. 77q(a), or Section 10(b) of the Securities Exchange Act, 15 U.S.C. 78j(b), or the Commission's antifraud rules issued under those statutory provisions.

## **B. Technical and Conforming Amendments**

As proposed, we are changing the reference to “principal residence” currently in Rule 501(e)(1)(i) of Regulation D<sup>66</sup> to “primary residence,” to conform it to the new language in Rule 501. We received one letter supporting this change,<sup>67</sup> and no letters objecting to this change.

Also as proposed, we are amending the references to former Securities Act Section 4(6) in Form D and several of our rules to refer to Section 4(5), as former Section 4(6) was renumbered by Section 944(a)(2) of the Dodd-Frank Act. Specifically, we are amending Rule 144(a)(3)(viii) (definition of “restricted securities”) and Rule 155(a) (integration of abandoned offerings) of the general Securities Act rules; Rule 500(a)(1) of the Securities Act form rules; Item 6 and the General Instructions to Form D under the Securities Act; Rule 17j-1(a)(8) (personal investment activities of investment company personnel) under the Investment Company Act, and Rule 204A-1(e)(7) (investment adviser codes of ethics) under the Investment Advisers Act.

We are also removing the authority citation preceding the Preliminary Notes to Regulation D.

## **III. Paperwork Reduction Act**

The amendments we are adopting do not contain a “collection of information” requirement within the meaning of the Paperwork Reduction Act of 1995.<sup>68</sup> Accordingly, the Paperwork Reduction Act is not applicable.

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<sup>66</sup> For purposes of calculating the number of purchasers in a Regulation D offering, Rule 501(e)(1)(i) uses the term “principal residence” to exclude any purchasers who are relatives or spouses of a purchaser of a Regulation D security and who share the same “principal residence” as the purchaser of the security. 17 CFR 230.501(e)(1)(i).

<sup>67</sup> See letter from ABA.

<sup>68</sup> 44 U.S.C. 3501-3521.

## **IV. Cost-Benefit Analysis**

### **A. Background and Summary of Proposals**

As discussed above, we are adopting amendments to the accredited investor standards in our rules under the Securities Act to implement the requirements of Section 413(a) of the Dodd-Frank Act.

Section 413(a) of the Dodd-Frank Act requires the definitions of “accredited investor” in the Securities Act 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 \$1 million. Under the previous standard, individuals qualified as accredited investors if they had a net worth of more than \$1 million, including the value of their primary residence. The substantive change to the net worth standard was effected by operation of the Dodd-Frank Act upon enactment; however, Section 413(a) also requires us to adjust the accredited investor definitions in our Securities Act rules to conform to the new standard. We are therefore adopting conforming amendments to Securities Act Rule 501(a)(5) of Regulation D and Securities Act Rule 215(e).

This analysis focuses on the costs and benefits to the economy of including the specific amendments described below, rather than on the costs and benefits of the new accredited investor net worth standard itself. The new standard was mandated by Congress in Section 413(a) of the Dodd-Frank Act and does not reflect the exercise of our rulemaking discretion.

The language we are adopting reflects our exercise of discretion in choosing a method to implement the statutory language set forth in Section 413(a) (namely, that net worth for purposes of accredited investor qualification should be calculated excluding the positive equity, if any, in the primary residence) over two other possible methods to implement the statutory language. As

explained in our Proposing Release, these two other methods of implementation of the Section 413(a) language are: (1) excluding from net worth the fair market value of the primary residence, but including all indebtedness secured by the primary residence; and (2) excluding from net worth the fair market value of the primary residence and all indebtedness secured by the primary residence, even if it exceeds the fair market value of the primary residence. We also exercised our discretion in requiring that incremental debt secured by the primary residence that is incurred in the 60 days before the accredited investor determination is made (other than debt incurred in connection with the acquisition of a primary residence) must be treated as a liability in the net worth calculation (*i.e.*, may not be netted against the value of the residence, even if the value of the residence exceeds the amount of debt secured against it), and in adding a limited grandfathering provision under which, in certain circumstances, the former accredited investor net worth standard will apply in connection with acquisitions of securities pursuant to rights held by a person before enactment of the Dodd-Frank Act.

**B. Comments on the Cost-Benefit Analysis**

In the Proposing Release, we requested qualitative and quantitative feedback on the nature of the benefits and costs described and any benefits and costs we may have overlooked. No comment letters expressly addressed the cost-benefit analysis in the Proposing Release, but some comment letters cited certain costs and benefits consistent with those described in this release in the course of making a variety of suggestions and observations. For example, the rules that we are adopting, which may result in individuals' having to estimate the value of their primary residence in order to determine whether the amount of debt secured against the residence exceeds the estimated fair market value of the residence, was criticized by some commentators

on the basis that it would increase compliance costs.<sup>69</sup> As indicated above, individuals were required to estimate the value of their primary residence to calculate net worth as defined before enactment of the Dodd-Frank Act, and the Commission is not aware that this caused a problem for individuals seeking to qualify as accredited investors on that basis. Others asserted that the failure to include grandfathering or other transition provisions in the new rules would impose costs on investors (who may be unable to protect their existing investments from dilution or to exercise pre-existing rights) and on issuers (which may have a harder time raising capital).<sup>70</sup> We have attempted to respond to that comment by providing for limited grandfathering.

### **C. Benefits**

We believe the rules we are adopting provide the most appropriate method to implement Section 413(a), and will result in the following benefits compared to other possible methods to implement Section 413(a):

- We believe the final amendments most accurately reflect the manner in which individual net worth has traditionally been determined and understood, and what is commonly understood by “the value of a person’s primary residence.” We believe investors and issuers will benefit from implementing rules that are easy to understand and consistent with conventional net worth calculation concepts through reduced transaction costs relative to other alternatives.<sup>71</sup>
- The amendments will result in a larger pool of accredited investors than the first alternative method of implementation, under which all indebtedness secured by the primary residence would be included as a liability in the net worth calculation. The

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<sup>69</sup> See letters from IPA, Georg Merkl.

<sup>70</sup> See e.g., letters from ABA, Investment Advisers Association, Investment Program Association, Real Estate Investment Securities Association, S&C, Sutherland Asbill & Brennan and Steven J. Thayer.

<sup>71</sup> See notes 35-36 above and accompanying text.

available data suggest that there is no material difference in the size of the accredited investor pool between the alternative we are adopting and the second alternative method, under which all indebtedness secured by the primary residence would be excluded from the net worth calculation, even if in excess of the estimated value of the primary residence.<sup>72</sup> To the extent that exempt offerings to accredited investors are less costly for issuers to complete than registered offerings, a larger pool of accredited investors that may participate in these offerings could result in cost savings for issuers conducting these offerings.

- The additional provision in the final rules that requires incremental debt secured against the primary residence to be treated as a liability in the net worth calculation for 60 days after it is incurred will eliminate individuals' ability to inflate their net worth for purposes of the accredited investor definition by taking on incremental debt secured against their primary residence shortly before securities are sold to them. The look-back period will reduce incentives to manipulate net worth calculations, should make investors whose net worth reaches the accredited investor threshold only if

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<sup>72</sup> Using data from the 2007 Federal Reserve Board Survey of Consumer Finances, our Division of Risk, Strategy and Financial Innovation estimates that in 2007 approximately 8.3 million households (7.2% of U.S. households) would have qualified as accredited under the standards in our new rules on the basis of net worth, annual income or both. Approximately 7.6 million of such households (6.5% of U.S. households) would have qualified on the basis of net worth. If we adopted a standard based on an alternative method of implementation of Section 413(a) that excludes from the net worth calculation the fair market value of the primary residence but not any indebtedness secured by the primary residence, only 7.8 million households (6.7%) would have qualified as accredited. Conversely, if we adopted a standard under which both the fair market value of the primary residence and all indebtedness secured by the primary residence, even indebtedness in excess of the fair market value of the primary residence, were excluded from the net worth calculation, the number of accredited U.S. households would have been the same as under the approach we are adopting. More information regarding the survey may be obtained at <http://www.federalreserve.gov/pubs/oss/oss2/scfindex.html>. See also note 46 above and accompanying text. Staff at the Federal Reserve also informed us that based on an unpublished 2009 supplemental Survey of Consumer Finances, which surveyed the same households that were surveyed in 2007, estimates of the number of qualifying households in 2009 under the various methods of implementation of Section 413(a) are qualitatively similar to estimates derived from the 2007 survey. For both 2007 and 2009, the data suggest that the number of households nationwide that qualify as accredited investors is not affected by whether the net worth calculation includes or excludes the underwater portion of debt secured by the primary residence.

- value of available home equity is included as part of a net worth calculation less susceptible to high-pressure sales tactics, and generally will provide investor protection benefits to households which, under the criteria of Section 413(a), are less able to bear the economic risk of an investment in unregistered securities.
- The provision in the final rules will apply the pre-Dodd-Frank Act accredited investor net worth test to acquisitions of securities pursuant to rights held on July 20, 2010 by persons who qualified as accredited investor on the basis of net worth at the time the rights were acquired and who held securities of the issuer other than the rights on July 20, 2010. Under this provision, investors who no longer qualify as accredited investors under the new net worth standard, but who would qualify under the former standard, will qualify as accredited investors in that limited context. This should provide a benefit to both investors and issuers, in that investors who have ceased to qualify as accredited investors because of the change in net worth standard will be able to exercise pre-existing rights even if the issuer is unable or unwilling to permit exercise by non-accredited investors, and at lower cost than if the individuals did not qualify as accredited investors.

#### **D. Costs**

Like our analysis of the benefits, our analysis of the costs focuses on the costs attributable to our adopted language on how to treat the primary residence and debt secured by the primary residence in the calculation of net worth, including the treatment of debt incurred in the 60 days before the net worth calculation is performed, and on the costs attributable to the transition provision included in the final rules.

Many of the potential costs of our amendments are dependent on a number of factors.

Costs may include the following:

- Our amendments involve more complex calculations than the two alternative possible approaches we have identified.<sup>73</sup> Although no third party appraisal is required, our amendments may require estimating the fair market value of the investor's primary residence to determine whether it exceeds the amount of indebtedness secured by the primary residence. In contrast, both of the alternative net worth calculations could be performed merely by ignoring the primary residence as an asset in determining the net worth amount, and in the case of the second alternative method of implementation also ignoring the indebtedness secured by the primary residence. However, this would appear to be a manageable cost. Investors had to estimate the fair market of their primary residence to calculate net worth under the net worth standard for accredited investor that applied before enactment of the Dodd-Frank Act, and the Commission is not aware that market participants found the need for such an estimate to be problematic.
- Where indebtedness secured by the primary residence has increased in the 60 days preceding the net worth calculation, other than in connection with the acquisition of the primary residence, our amendments will also require determining the amount of that increase, and treating that amount as a liability in the net worth calculation.
- The amendments could encourage investors (or incentivize salespeople to encourage investors) to take on indebtedness secured by their primary residence with the primary motive of inflating their net worth in order to satisfy the new accredited investor net worth standard. As noted above, we believe the requirement to treat as a liability any incremental debt secured by the primary residence that is incurred in the 60 days before

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<sup>73</sup> Some commentators objected to the proposal on this basis. See note 39 and accompanying text.

the accredited investor determination will reduce this incentive by requiring 60 days to pass before assets obtained with the proceeds of incremental indebtedness secured by the primary residence could result in an increase in net worth under the rule.

- Our amendments require that an investor's net worth calculation include as a liability any amount by which the indebtedness secured by the investor's primary residence exceeds the estimated fair market value of the residence. It is possible that our amendments will result in a smaller pool of eligible accredited investors than if we implemented an alternative approach that would exclude all indebtedness secured by the primary residence, even amounts in excess of the value of the residence. The data available to us do not support this view. The 2007 Federal Reserve Board Survey of Consumer Finances suggests that there is no difference in the number of households that would have qualified under the two standards in 2007 (that is, subject to sampling error, there were no households that had a net worth of \$1 million or less if the underwater portion of the mortgage was considered as a liability but greater than \$1 million if it was disregarded).<sup>74</sup> Staff at the Federal Reserve have informed us that based on an unpublished 2009 supplemental Survey of Consumer Finances, estimates of the number of qualifying households in 2009 under the two methods of implementation are qualitatively similar to estimates derived from the 2007 survey. Nevertheless, if our amendments result in a smaller pool of accredited investors than would otherwise be the case, that could result in increased costs for companies and funds that are seeking accredited investors to participate in their exempt offerings.
- The treatment of indebtedness secured by the primary residence that is incurred within 60

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<sup>74</sup> See note 46 above.

days before the accredited investor determination may result in some individuals failing to meet the \$1 million net worth threshold for 60 days after entering into new financing or refinancing arrangements, who would have met such threshold if no look-back provision applied, if the proceeds of such refinancing are invested in the primary residence or are otherwise disposed of without acquiring an asset that is included in the net worth calculation. Such individuals may lose investment opportunities if issuers are not willing or able to allow them to participate in offerings conducted during the period in which they do not qualify as accredited investors.

- The transition provision we are including will, in limited circumstances, permit investors who do not qualify as accredited investors under the new net worth standard, but who do qualify under the previous standard, to acquire securities pursuant to pre-existing rights without the protections afforded to non-accredited investors. This will impose costs to the extent that such investors would have benefited from such protections. The transition provision applies only in limited circumstances, which may prevent some investors from participating in some offerings and may cause issuers to incur the cost of seeking out other investors.

## **V. Consideration of Burden on Competition and Promotion of Efficiency, Competition and Capital Formation**

Section 2(b) of the Securities Act requires us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. In the Proposing Release, we considered our proposed amendments and requested comment on their potential impact in light of those standards. We believe the amendments adopted today may facilitate capital formation and

promote efficiency, relative to an alternative method of implementation that would exclude only the fair market value of the primary residence from the net worth calculation and would not provide grandfathering to facilitate exercise of pre-existing rights under certain circumstances. We do not anticipate that the amendments will have any effects on competition.

We believe the amendments impose no significant burden on efficiency, competition and capital formation beyond any that may have been imposed by enactment of the Dodd-Frank Act. As discussed in the cost-benefit analysis in Part IV above, however, the language of Section 413(a) could be subject to alternative methods of implementation if our rules do not provide standards for how to calculate the value of the primary residence. In this regard, we added explanatory language to our rules on how to treat the primary residence and indebtedness secured by the primary residence in determining whether a person qualifies under the accredited investor net worth standard. We believe these amendments further the purposes underlying the requirements of Section 413(a) of the Dodd-Frank Act.

The adopted explanatory language requires that in calculating net worth:

- the primary residence not be included as an asset; and
- debt secured by the primary residence not be included as a liability, except that
  - if the amount of debt secured by the primary residence has increased in the 60 days preceding the accredited investor determination, other than in connection with the acquisition of the residence, the amount of such increase must be included as a liability; and
  - if the amount of debt secured by the primary residence exceeds the estimated fair market value of the primary residence, the amount of such excess must be included as a liability.

As described above, we believe the approach we are adopting is generally consistent with what is commonly understood by “the value of a person’s primary residence,” and is preferable to either of the two alternative approaches. The addition of provisions related to any net increase in the amount of debt secured by the primary residence in the 60 days preceding a sale of securities is a straightforward provision to safeguard against manipulation of the general rule. Several comment letters addressed the burden and uncertainty on investors and issuers inherent in an approach that relies on a determination of the fair market value of the primary residence, which is necessary in order to determine whether any indebtedness secured by the primary residence exceeds the value of the residence.<sup>75</sup> These letters favored an approach that excludes from the net worth calculation both the value of the primary residence and all indebtedness secured by the primary residence, which they argue would provide investors and their advisors with certainty regarding the net worth calculation. We believe, however, that it would be inappropriate to implement Section 413(a) in this way, because it would result in a higher net worth for investors with “underwater” mortgages as compared to the same investors’ basic net worth calculated without excluding the value of the primary residence.<sup>76</sup> Furthermore, we note that, before the enactment of the Dodd-Frank Act, a net worth calculation in connection with determining accredited investor status required estimating the fair market value of the primary residence. The existing pool of accredited investors and issuers should be familiar with this kind of estimate, which should mitigate the burdens cited in these letters.

The final amendments may result in a pool of accredited investors that is larger than the first alternative approach, which would not net out debt secured by the primary residence.<sup>77</sup> To

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<sup>75</sup> See letters from IPA, Georg Merkl, REISA and Steven J. Thayer.

<sup>76</sup> See note 42 above and accompanying text.

<sup>77</sup> See note 72 above and accompanying text.

the extent that exempt offerings to accredited investors are less costly for issuers to complete compared to registered offerings, issuers conducting these exempt offerings under the new amendments could potentially experience greater cost savings than under the first alternative standard. Based on the available data, the second alternative approach to excluding the value of the primary residence under Section 413(a) (excluding from net worth the fair market value of the primary residence and all indebtedness secured by the primary residence, including all such indebtedness in excess of the fair market value of the property) would not result in a measurably larger pool of eligible accredited investors than under our amendments, and therefore would not appear to result in additional cost savings compared to our amendments.<sup>78</sup>

We believe that the provisions in the final rules dealing with the treatment of debt secured by the primary residence will not significantly affect the costs of compliance for most market participants, and therefore will not have a significant effect on efficiency or capital formation. Where the estimated fair market value of the primary residence may be less than the amount of debt secured by the residence, individuals will have to estimate such fair market value in order to establish whether any portion of the debt secured by the primary residence must be included as a liability in the net worth calculation. The rules require an estimated fair market value only; no third party valuation will be required.

There is some further complexity to the net worth calculation for individuals who have increased the amount of debt secured by their primary residence in the 60 days before seeking to qualify as accredited investors, in that they will be required to treat the incremental debt as a liability. This provision may also result in some individuals' ceasing to satisfy the \$1 million net worth threshold for 60 days after entering into new financing arrangements that increase the

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<sup>78</sup> See note 46 above and accompanying text.

amount of indebtedness secured by their primary residence, if the proceeds of such financing are invested in the primary residence or are otherwise disposed of without creating an asset for net worth purposes. This may result in the individuals' losing investment opportunities, and issuers' losing qualified investors during such 60-day period.

Several commentators expressed concern that not providing grandfathering could impose costs on both investors and issuers, including increased transaction costs for offerings that no longer qualify for exemption or that include non-accredited investors;<sup>79</sup> dilution or other impairment of existing investments for investors that are excluded from follow-on investment opportunities because they no longer qualify as accredited;<sup>80</sup> investors being forced to abandon investment strategies;<sup>81</sup> investors losing the benefit of previously bargained-for rights;<sup>82</sup> burdens on issuers because existing investors may be ineligible to make follow-on investments;<sup>83</sup> and the impact on private company capital formation attributable to a decrease in the number of accredited investors and the withdrawal of broker-dealers from the private placement market.<sup>84</sup>

While the Commission acknowledges these potential costs, there are no available data tracking Regulation D investment by household, so we cannot develop quantitative estimates of the economic impact of eliminating from the pool of accredited investors the households that no longer qualify based on the new net worth standard, or of providing exemptive or other relief from the new standard, which would keep such households in the accredited investor pool. This

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<sup>79</sup> Georg Merkl; REISA.

<sup>80</sup> Georg Merkl; S&C; Sutherland; ABA; IPA; REISA; IAA; Steven J. Thayer.

<sup>81</sup> Sutherland; IAA.

<sup>82</sup> Robert G. Edgerton; S&C; IAA; Steven J. Thayer.

<sup>83</sup> IPA; REISA; IAA.

<sup>84</sup> REISA.

impact arises principally as a result of the enactment of Section 413(a) of the Dodd-Frank Act and only to a limited extent from our exercise of rulemaking discretion.

The final rules provide for limited transition relief by applying the former accredited investor net worth test to acquisitions of securities pursuant to rights to acquire securities, if the rights were held on July 20, 2010, the person qualified as an accredited investor on the basis of net worth at the time the rights were acquired, and the person held securities of the issuer other than the rights on July 20, 2010. We believe this provision strikes an appropriate balance between preserving investors' ability to exercise previously bargained-for rights, which otherwise may have been impaired by the change in the accredited investor definition, and maintaining the investor protection benefits that Section 413(a) seeks to achieve.

Where the transition provision is unavailable, the new accredited investor net worth test will apply. This may prevent some investors from participating in some offerings and cause issuers to seek out other investors. However, we believe the final rules will provide benefits for individuals who would meet the \$1 million accredited investor net worth standard only if their home equity were taken into account, to the extent they are protected by the enhanced disclosures required in registered offerings and offerings involving non-accredited investors, or become ineligible to participate in investments in restricted securities pursuant to Regulation D or Section 4(5), which are generally substantially less liquid than securities issued in registered offerings and may entail substantial additional risks.

We do not believe the amendments affect competition beyond what is required by Section 413(a). The amendments would apply equally to all issuers participating in exempt offerings under Regulation D and Section 4(5), in respect of all of their investors. We also do

not believe that Section 413(a) itself places a burden on competition that our rules should ameliorate, except to the extent provided by the transition provision.

In addition to the effects described above, the amendments may positively affect efficiency and capital formation in other ways by providing a clear standard to calculate and exclude the value of the primary residence. This should generally benefit issuers and investors by making the requirements of Section 413(a) easier to apply and comply with, reducing the risk of sales to investors who do not meet the new accredited investor net worth standards, as well as the risk that an issuer may violate Securities Act registration requirements. Clear rules will also serve to promote efficiency by reducing the risk of issuers' inability to raise capital because of uncertainty in interpreting our rules. Greater clarity and certainty in our accredited investor net worth standards also should foster greater confidence in our private placement markets and ultimately reduce the cost of capital, promoting increased capital formation, especially small business capital formation, which Regulation D was originally designed to promote.

## **VI. Final Regulatory Flexibility Act Analysis**

This final regulatory flexibility analysis has been prepared in accordance with the Regulatory Flexibility Act.<sup>85</sup> This final regulatory flexibility analysis relates to amendments to our accredited investor rules under the Securities Act to implement the requirements of Section 413(a) of the Dodd-Frank Act.

### **A. Reasons for and Objectives of the Amendments**

The reason for the amendments is to implement the requirements of the Dodd-Frank Act, primarily the requirements of Section 413(a) of that statute. Section 413(a) requires the definitions of "accredited investor" in the Securities Act rules to exclude the value of a person's

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<sup>85</sup> 5 U.S.C. §§ 601 *et seq.*

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 \$1 million. Under the previous standard, individuals qualified as accredited investors if they had a net worth of more than \$1 million, including the value of their primary residence. The change to the net worth standard was effective upon enactment by operation of the Dodd-Frank Act; but Section 413(a) also requires us to revise the Securities Act accredited investor definitions to conform to the new standard, which we are doing by revising Securities Act Rule 501(a)(5) of Regulation D and Rule 215(e).

Our primary objective is to implement the requirements for a new accredited investor net worth standard in Section 413(a) of the Dodd-Frank Act. We note that Section 413(a) does not prescribe the method for calculating the value of the primary residence, nor does it address specifically the treatment of indebtedness secured by the residence for purposes of the net worth determination. Accordingly, we are exercising our discretion by providing explicit requirements regarding the treatment of the primary residence and indebtedness secured by the primary residence in the calculation of net worth. We believe this standard is generally consistent with conventional and commonly understood methods of determining net worth, and what is commonly understood by “the value of a person’s primary residence” (with the addition of a provision for the special treatment of debt secured by a primary residence that is incurred in the 60 days preceding a sale of securities), and is preferable to other possible methods of implementation of the statutory language, such as: (1) excluding from net worth the fair market value of the primary residence without netting out indebtedness secured by the primary residence; and (2) excluding from net worth the fair market value of the primary residence and

all indebtedness secured by the primary residence, regardless of whether it exceeds the fair market value of the primary residence.

We are describing how to treat the primary residence and indebtedness secured by the primary residence in the calculation of net worth, so that implementation proceeds efficiently, with a minimum amount of uncertainty. We believe these amendments will help to reduce the cost of exempt offerings under Regulation D and Section 4(5), relative to the cost of such transactions with less specific implementation of Section 413(a), by reducing uncertainty among issuers and investors in applying the new accredited investor net worth standard mandated by Section 413(a) of the Dodd-Frank Act. By providing greater specificity, we are attempting to remove a possible impediment to issuers using these forms of offering, thereby potentially lowering the cost of capital generally and facilitating capital formation, especially for smaller issuers, while protecting investors.

The final amendments also address incremental indebtedness secured by the primary residence that is incurred within 60 days before the relevant sale of securities. This provision will eliminate individuals' ability to artificially inflate their net worth for purposes of the accredited investor definition by taking on incremental debt secured against their residence shortly before participating in an exempt offering.

The final amendments also include a transition provision, under which the former accredited investor net worth test will apply to acquisitions of securities pursuant to rights to acquire securities, if the rights were held on July 20, 2010, the person qualified as an accredited investor on the basis of net worth at the time the rights were acquired, and the person held securities of the issuer other than the rights on July 20, 2010. This provision should facilitate the exercise of rights held at the time of enactment of the Dodd-Frank Act by persons who would

qualify as accredited investors under the former test but not the new test in limited circumstances that should not give rise to significant investor protection concerns.

## **B. Significant Issues Raised by Public Comments**

In the Proposing Release, we requested comment on every aspect of the initial regulatory flexibility analysis (“IRFA”), including the number of small entities that would be affected by the proposed amendments, the nature of the impact, how to quantify the number of small entities that would be affected, and how to quantify the impact of the proposed amendments. We did not receive comments specifically addressing the IRFA.

## **C. Small Entities Subject to the Rule**

The amendments will affect issuers that are small entities, because issuers that are small entities must believe or have a reasonable basis to believe that prospective investors are accredited investors at the time of the sale of securities if they are relying on the definition of “accredited investor” for an exemption under Regulation D or Section 4(5). For purposes of the Regulatory Flexibility Act under our rules, an issuer is a “small business” or “small organization” if it has total assets of \$5 million or less as of the end of its most recent fiscal year.<sup>86</sup> For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year. The amendments apply to all issuers that rely on the accredited investor net worth standards in the exemptions to Securities Act registration in Regulation D and Section 4(5).

All issuers that sell securities in reliance on Regulation D and Section 4(5) must file a

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<sup>86</sup> 17 CFR 230.157.

notice on Form D with the Commission. However, the vast majority of companies and funds filing notices on Form D are not required to provide financial reports to the Commission. For the fiscal year ended September 30, 2010, 22,941 issuers filed a notice on Form D. We believe that many of these issuers are small entities, but we currently do not collect information on total assets of all issuers to determine if they are small entities for purposes of this analysis. We note, however, that for the fiscal year ended September 30, 2010, the median offering size for offerings under Regulation D was approximately \$1 million, which is consistent with the prevalence of small issuers.

**D. Projected Reporting, Recordkeeping and Other Compliance Requirements**

None of our amendments will increase the information or time required to complete the Form D that must be filed with the Commission in connection with sales under Regulation D and Section 4(5). Our amendments adjust our rules so they comply with the requirements of Section 413(a) of the Dodd-Frank Act, including adding an anti-evasion provision with respect to debt secured by a primary residence incurred within the 60 days before a sale of securities and a limited transition provision. The rules would not require any further disclosure than is currently required in offerings made in reliance on Regulation D and Section 4(5). To the extent that the amendments provide standards on how to treat the primary residence and indebtedness secured by the primary residence in calculating net worth under the accredited investor definition, we believe that they will eliminate potential ambiguity and facilitate compliance with the accredited investor net worth standard mandated by the Dodd-Frank Act.

**E. Agency Action to Minimize Effect on Small Entities**

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objective of our amendments, while minimizing any significant adverse

impact on small entities. In connection with the amendments, we considered the following alternatives:

- the establishment of different compliance or reporting requirements or timetables that take into account the resources available to small entities;
- the clarification, consolidation, or simplification of the rule's compliance and reporting requirements for small entities;
- the use of performance rather than design standards; and
- an exemption from coverage of the amendments, or any part thereof, for small entities.

With respect to the establishment of special compliance requirements or timetables under our amendments for small entities, we do not think this is feasible or appropriate. Our amendments do not establish any compliance requirements or timetables for compliance that we could adjust to take into account the resources available to small entities. Moreover, the amendments are designed to eliminate uncertainty among issuers and investors that may otherwise result from inserting only the bare operative language from Section 413(a) of the Dodd-Frank Act in our rules. Providing greater specificity in our rules should provide issuers, including small entities, and investors with greater certainty concerning the availability of the Regulation D and Section 4(5) exemptions to Securities Act registration that rely on the accredited investor definition. This should facilitate efficient access to capital for both large and small entities consistent with investor protection.

Likewise, with respect to potentially clarifying, consolidating, or simplifying compliance and reporting requirements, the amendments do not impose any new compliance or reporting requirements or change any existing requirements.

With respect to using performance rather than design standards, we do not believe doing so in this context would be consistent with our objective or with the statutory requirement. Our amendments seek to specify how issuers should calculate the value of a person's primary residence for purposes of excluding its value in determining whether the person qualifies as an accredited investor on the basis of net worth. Specifying that issuers should calculate net worth by excluding the value of the primary residence and leaving the method of calculation to the discretion of the issuer, as a performance standard would, frustrates our purpose and denies small entities and others of the benefits of certainty that the amendments are designed to provide.

With respect to exempting small entities from coverage of these amendments, we believe such a provision would have no impact on the regulatory burdens on small entities, since Section 413(a) became effective upon enactment. Our amendments are designed to provide for the protection of investors without unduly burdening both issuers and investors, including small entities and their investors. They also are designed to minimize confusion among issuers and investors. Exempting small entities could potentially increase their regulatory burdens and increase confusion. We have endeavored to minimize the regulatory burden on all issuers, including small entities, while meeting our regulatory objectives.

### **VIII. Statutory Authority and Text of the Amendments**

The amendments described in this release are being adopted under the authority set forth in Sections 2(a)(15), 3(b), 4(2), 19 and 28 of the Securities Act, as amended,<sup>87</sup> Section 38(a) of the Investment Company Act,<sup>88</sup> Section 211(a) of the Investment Advisers Act<sup>89</sup> and Sections 413(a) and 944(a) of the Dodd-Frank Act.

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<sup>87</sup> 15 U.S.C. 77b(a)(15), 77c(b), 77d(2), 77s and 77z-3.

<sup>88</sup> 15 U.S.C. 80a-38(a).

<sup>89</sup> 15 U.S.C. 80b-11(a).

**List of Subjects in 17 CFR Parts 230, 239, 270 and 275**

Reporting and recordkeeping requirements, Securities.

For the reasons set out above, the Commission amends Title 17, Chapter II of the Code of Federal Regulations as follows:

**PART 230--GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933**

1. The general authority citation for Part 230 is revised to read as follows:

Authority: 15 U.S.C. 77b, 77b note, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78o-7 note, 78t, 78w, 78ll(d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

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2. Amend § 230.144, paragraph (a)(3)(viii), by removing the reference to “4(6) (15 U.S.C. 77d(6))” and adding in its place “4(5) (15 U.S.C.77d(5))”.

3. Amend § 230.155, paragraph (a), by removing the references to “4(6)” and “77d(6)” and adding in their places “4(5)” and “77d(5)”, respectively.

4. Amend § 230.215 by revising paragraph (e) to read as follows:

**§ 230.215 Accredited investor.**

\* \* \* \* \*

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

(1) Except as provided in paragraph (e)(2) of this section, for purposes of calculating net worth under this paragraph (e):

(i) The person’s primary residence shall not be included as an asset;

(ii) 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 the 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

(iii) Indebtedness that is secured by the person's primary residence in excess of the estimated fair market value of the primary residence shall be included as a liability.

(2) Paragraph (1) 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:

(i) Such right was held by the person on July 20, 2010;

(ii) The person qualified as an accredited investor on the basis of net worth at the time the person acquired such right; and

(iii) The person held securities of the same issuer, other than such right, on July 20, 2010.

\* \* \* \* \*

5. Amend Part 230 by removing the authority citation after the undesignated center heading "Regulation D—Rules Governing the Limited Offer and Sale of Securities Without Registration Under the Securities Act of 1933" and preliminary notes preceding §§ 230.501 to 230.508.

6. Amend § 230.501 by:

a. revising paragraph (a)(5); and

b. removing the word “principal” and adding in its place the word “primary” in paragraph (e)(1)(i).

The revision reads as follows:

**§ 230.501 Definitions and terms used in Regulation D.**

\* \* \* \* \*

(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.

\* \* \* \* \*

**PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933**

7. The general authority citation for Part 239 is revised to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78o-7 note, 78u-5, 78w(a), 78ll, 78mm, 80a-2(a), 80a-3, 80a-8, 80a-9, 80a-10, 80a-13, 80a-24, 80a-26, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

\* \* \* \* \*

8. Amend § 239.500 by removing the reference to “4(6)” and adding in its place “4(5)” in the heading and in the first sentence of paragraph (a)(1).

9. Amend Item 6 in Form D (referenced in § 239.500) by:

a. Removing the phrase “Securities Act Section 4(6)” and adding in its place “Securities Act Section 4(5)” next to the appropriate check box; and

b. Removing the reference to “4(6)” and adding in its place “4(5)” in the first sentence of the first paragraph of the General Instructions.

**Note:** The text of Form D does not, and the amendments will not, appear in the Code of Federal Regulations.

**PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940**

10. The general authority citation for Part 270 continues to read in part as follows:

Authority: 15 U.S.C. 80a-1 *et seq.*, 80a-34(d), 80a-37, and 80a-39, unless otherwise noted.

\* \* \* \* \*

11. Amend § 270.17j-1, paragraph (a)(8), by removing the references to “4(6)” and “77d(6)” and adding in their places “4(5)” and “77d(5)”, respectively.

**PART 275—RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940**

12. The authority citation for Part 275 continues to read in part as follows:

Authority: 15 U.S.C. 80b-2(a)(11)(G), 80b-2(a)(11)(H), 80b-2(a)(17), 80b-3, 80b-4, 80b-4a, 80b-6(4), 80b-6a, and 80b-11, unless otherwise noted.

\* \* \* \* \*

13. Amend § 275.204A-1, paragraph (e)(7) by removing the references to “4(6)” and “77d(6)” and adding in their places “4(5)” and “77d(5)”, respectively.

By the Commission.

Kevin M. O’Neill  
Deputy Secretary

Dated: December 21, 2011