

**SECURITIES AND EXCHANGE COMMISSION**

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

**RELEASE NOS. 33-9177; IA-3144; IC-29572; File No. S7-04-11**

**RIN 3235-AK90**

**NET WORTH STANDARD FOR ACCREDITED INVESTORS**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule.

**SUMMARY:** We are proposing amendments to the accredited investor standards in our rules under the Securities Act of 1933 to reflect 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 statute, but Section 413(a) also requires us to revise our current Securities Act rules to reflect the new standard. We also are proposing technical amendments to Form D and a number of our rules to conform them to the language 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:** Comments should be received on or before March 11, 2011.

**ADDRESSES:** Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission’s Internet comment form

(<http://www.sec.gov/rules/proposed.shtml>); or

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-04-11 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-04-11. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/proposed.shtml>).

Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** Anthony G. Barone, Special Counsel, or Gerald J. Laporte, Chief, Office of Small Business Policy, at (202) 551-3460, Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

**SUPPLEMENTARY INFORMATION:** We are requesting public comment on proposed 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> of

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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.

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>

## TABLE OF CONTENTS

- I. BACKGROUND AND SUMMARY**
- II. DISCUSSION**
  - (A) Net Worth Standard for Accredited Investors
    - (1) Proposed Language
    - (2) Other Issues Considered
  - (B) Technical and Conforming Amendments
- III. GENERAL REQUEST FOR COMMENT**
- IV. PAPERWORK REDUCTION ACT**
- V. COST-BENEFIT ANALYSIS**
- VI. CONSIDERATION OF BURDEN ON COMPETITION AND PROMOTION OF EFFICIENCY, COMPETITION AND CAPITAL FORMATION**
- VII. INITIAL REGULATORY FLEXIBILITY ACT ANALYSIS**
- VIII. SMALL BUSINESS REGULATORY ENFORCEMENT FAIRNESS ACT**
- IX. STATUTORY AUTHORITY AND TEXT OF PROPOSED AMENDMENTS**

### **I. BACKGROUND AND SUMMARY**

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) became law on July 21, 2010.<sup>13</sup> Among other things, the Dodd-Frank Act changed certain

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<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.*

<sup>13</sup> Pub. L. No. 111-203, 124 Stat. 1376.

legal requirements governing private and other limited offers and sales of securities without registration under the Securities Act.

Section 413(a) of the Dodd-Frank Act requires us to adjust the net worth standards for accredited investors in our rules under the Securities Act.<sup>14</sup> These standards delineate investors to whom issuers may sell securities in specified private and other limited offerings without registration of the offering under the Securities Act. The Dodd-Frank Act requires us to adjust the net worth standards in these rules that apply to a natural person individually, or jointly with the spouse of that person, to “more than \$1,000,000 . . . excluding the value of the primary residence of such natural person.”<sup>15</sup> Previously, these standards required a minimum net worth of more than \$1,000,000, but permitted the primary residence to be included in calculating net worth.<sup>16</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.

In addition, 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 definition after each such review. We are not proposing to make revisions to the definitions of “accredited investor” that are not required by the Dodd-Frank Act at this time,

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<sup>14</sup> *Id.* § 413(a), 124 Stat. 1577 (to be codified at 15 U.S.C. 77b note).

<sup>15</sup> The text of Section 413(a) reads as follows:

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>16</sup> *See* 17 CFR 230.215(e), 230.501(a)(5) (2010).

but may consider doing so in future rulemaking. 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>17</sup> The study is due three years after enactment of the legislation. We expect that the results of this study will inform any future rulemaking in this area that takes place after the study is completed.<sup>18</sup>

Section 944 of the Dodd-Frank Act deleted former Section 4(5) of the Securities Act and renumbered former Section 4(6) as Section 4(5).<sup>19</sup> Former Section 4(6) provides an exemption from the registration requirements of the Securities Act for certain limited offerings to accredited investors if there is no advertising or public solicitation by the issuer. Our proposals include technical corrections to cross-references necessitated by this change.<sup>20</sup>

## II. DISCUSSION

### (A) Net Worth Standard for Accredited Investors

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<sup>17</sup> Pub. L. No. 111-203, § 415, 124 Stat. 1376, 1578 (to be codified at 15 U.S.C. 80b-18c).

<sup>18</sup> To facilitate public input on its Dodd-Frank Act rulemaking before issuance of rule proposals, the Commission has 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 comment letters we received in response to this invitation as “advance comment letters.” The advance comment letters we received in anticipation of this rule proposal, concerning revisions to the accredited investor net worth standards under Section 413(a) of the Dodd-Frank Act, are available at <http://www.sec.gov/comments/df-title-iv/accredited-investor/accredited-investor.shtml>. One of those comment letters, from the North American Securities Administrators Association, Inc. (“NASAA”), urged us to modify the accredited investor definition to incorporate an “investments owned” standard. See [Advance Comment Letter from NASAA \(Nov. 4, 2010\)](http://www.sec.gov/comments/df-title-iv/accredited-investor/accredited-investor-11.pdf) (available at <http://www.sec.gov/comments/df-title-iv/accredited-investor/accredited-investor-11.pdf>). This topic may be considered in connection with our future review of the definition of “accredited investor” and any resultant rulemaking.

<sup>19</sup> Pub. L. No. 111-203, § 944, 124 Stat. 1376, 1897 (renumbering Securities Act Section 4(6), 15 USC 77d(6) (2006), as Section 4(5), 15 USC 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 USC 77d(6) (2006).

<sup>20</sup> Section 926 of the Dodd-Frank Act requires the Commission to revise the standards for offerings under Rule 506 of Regulation D, 17 CFR 230.506, to impose certain “bad actor” disqualifications. We will propose those changes in a subsequent rulemaking.

## (1) Proposed Language

As discussed above, Section 413(a) of the Dodd-Frank Act requires us to adjust the net worth standards for an accredited investor in our Securities Act rules that apply to any natural person individually, or jointly with the spouse of that person, to “more than \$1,000,000 . . . excluding the value of the primary residence of such natural person.” Previously, these standards required a minimum net worth of more 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>21</sup>

Rule 501 sets the standards for accredited investor status under certain exemptive provisions for private and other limited offerings under Regulation D. Rule 215 defines the term “accredited investor” under Section 2(a)(15) of the Securities Act.<sup>22</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).<sup>23</sup> While Regulation D is frequently relied upon,<sup>24</sup> exclusive reliance on Section 4(5) is rare.<sup>25</sup>

Neither the Securities Act nor our rules promulgated under the Securities Act define the term “net worth.” The conventional or commonly understood meaning of the term is the

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<sup>21</sup> 17 CFR 230.501(a)(5) and 230.215(e) (2010).

<sup>22</sup> 15 U.S.C. 77b(a)(15).

<sup>23</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>24</sup> In fiscal year 2010, we received 16,856 initial filings on Form D notifying us of a claim 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 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>25</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%, claimed the Section 4(5) exemption exclusively. The other 844 of these Form D filings indicated that both Section 4(5) and a Regulation D exemption were being relied upon.

difference between the value of a person's assets and the value of the person's liabilities.<sup>26</sup>

The proposed amendments would set the same standard under both Rule 501 and Rule 215 for individuals to qualify as accredited investors on the basis of net worth, either individually or with their spouses.<sup>27</sup> The amendments would implement Section 413(a) by adding to the relevant rules the language from Section 413(a)—“excluding the value of the primary residence of such natural person”—after the requirement that the investor's net worth “exceeds \$1,000,000” currently in the rules.

In addition, our proposed amendments would add, after the Dodd-Frank statutory language, the phrase “calculated by subtracting from the estimated fair market value of the property the amount of debt secured by the property, up to the estimated fair market value of the property.” As so amended, the accredited investor net worth standards in the relevant rules would define as an accredited investor:

Any natural person whose individual net worth, or joint net worth with that person's spouse, at the time of purchase, exceeds \$1,000,000, excluding the value of the primary residence of such natural person, calculated by subtracting from the estimated fair market value of the property the amount of debt secured by the property, up to the estimated fair market value of the property.

The purpose of adding the phrase introduced by the words “calculated by” is to clarify that net worth is calculated by excluding only the investor's net equity in the primary residence.<sup>28</sup>

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<sup>26</sup> See, e.g., *Interpretive Release on Regulation D*, Release No. 33-6455 (Mar. 3, 1983) [48 FR 10045] (Questions 21 and 45). See also *Barron's Financial Guides*, Dictionary of Finance and Investment Terms, at 457 (7<sup>th</sup> ed. 2006).

<sup>27</sup> Historically, we have maintained identical accredited investor standards under both rules.

<sup>28</sup> Soon after enactment of Section 413(a), the staff of the Division of Corporation Finance issued the following interpretation:

Question: Under Section 413(a) of the Dodd-Frank Act, the net worth standard for an accredited investor, as set forth in Securities Act Rules 215 and 501(a)(5), is adjusted to delete from the calculation of net worth the “value of the primary residence” of the investor. How should the “value of the primary residence” be determined for purposes of calculating an investor's net worth?

We believe this approach is appropriate because it is consistent with, and advances the regulatory purposes of, Section 413(a). It reduces the net worth measure by the amount or “value” that the primary residence contributed to the investor’s net worth before enactment of Section 413(a). Consequently, it removes the value of the primary residence from net worth without reducing net worth by more than the amount contributed by the residence before the amendment.<sup>29</sup>

We note that some of our existing rules follow an approach similar to our proposal in calculating net worth. For example, Rule 701 under Regulation R, which provides for the exclusion of the value of a person’s primary residence in applying a net worth standard, provides for the exclusion of “associated liabilities,” such as mortgages on the property.<sup>30</sup>

Under our proposed amendments, if an investor with a net worth of \$2 million (calculated

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Answer: Section 413(a) of the Dodd-Frank Act does not define the term “value,” nor does it address the treatment of mortgage and other indebtedness secured by the residence for purposes of the net worth calculation. As required by Section 413(a) of the Dodd-Frank Act, the Commission will issue amendments to its rules to conform them to the adjustment to the accredited investor net worth standard made by the Act. However, Section 413(a) provides that the adjustment is effective upon enactment of the Act. When determining net worth for purposes of Securities Act Rules 215 and 501(a)(5), the value of the person’s primary residence must be excluded. Pending implementation of the changes to the Commission’s rules required by the Act, the related amount of indebtedness secured by the primary residence up to its fair market value may also be excluded. Indebtedness secured by the residence in excess of the value of the home should be considered a liability and deducted from the investor’s net worth.

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>29</sup> Moreover, this approach to calculating net worth is generally consistent with the manner in which net worth has conventionally been determined since the adoption of Regulation D in 1982, which served as the background for Congress when it enacted Section 413(a).

<sup>30</sup> 17 CFR 247.701(d)(1)(A) (defining “high net worth customer” as a natural person who, individually or jointly with his or her spouse, has at least \$5 million in net worth “excluding the primary residence and associated liabilities of the person and, if applicable, his or her spouse”). Rule 701 was jointly adopted by the Securities and Exchange Commission and the Federal Reserve Board after consultation with and the concurrence of the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Office of Thrift Supervision. *See Definitions of Terms and Exemptions Relating to the “Broker” Exception for Banks*, Release No. 34-56501 (Sept. 24, 2007) [72 FR 56514 (Oct. 3, 2007)]. In addition, Rule 17a-3(a)(17)(i)(A) under the Exchange Act requires exchange members, brokers, and dealers to make and keep records of accounts of natural persons, including a record of the person’s net worth “excluding the value of primary residence.” 17 CFR 240.17a-3(a)(17)(i)(A). Our Division of Trading and Markets, which administers this rule, interprets this provision to exclude the associated liabilities of the primary residence for purposes of the net worth test.



in the conventional manner 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 would be \$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 proposed rule, exclusion of the value of the primary residence would reduce the investor's net worth by the same amount of \$400,000.

We believe our approach is preferable to possible alternative interpretations. One alternative interpretation, excluding the fair market value of the residence without netting out the secured indebtedness, would reduce the net worth of any investor who has a mortgage by more than the amount that the primary residence contributed to the investor's net worth before enactment of Section 413(a). In the example above, if the new standard did not allow exclusion of the associated indebtedness, removal of the primary residence would reduce the investor's net worth by \$1.2 million, for a revised net worth of \$800,000, since the entire fair market value of the house (\$1.2 million) would be subtracted from the investor's net worth of \$2 million and the \$800,000 mortgage loan would still be included as a liability in the calculation.

We believe that following this alternative approach and reducing the net worth by the value of the primary residence without excluding associated indebtedness would not accord with the manner in which net worth was determined before enactment of Section 413(a).<sup>31</sup> Absent

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<sup>31</sup> In addition, this alternative approach would also result in a substantially greater reduction in the pool of accredited investors. Using data from the 2007 Federal Reserve Board Survey of Consumer Finances, the latest data available, our Division of Risk, Strategy and Financial Innovation estimates that 10,496,312 of the 116,122,128 U.S. households (9.04%) qualified for accredited investor status on the basis of the net worth standard before it was

legislative history suggesting Section 413(a) was clearly intended to be implemented in that fashion, we believe our proposed approach is appropriate and consistent with the purpose of Section 413(a)—to remove the “value of the primary residence” from the calculation of net worth for accredited investor determinations.<sup>32</sup>

Under our proposed amendments, indebtedness secured by the primary residence would be netted against the value of the primary residence only up to the fair market value of the property. For example, if an investor with a net worth of \$2 million has a primary residence with an estimated fair market value of \$600,000 and secured indebtedness of \$800,000, a \$600,000 portion of the secured indebtedness would be netted against the entire \$600,000 value of the house, so the investor’s net worth for purposes of the new accredited investor standard would remain at \$2 million. The \$200,000 in secured indebtedness in excess of the value of the property would already have been accounted for (i.e., subtracted from the value of other assets) in determining the investor’s net worth.

In comparison, another possible interpretation of Section 413(a) would be to exclude

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modified by Section 413(a) of the Dodd-Frank Act; 7,604,374 (6.55%) would have qualified on the basis of the net worth standard after modification based on Section 413(a), as interpreted by our proposed approach to exclude from the net worth calculation both the estimated fair market value of the primary residence and all indebtedness secured by the residence up to the fair market value of the property; and 6,858,335 (5.91%) would have qualified if we adopted a standard based on the alternative interpretation of Section 413(a) to exclude from the net worth calculation the fair market value of the primary residence but not any indebtedness secured by the residence. More information regarding the survey may be obtained at <http://www.federalreserve.gov/pubs/oss/oss2/scfindex.html>. See also note 49 below and accompanying text.

<sup>32</sup> Section 413(a) was one element of an amendment introduced on the floor of the Senate and adopted by voice vote. See 156 Cong. Rec. S3817 (daily ed. May 17, 2010). The amendment, as explained by Senator Dodd, *id.* at S3813, would (1) “disqualify felons and other ‘bad actors’ who have violated Federal and State securities laws from continuing to take advantage of the rule 506 private placement process,” (2) “amend the ‘accredited investor’ wealth threshold by excluding the value of an investor’s primary residence,” and (3) direct the SEC “to review the [accredited investor] financial standards at least [every] 4 years,” and replaced a provision that would have required the Commission to adjust both the net worth and the income standards for accredited investors to reflect inflation from the date of their determination in 1982 to the date of enactment of the Dodd-Frank Act in 2010. See Amendment as Substitute No. 3789 to S. 3217, 111<sup>th</sup> Cong., 2d Sess. § 412 (available at [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111\\_cong\\_bills&docid=f:s3217as.txt.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:s3217as.txt.pdf)). The legislative history does not suggest that the amount of associated mortgage debt should not also be deleted in calculating net worth.

from net worth both the fair market value of the primary residence and all indebtedness secured by the primary residence, regardless of whether the indebtedness exceeds the fair market value of the property. This alternative interpretation is the same as our proposal when the value of the property exceeds the secured indebtedness, but provides a different result if the amount of secured debt exceeds the value of the property (*i.e.*, the case of an underwater mortgage). For example, under this interpretation, if an investor with a net worth of \$2 million has a primary residence with an estimated fair market value of \$600,000 and a mortgage loan of \$800,000 and no other secured indebtedness, the investor's net worth for purposes of the new accredited investor standard would be \$2,200,000. Net worth is effectively increased over the conventional net worth calculation by \$200,000 (the amount the underwater mortgage exceeds the value of the property). We do not believe, however, that it would be appropriate for us to implement Section 413(a) in a way that results in increased net worth (compared to a conventional calculation) for investors with underwater mortgages.

As noted above, the requirement to exclude the value of the primary residence became operative when the statute was enacted. Therefore, we are not making any special provision for the transition to the new requirement. We are nevertheless specifically requesting comment below on whether some transition provisions would be appropriate.

## **(2) Other Issues Considered**

We considered a number of issues described below, as to which the proposed amendments reflect our preliminary determinations. These issues are the subject of specific requests for comment at the end of this section.

**Defining “Primary Residence.”** We considered proposing amendments that would have defined the term “primary residence” for purposes of the rules we are amending. While we are

soliciting comment on whether a definition should be added to the rule, the proposal does not contain a definition, consistent with our past policies in this area,<sup>33</sup> and in an attempt to avoid unnecessary complexity.<sup>34</sup>

Issuers and investors should be able to use the commonly understood meaning of “primary residence”—the home where a person lives most of the time.<sup>35</sup> If additional analysis is needed under complex or unusual circumstances, helpful guidance may be found in rules that apply in other contexts, such as income tax rules and rules that apply when acquiring a mortgage loan for a primary residence, which often bears a lower interest rate than other mortgage loans.<sup>36</sup>

### **Proceeds of Debt Secured by Primary Residence Incurred to Invest in**

**Securities.** The North American Securities Administrators Association (“NASAA”) has recommended that we not permit the exclusion of debt secured by a primary residence from the calculation of net worth if proceeds of the debt are used to invest in securities.<sup>37</sup> NASAA is concerned that, in the absence of such a rule, an “unscrupulous salesperson might encourage a

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<sup>33</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) & 17 CFR 210.2-01(c)(1)(ii)(A)(4). Regulation D also does 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). There, Regulation D uses 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 propose to change this reference from “principal residence” to “primary residence” so that it conforms to the terminology of the Dodd-Frank Act. *See* note 44 below and accompanying text.

<sup>34</sup> We followed this approach when we adopted Regulation D originally and decided not to define the term “income,” an element of another of our accredited investor standards. At the time, we explained that, “[r]ather than adopting a definition [of the term “income,” we] determined to utilize a flexible approach” to avoid problems with a defined term. *Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales*, Release No. 33-6389 (Mar. 8, 1982) [47 FR 11251, 11255 (Mar. 18, 1982)].

<sup>35</sup> *See* IRS Publication 523, *Selling Your Home 2* (Mar. 8, 2010) (“Usually, the home you live in most of the time is your main home...”).

<sup>36</sup> For example, the IRS Publication *Selling Your Home* lists the following factors to be used, in addition to the amount of time a person lives in each of several homes, to determine a person’s “principal residence” under Section 121 of the Internal Revenue Code, 26 U.S.C. 121: place of employment; location of family members’ main home; mailing address for bills and correspondence; address listed on federal and state tax returns, driver’s license, car registration, and voter registration card; location of banks used and recreational clubs and religious organizations. *Id.* at 4.

<sup>37</sup> Advance Comment Letter from NASAA, note 18 above.

person with a significant amount of equity in the person's home, which is not uncommon for older investors, to take out a mortgage on the residence in order to manipulate their status under the accredited investor test and to use the proceeds to invest in what would otherwise be unsuitable private placement securities."<sup>38</sup> We agree that such actions would raise serious concerns under the federal securities laws. If broker-dealer sales personnel engage in this type of activity, their conduct can be addressed under the standards governing broker-dealer sales practices.<sup>39</sup> However, we preliminarily do not believe that the potential for inappropriate sales practices, whether by issuers or by broker-dealers, necessitates adding significant complexity to the calculation of net worth. As noted above, Regulation D is designed to be relatively straightforward to apply, and we are concerned that a rule that attempts to trace the use of mortgage or home equity loan proceeds and to distinguish between permissible and impermissible uses of proceeds would introduce undue complexity into Regulation D. We request public comment on this preliminary judgment below.

We also are soliciting comment on whether the proposed amendments should contain a timing provision in order to prevent investors from inflating their net worth by purchasing assets with the proceeds of indebtedness secured by their homes with the intent to qualify as accredited investors and purchase Regulation D securities. For example, the proposed amendments could provide that the net worth calculation must be as of a date 30 or 60 days before the sale of the

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<sup>38</sup> *Id.* at 2.

<sup>39</sup> 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.

securities, as well as at the time of sale. Because we have some concern that this could complicate issuers' and investors' calculations, particularly as the date of the sale may not be known sufficiently in advance, we are not proposing such a timing provision, but request comment on this preliminary judgment.

**Transition and Other Rules on Subsequent Investments.** We are not proposing any special rules for transition to the new accredited investor net worth standards, since these new standards were effective upon enactment of the Dodd-Frank Act. Under the current rules, a company or fund is not permitted to treat an investor as accredited if the investor subsequently loses that status, even if the investor has previously invested in the company or fund at a time when it satisfied the accredited investor standard. Investors must satisfy the applicable accredited investor income or net worth standard in effect at the time of every exempt sale of securities to the investor that is made in reliance upon the investor's status as such. The proposed amendments would not change this situation.

We nevertheless are seeking comment below on whether some transition and other rules might be appropriate to facilitate subsequent investments by an investor who previously qualified as accredited but was disqualified by the change effected by the Dodd-Frank Act. For example, an investor that qualified as an accredited investor in a previous sale under Regulation D before enactment of the Dodd-Frank Act may wish to invest in the same company or fund in order to retain its proportionate interest in the company or fund or to exercise rights that have arisen because of that interest.<sup>40</sup> Or a company may wish to make a rights offering to current investors who invested as accredited investors. In this case, the company may not wish to be subject to the

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<sup>40</sup> Such contractual rights may include preemptive rights, rights of first refusal, rights of co-sale, buy-sell agreements and so-called pay to play provisions that provide for dilution or other adverse consequences to affected investors who do not fund capital calls or otherwise reinvest in future rounds of financing.

additional information requirements it may incur under Regulation D if it offers and sells securities to non-accredited investors,<sup>41</sup> and the company may be precluded from making the offering if the number of non-accredited investors exceeds the limit of 35 non-accredited investors imposed in Rule 505 and Rule 506 offerings. In some of these cases, the investor may have spent a substantial amount of time and money performing due diligence on the company or fund before his or her previous investments and may be familiar with the issuer as an existing investor. Under these circumstances, some have argued that the investor should be able to invest again as an accredited investor even if the investor does not satisfy the standards applicable at the time of the subsequent investment.<sup>42</sup>

### **Specific Requests for Comment**

1. Should the value of the residence be calculated by netting out the debt secured by the residence, as proposed? Or would it be more appropriate to exclude the entire fair market value of the residence from net worth, without netting out any associated debt?
2. Would it be more appropriate to substitute the word “equity” for the word “value” when referring to the primary residence in our accredited investor net worth standards?
3. Should we interpret Section 413(a) to exclude 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 property?

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<sup>41</sup> See CFR 230.502(b)(1).

<sup>42</sup> A speaker at the SEC Forum on Small Business Capital Formation conducted on November 18, 2010 suggested that an investor that qualified as an accredited investor when initially investing in a company or fund should be able to continue to invest in future offerings of that issuer, even if the investor no longer meets any new elevated accredited investor standards. See Record of Proceedings of 29<sup>th</sup> Annual SEC Government-Business Forum on Small Business Capital Formation, at 18 (Nov. 18, 2010) (remarks of Alan J. Berkeley) (available at <http://www.sec.gov/info/smallbus/sbforumtrans-111810.pdf>).

4. Is another interpretation of Section 413(a) superior to those we discussed?
5. Should we define the term “primary residence” for purposes of our accredited investor net worth rules? If we define the term, should we use a definition under the federal income tax code? If so, should we also incorporate into our definition a reference to guidelines issued under the federal income tax code? Alternatively, should we define “primary residence” as the commonly understood meaning of the term—the home where a person lives most of the time? What alternative definitions would you recommend? For example, should we define the term by listing several factors to consider? Would the factors from the IRS publication listed in note 35 be the appropriate factors, or are there different factors that should be included?
6. Should we require inclusion of debt secured by a primary residence in our proposed accredited investor net worth standard if proceeds of the debt are used to invest in securities? How would these proceeds be traced? Would companies and their prospective investors find this standard workable? Should distinctions be made among different kinds of securities? Are there other assets besides securities that should be taken into account?
7. Should the rule provide that the calculation of net worth must be made as of a specified date before the sale of securities under Regulation D, for example, 30, 60 or 90 days, as well as at the time of sale? If not, would investors be likely to inflate their net worth by borrowing against their homes to attain accredited investor status? If we required that the net worth calculation be made a significant period of time in advance of the sale, would such a requirement make the calculation unduly complex or otherwise make exempt offerings to accredited investors less useful for issuers?



8. Issuers and investors have calculated net worth under the Regulation D accredited investor standards for many years without specific instructions in the rules on how the calculation should be performed. Would guidance in the rules on how to calculate net worth, in addition to the new standards governing valuing the primary residence and treating related mortgage debt, be helpful? For example, should we adopt rules specifying what should be included as assets and debt, and how various kinds of assets should be valued? If so, what additional rules would be appropriate?
9. Should we adopt any transition or other rules providing that an investor who previously qualified as an accredited investor before enactment of Section 413(a), or adoption of the proposed amendments, may continue to qualify as such for purposes of subsequent or “follow-on” investments, such as investments to protect its proportionate interest in a company or fund or to exercise rights that arise because of that interest, or would that be inconsistent with the purposes of Section 413(a)? If we should adopt such an approach, are there other types of investments that should qualify for such treatment? Would investors’ ability to protect their then-existing investments be inappropriately adversely affected if we did not provide such treatment? Would issuers’ ability to raise capital be inappropriately impeded if we did not provide such treatment? If we did this, should we limit the amount of permissible follow-on investments, such as limiting them to the amount necessary to protect the investor from dilution? What conditions should we place on qualifying for such treatment? Is this unnecessary because the Section 4(2) private placement exemption may be available for sales to such an existing investor? Instead, should we provide that an investor who previously qualified as an accredited investor, but no longer qualifies as a result of Section 413(a), would not count towards the 35 non-

accredited investor limitation of Rules 505(b) and 506(b)<sup>43</sup> for offerings by issuers in which the investor held investments at the time the Dodd-Frank Act was enacted?

### **(B) Technical and Conforming Amendments**

In order to avoid confusion, we are proposing to change the reference currently in Rule 501(e)(1)(i) of Regulation D to “principal residence” so that it reads “primary residence” and conforms to the language we are adding to Rule 501 to implement Section 413(a) of the Dodd-Frank Act. We believe the terms are synonymous and should read the same.<sup>44</sup>

Also to avoid confusion, we propose to revise 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 propose to amend 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; 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. GENERAL REQUEST FOR COMMENT**

We request comment, both specific and general, on each component of the proposals.

We request and encourage any interested person to submit comments regarding:

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<sup>43</sup> 17 CFR 230.505(b) and 230.506(c).

<sup>44</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).

- the proposals that are the subject of this release; and
- other matters that may have an effect on the proposals contained in this release.

Comment is solicited from the point of view of both investors and issuers, as well as of capital formation facilitators, such as broker-dealers, and other regulatory bodies, such as state securities regulators. Any interested person wishing to submit written comments on any aspect of the proposal is requested to do so.

#### **IV. PAPERWORK REDUCTION ACT**

The proposed amendments do not contain a “collection of information” requirement within the meaning of the Paperwork Reduction Act of 1995.<sup>45</sup> Accordingly, the Paperwork Reduction Act is not applicable.

#### **V. COST-BENEFIT ANALYSIS**

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

As discussed above, we are proposing amendments to the accredited investor standards in our rules under the Securities Act to reflect 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 the primary residence. The substantive change to the net worth standards was effective by operation of the Dodd-Frank Act upon enactment; however, Section 413 also requires us to adjust the accredited

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<sup>45</sup> 44 U.S.C. 3501-3521.

investor definitions in our Securities Act rules to reflect the new standard. We therefore propose to revise Securities Act Rule 501(a)(5) of Regulation D and Securities Act Rule 215(e) to reflect the new standard.

Our proposed revisions go beyond the minimum language necessary to reflect the new standard by providing guidance on how to exclude the value of the primary residence from the net worth calculation. This language would explain that the value of the primary residence would be “calculated by subtracting from the estimated fair market value of the property the amount of debt secured by the property, up to the estimated fair market value of the property.”

Our analysis here focuses on the costs and benefits to the economy of including our proposed explanatory language, as compared to the alternatives discussed, rather than the costs and benefits of the new heightened accredited investor net worth standard, which was mandated by Congress in Section 413(a) of the Dodd-Frank Act.

The language we propose reflects our exercise of discretion in choosing one interpretation of the statutory language set forth in Section 413(a) over two other possible interpretations. These two other interpretations of the Section 413(a) language are: (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 residence.

We are also proposing technical changes to Form D and a number of rules to conform them to the Dodd-Frank Act, in all but one instance to revise cross-references to former Section 4(6) of the Securities Act, which was renumbered Section 4(5) in Section 944 of the Dodd-Frank Act.

We have identified certain benefits and costs that may result from the proposed explanatory language. We encourage the public to identify, discuss, analyze and supply relevant data regarding these or any additional benefits and costs in comment letters on these proposed amendments.

## **B. Benefits**

We preliminarily believe the proposed explanatory language provides the most appropriate interpretation of the words of Section 413(a). The proposed explanatory language would result in the following benefits:

- We believe the proposed amendments most accurately reflect the manner in which net worth has conventionally been determined and understood. We believe investors and issuers would benefit from implementing rules that are easy to understand and consistent with conventional net worth calculation concepts.<sup>46</sup>
- The interpretation reflected in the proposed amendments would result in a smaller reduction in the pool of accredited investors than the first alternative interpretation.<sup>47</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.
- Limiting the amount of debt secured by the primary residence that may be excluded from net worth to the estimated fair market value of the property, as proposed, would limit investors' incentives to incur indebtedness secured by their primary residence in

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<sup>46</sup> See note 26 above and accompanying text.

<sup>47</sup> See note 31 above.

an amount greater than the value of their property. This result is preferable to an alternative possible interpretation of Section 413(a) that would allow investors to exclude both the fair market value of the property and all indebtedness secured by the property, regardless of whether such indebtedness exceeded the fair market value of their property. Under this alternative interpretation, investors with underwater mortgages would have a higher net worth than they would under a conventional calculation, since all such indebtedness would be excluded in determining whether they qualify as accredited investors on the basis of their net worth. In contrast, under our proposal, the investor's net worth would continue to be reduced to reflect any liability in the amount of any shortfall between the mortgage indebtedness and the estimated fair market value of the property.

### **C. Costs**

Like our analysis of the benefits, our analysis of the costs focuses on the costs attributable to our proposed language on how to calculate the “value of the primary residence” to be excluded from the net worth calculation. Many of the costs of our proposal are dependent on a number of factors, but may include the following:

- The proposed amendments could encourage investors to obtain indebtedness secured by their primary residence up to the estimated fair market value of the property with the primary motive to inflate their net worth in order to satisfy the new heightened accredited investor net worth standard in Section 413(a) by purchasing assets unrelated to their home, such as stocks, bonds, cars, etc. The net effect would be to increase net worth under the rule, since these assets, unrelated to the home, would be included in their net worth calculation, but the indebtedness secured by the primary residence to acquire these

assets would be excluded from the net worth calculation under our proposed amendments.<sup>48</sup>

- The proposed approach would require that an investor's net worth reflect the amount that the investor's secured indebtedness exceeds the estimated fair market value of the property. While the 2007 Federal Reserve Board Survey of Consumer Finances does not indicate that there was any difference in the number of households that would qualify under the two standards,<sup>49</sup> given recent downward trends in real estate values, our proposed approach could 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. This could result in increased costs for companies and funds that are seeking accredited investors to participate in their exempt offerings.
- The proposed approach involves more complex calculations than the two alternative possible approaches we have identified. The proposed approach involves estimating the fair market value of the investor's primary residence, subtracting the indebtedness secured by the residence, and subtracting the difference or net amount from the investor's net worth calculation. Both of the alternative net worth calculations, however, 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 interpretation also ignoring the

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<sup>48</sup> NASAA has recommended that we not permit the exclusion of debt secured by a primary residence from the calculation of net worth if the proceeds of the debt are used to invest in securities. *See* Advance Comment Letter from NASAA, note 18 above, and note 37 above and accompanying text. We have solicited comment above on this issue.

<sup>49</sup> Based on its analysis of the data from the 2007 Federal Reserve Board Survey of Consumer Finances, discussed in note 31 above, our staff estimates that approximately 7.6 million households would have qualified for accredited investor status under both our proposed approach and the second alternative interpretation of Section 413(a), which would exclude from the net worth calculation both the fair market value of the primary residence and all indebtedness secured by the residence, regardless of whether the indebtedness exceeds the fair market value of the property.

indebtedness secured by the primary residence.

#### **D. Request for Comment**

We solicit comments on the costs and benefits of the proposed amendments. We request your views on the costs and benefits described above, as well as on any other costs and benefits that could result from the adoption of our proposals. We encourage the public to identify, discuss, analyze, and supply relevant data regarding these or any additional costs and benefits in comment letters.

In general, we request comment on all aspects of this cost-benefit analysis, including identification of any additional costs or benefits of the proposals not already identified, that may result from the adoption of these proposed amendments. We request that comment letters responding to these requests provide empirical data and other factual support for their views to the extent possible.

### **VI. CONSIDERATION OF BURDEN ON COMPETITION AND PROMOTION OF EFFICIENCY, COMPETITION AND CAPITAL FORMATION**

Section 2(b) of the Securities Act<sup>50</sup> 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. We believe our proposed amendments may facilitate capital formation and promote efficiency. We do not anticipate that the proposed amendments would have any effects on competition.

We believe the proposed amendments impose no burden on efficiency, competition and capital formation beyond what is required by implementation of the Dodd-Frank Act. As

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<sup>50</sup> 15 U.S.C. 77b(b).



discussed in the cost-benefit analysis in Part V above, however, the language of Section 413(a) could be subject to alternative interpretations if our rules do not provide guidance on how to calculate the value of the primary residence. In this regard, we propose to add explanatory language to our rules on how to calculate and exclude the value of the primary residence in determining whether a person qualifies under the accredited investor net worth standard. We believe these proposed amendments further the purposes underlying the requirements of Section 413(a) of the Dodd-Frank Act.

The proposed explanatory language states that the value of the primary residence would be “calculated by subtracting from the estimated fair market value of the property the amount of debt secured by the property, up to the estimated fair market value of the property.” As described above, we believe this approach is consistent with Section 413(a) of the Dodd-Frank Act, as well as with the conventional and commonly understood method of determining net worth, and, as a result, is preferable to an alternative approach that would exclude from net worth the fair market value of the primary residence, without netting out indebtedness secured by the primary residence. To the extent that exempt offerings to accredited investors are less costly for issuers to complete compared to registered offerings, since the explanatory language would reduce the size of the accredited investor pool to a lesser extent than the alternative approach,<sup>51</sup> issuers conducting these exempt offerings potentially could experience greater cost savings than under the alternative interpretation.

The least restrictive approach to excluding the value of the primary residence under Section 413(a) would be to exclude from net worth the fair market value of the primary residence and all indebtedness secured by the primary residence, regardless of whether the debt exceeds

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<sup>51</sup> See note 31 above and accompanying text.

the fair market value of the property. Based on the survey data, this approach would not result in a larger pool of eligible accredited investors than under our proposal, and therefore would not appear to result in additional cost savings for capital raising transactions by issuers relying on exempt sales to accredited investors compared to our proposal.<sup>52</sup>

We do not believe the proposed amendments place any significant burden on or otherwise affect competition beyond what is required by the Congressionally-mandated requirements of Section 413(a). The proposed amendments would apply equally to all investors and issuers participating in exempt offerings under Regulation D and Section 4(5). Nevertheless, we request comment on our proposal in the event members of the public perceive it as advantaging one group or category of issuers or investors over another.

We believe the proposed amendments may positively affect efficiency and capital formation. Providing clear guidance on how to calculate and exclude the value of the primary residence, we believe, should generally benefit investors and issuers by making the requirements of Section 413(a) easier to apply. 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, as well as the risk of sales by issuers to investors who do not meet the new heightened accredited investor net worth standards. Avoiding this latter problem would also serve to lower the risk that an issuer may need to make a rescission offer. 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.

We request comment on whether the proposed amendments, if adopted, would promote or burden efficiency, competition and capital formation. Finally, we request those who submit

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<sup>52</sup> See note 49 above and accompanying text.

comment letters to provide empirical data and other factual support for their views if possible.

## **VII. INITIAL REGULATORY FLEXIBILITY ACT ANALYSIS**

This initial regulatory flexibility analysis has been prepared in accordance with 5 U.S.C. 603. It relates to proposed amendments to our accredited investor rules under the Securities Act to reflect the requirements of Section 413(a) of the Dodd-Frank Act.

### **A. Reasons for the Proposed Action**

The reason for the proposed 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 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 the 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 reflect the new standard, which we propose to do by revising Securities Act Rule 501(a)(5) of Regulation D and Rule 215(e).

### **B. Objectives**

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 also propose to add language explaining how to “exclude the value of the primary residence” properly so that implementation proceeds in the most efficient way possible, with a minimum amount of uncertainty. We believe this proposal will reduce the cost of exempt offerings under Regulation D and Section 4(5) by

reducing uncertainty among issuers and investors in interpreting the new heightened 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 this form of offering, thereby potentially lowering the cost of capital generally, and facilitating capital formation for smaller issuers, while protecting investors.

We note that Section 413(a) of the Dodd-Frank Act does not prescribe the method for calculating the value of the primary residence, nor does it address specifically the treatment of mortgage and other indebtedness secured by the residence for purposes of the net worth determination. Accordingly, we have proposed to exercise our discretion by adding explanatory language to the accredited investor net worth standard stating that the value of the primary residence should be calculated by subtracting from the estimated fair market value of the property the amount of debt secured by the property, up to the estimated fair market value of the property. We believe this interpretation is consistent with conventional and commonly understood methods of determining net worth, and is preferable to other possible interpretations of the statutory language set forth in Section 413(a), 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 property.

### **C. Legal Basis**

The amendments to the accredited investor net worth standards are being proposed under the authority set forth in Sections 2(a)(15), 3(b), 4(2), 19, and 28 of the Securities Act and in Section 413(a) of the Dodd-Frank Act, which is to be codified in a note to Section 2 of the

Securities Act, 15 U.S.C. 77b.

**D. Small Entities Subject to the Proposed Rules**

The proposals would 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>53</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 proposed amendments would 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 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 Sept. 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 reliable information on total assets to determine if they are small entities for purposes of this analysis.

**E. Reporting, Recordkeeping and Other Compliance Requirements**

None of our proposed amendments would increase the information or time required to complete the Form D that must be filed with the Commission in connection with sales under

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<sup>53</sup> 17 CFR 230.157.

Regulation D and Section 4(5). Our proposed amendments merely adjust our rules so they reflect the requirements of Section 413(a) of the Dodd-Frank Act. They would not require any further disclosure than is currently required in offerings made in reliance on Regulation D and Section 4(5).

**F. Duplicative, Overlapping or Conflicting Federal Rules**

We believe that there are no rules that conflict with or duplicate the proposed amendments.

**G. Significant Alternatives**

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objective of our proposals, while minimizing any significant adverse impact on small entities. In connection with the proposed 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 proposed amendments, or any part thereof, for small entities.

With respect to the establishment of special compliance requirements or timetables under our proposed amendments for small entities, we do not think this is feasible or appropriate. As described earlier, we believe our proposed amendments are preferable to other possible interpretations of the statutory language set forth in Section 413(a) and are consistent with

Congressional intent. Our proposals 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 proposals 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 and thereby further 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 proposed rules 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 proposal seeks 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 the value and leaving the method of attaining that end to the discretion of the issuer, as a performance standard would do, would frustrate our purpose and deny small entities and others of the benefits of certainty that the proposal is designed to provide.

With respect to exempting small entities from coverage of these proposed amendments, we believe such a proposal would increase rather than decrease regulatory burdens on small entities. Our proposals are designed to provide sufficient 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 would 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. Nevertheless, we request comment on ways in which we could exempt small entities from coverage of any aspects of the proposed amendments that members of the public consider unduly onerous.

#### **H. Request for Comment**

We encourage comments with respect to any aspect of this initial regulatory flexibility analysis. In particular, we request comments regarding:

- the number of small entities that may be affected by the proposals;
- the existence or nature of the potential impact of the proposals on small entities discussed in this analysis; and
- how to quantify the impact of the proposed amendments.

We request members of the public to submit comment letters on our proposals and ask them to describe the nature of any impact on small entities they identify and provide empirical data supporting the extent of the impact. Such comments will be considered in the preparation of the final regulatory flexibility analysis, if the proposals are adopted, and will be placed in the same public file as comments on the proposed amendments themselves.

### **VIII. SMALL BUSINESS REGULATORY ENFORCEMENT FAIRNESS ACT**

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,<sup>54</sup> a rule is “major” if it has resulted, or is likely to result in:

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<sup>54</sup> Pub. L. No. 104-121, tit. II, 110 Stat. 857 (1996).



- an annual effect on the economy of \$100 million or more;
- a major increase in costs or prices for consumers or individual industries; or
- significant adverse effects on competition, investment or innovation.

We request comment on whether our proposals would be a “major rule” for purposes of SBREFA. We solicit comment and empirical data on:

- the potential effect on the U.S. economy on an annual basis;
- any potential increase in costs or prices for consumers or individual industries;
- and
- any potential effect on competition, investment or innovation.

## **IX. STATUTORY AUTHORITY AND TEXT OF PROPOSED AMENDMENTS**

We are proposing the amendments contained in this document under the authority set forth in Sections 2(a)(15), 3(b), 4(2), 19 and 28 of the Securities Act, as amended,<sup>55</sup> Section 38(a) of the Investment Company Act,<sup>56</sup> Section 211(a) of the Investment Advisers Act<sup>57</sup> and Sections 413(a) and 944(a) of the Dodd-Frank Act.

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

Reporting and recordkeeping requirements, Securities.

For the reasons set out above, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended 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, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d,

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<sup>55</sup> 15 U.S.C. 77b(a)(15), 77c(b), 77d(2), 77s and 77z-3.

<sup>56</sup> 15 U.S.C. 80a-38(a).

<sup>57</sup> 15 U.S.C. 80b-11(a).

78j, 78l, 78m, 78n, 78o, 78t, 78w, 78ll(d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37 and Pub. L. No. 111-203, § 413(a), 124 Stat. 1577 (2010) (15 U.S.C. 77b note), unless otherwise noted.

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 “77(d)(6)” and adding in their places “4(5)” and “77(d)(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, at the time of purchase, exceeds \$1,000,000, excluding the value of the primary residence of such natural person, calculated by subtracting from the estimated fair market value of the property the amount of debt secured by the property, up to the estimated fair market value of the property;

\* \* \* \* \*

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 read 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, at the time of purchase, exceeds \$1,000,000, excluding the value of the primary residence of such natural person, calculated by subtracting from the estimated fair market value of the property the amount of debt secured by the property, up to the estimated fair market value of the property;

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

7. The general authority citation for Part 239 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78u-5, 78w(a), 78ll(e), 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)(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.

Elizabeth M. Murphy  
Secretary

Dated: January 25, 2011