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United States Government Accountability Office  
Washington, DC 20548

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B-322892

January 12, 2012

The Honorable Tim Johnson  
Chairman  
The Honorable Richard C. Shelby  
Ranking Member  
Committee on Banking, Housing, and Urban Affairs  
United States Senate

The Honorable Spencer Bachus  
Chairman  
The Honorable Barney Frank  
Ranking Member  
Committee on Financial Services  
House of Representatives

Subject: *Securities and Exchange Commission: Net Worth Standard for Accredited Investors*

Pursuant to section 801(a)(2)(A) of title 5, United States Code, this is our report on a major rule promulgated by the Securities and Exchange Commission (Commission), entitled “Net Worth Standard for Accredited Investors” (RIN: 3235-AK90). We received the rule on December 22, 2011. It was published in the *Federal Register* as a final rule on December 29, 2011, with an effective date of February 27, 2012. 76 Fed. Reg. 81,793.

The final rule amends the accredited investor standards in the Commission’s rules under the Securities Act of 1933 to implement the requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The 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. This change to the net worth standard was effective upon enactment by operation of the Dodd-Frank Act, but it also requires the Commission to revise its current Securities Act rules to conform to the new standard. The Commission is also adopting technical amendments to Form D and a number of rules to conform them to the

requirements of the Act 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.

Enclosed is our assessment of the Commission's compliance with the procedural steps required by section 801(a)(1)(B)(i) through (iv) of title 5 with respect to the rule. Our review of the procedural steps taken indicates that the Commission complied with the applicable requirements.

If you have any questions about this report or wish to contact GAO officials responsible for the evaluation work relating to the subject matter of the rule, please contact Shirley A. Jones, Assistant General Counsel, at (202) 512-8156.

signed

Robert J. Cramer  
Managing Associate General Counsel

Enclosure

cc: Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission

REPORT UNDER 5 U.S.C. § 801(a)(2)(A) ON A MAJOR RULE  
ISSUED BY THE  
SECURITIES EXCHANGE COMMISSION  
ENTITLED  
"NET WORTH STANDARD FOR  
ACCREDITED INVESTORS"  
(RIN: 3235-AK90)

(i) Cost-benefit analysis

The Commission states that its cost-benefit 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 Commission believes the rules it is 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). The Commission believes 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, and 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. Additionally, the Commission states that the look back period will reduce incentives to manipulate net worth calculations which should make investors whose net worth reaches the accredited investor threshold only if the 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 Commission also states that 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 Commission states that like its analysis of the benefits, its analysis of the costs focuses on the costs attributable to its 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. The Commission states that the transition provision 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. The Commission believes this will impose costs to the extent that such investors would have benefited from such protections. According to the Commission, 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. Additionally, the Commission explains that the treatment of indebtedness secured by the primary residence that is incurred within 60 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. The Commission states that 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 Commission notes that the amendments may require investors to estimate the fair market value of the investor's primary residence to determine whether it exceeds the amount of indebtedness secured by the primary residence and believes this to be a manageable cost because 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. The Commission is not aware that market participants found the need for such an estimate to be problematic.

(ii) Agency actions relevant to the Regulatory Flexibility Act, 5 U.S.C. §§ 603-605, 607, and 609

The Commission states that a final regulatory flexibility analysis has been prepared in accordance with the Regulatory Flexibility Act and relates to amendments to its accredited investor rules under the Securities Act to implement the requirements of section 413(a) of the Dodd-Frank Act. According to the Commission, 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). The Commission explains that, 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 and 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 Commission also states that 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).

With respect to exempting small entities from coverage of these amendments, the Commission believes such a provision would have no impact on the regulatory burdens on small entities, since section 413(a) became effective upon enactment. The Commission believes its amendments are designed to minimize confusion among issuers and investors and to provide for the protection of investors without unduly burdening both issuers and investors, including small entities and their investors. The Commission believes exempting small entities could potentially increase their regulatory burdens and increase confusion and has endeavored to minimize the regulatory burden on all issuers, including small entities, while meeting its regulatory objectives.

(iii) Agency actions relevant to sections 202-205 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. §§ 1532-1535

As an independent regulatory agency, the Commission is not subject to title II of the Unfunded Mandates Reform Act of 1995.

(iv) Other relevant information or requirements under acts and executive orders

Administrative Procedure Act, 5 U.S.C. §§ 551 et seq.

The final regulations were issued using the notice and comment procedures found at 5 U.S.C. § 553. On January 25, 2011, the Commission published a proposing release entitled “Net Worth Standard for Accredited Investors.” 76 Fed. Reg. 5307. The Commission received 43 comment letters in response to the proposing release and 15 letters commenting on section 413(a) of the Dodd-Frank Act before the publication of the proposing release 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. The Commission states that 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 Commission notes that the final rule reflects changes made in response to these comments, as well as other clarifying changes.

Paperwork Reduction Act, 44 U.S.C. §§ 3501-3520

The Commission states that the amendments it is adopting do not contain a “collection of information” requirement within the meaning of the Paperwork Reduction Act of 1995 and, accordingly, the Paperwork Reduction Act is not applicable.

## Statutory authorization for the rule

The Commission states that the final rule is authorized by sections 2(a)(15), 3(b), 4(2), 19 and 28 of the Securities Act, as amended, section 38(a) of the Investment Company Act, section 211(a) of the Investment Advisers Act and sections 413(a) and 944(a) of the Dodd-Frank Act. 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.

### Executive Order No. 12,866 (Regulatory Planning and Review)

As an independent regulatory agency, the Commission is not subject to the review requirements of the order.

### Executive Order No. 13,132 (Federalism)

As an independent regulatory agency, the Commission is not subject to the review requirements of the order.