



NASAA

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November 4, 2010

Elizabeth M. Murphy, Secretary  
Securities and Exchange Commission  
100 F Street NE  
Washington, D.C. 20549-1090

**Subject: Accredited Investor Standard, Title IV Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, File No. DF Title IV – Accredited Investor**

Dear Ms. Murphy:

The North American Securities Administrators Association, Inc. (“NASAA”)<sup>1</sup> appreciates the opportunity to provide comments to the Securities and Exchange Commission (“Commission”) concerning the definition of accredited investor prior to potential rule-making following the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act.<sup>2</sup> NASAA is pleased that Congress has recognized the need to adjust the financial thresholds for determining accredited investor status and has encouraged the Commission to evaluate whether other adjustments or modifications are necessary for the protection of investors. Beyond the adjustment of the financial thresholds already set forth in the definition of accredited investor, NASAA believes further modifications are necessary for the protection of investors. Our comments are set forth below.

**1. NASAA strongly recommends the adoption of an “investments owned” standard as an additional requirement to the accredited investor test.**

The “accredited investor” definition was adopted as a quantitative standard to identify investors that could presumably “fend for themselves without the protections afforded by registration”<sup>3</sup> when investing in private offerings. As we have asserted in the past,<sup>4</sup> the current accredited investor definition bears little correlation, if any, with investor qualification.

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<sup>1</sup> The oldest international organization devoted to investor protection, the North American Securities Administrators, Inc. was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

<sup>2</sup> Public Law No. 111-203 [hereinafter Dodd-Frank Act].

<sup>3</sup> Proposed Revision of Certain Exemptions from the Registration Provisions of the Securities Act of 1933 for Transactions Involving Limited Offers and Sales, Securities Act Release No. 33-6339, 46 FR 41791, 1981 SEC LEXIS 924 (Aug. 7, 1981).

<sup>4</sup> See, e.g., Letter from Karen Tyler, NASAA President and Commissioner of the North Dakota Securities Department, to Nancy M. Morris, Secretary, SEC (Oct. 26, 2007) (regarding Securities Act Release No. 33-8828),

The adjustment of the current thresholds set forth in the accredited investor definition for inflation and to exclude the primary residence from the calculation of an investor's net worth are admirable steps towards improving the definition in order to assure that these investors are financially qualified to invest in private offerings. These standards do not, however, lend themselves to a presumption that an investor has any investment decision making experience such that issuers should be allowed to sell them securities in private offerings rather than have to register the securities in the interest of investor protection.

In its rule-making release in 2007, the Commission proposed adopting an "investments owned" test as an alternative basis for determining accredited investor status in addition to the existing net worth and income standards.<sup>5</sup> An "investments owned" test is a better quantitative standard for determining investor qualification as it is a more appropriate presumption that investors who have amassed a significant amount of investments may have sufficient investment decision making experience as compared to an investor who has a high net worth or income but may have little or no investment experience. For this reason, NASAA again urges the Commission to modify the accredited investor definition to incorporate an "investments owned" standard. Such a standard should, however, be an additional requirement for determining accredited investor status as opposed to an alternative. In particular, the accredited investor test should require that, in addition to satisfying the current financial thresholds for natural persons, the investor must have at least \$1,000,000 in investments to qualify as an accredited investor.<sup>6</sup>

**2. NASAA urges the Commission to clarify the staff interpretation of the Dodd-Frank Act concerning the exclusion of the value of indebtedness secured by an investor's primary residence to specify that the calculation of net worth shall include indebtedness secured by an investor's primary residence to the extent the debt was incurred to invest in securities.**

The Dodd-Frank Act mandates the exclusion of the value of an investor's primary residence from the calculation of the investor's net worth.<sup>7</sup> Commission staff has issued guidance stating that the indebtedness secured by the primary residence up to the value of the residence may also be excluded.<sup>8</sup> Without further clarification, the Commission's guidance may create a loophole to the adjustment mandated by the Dodd-Frank Act itself.

As recognized by the Dodd-Frank Act, an individual who would satisfy the accredited investor definition based primarily on the value of their home should not be presumed to be financially sophisticated such that they may be sold securities in private offerings. They should instead be afforded the protections of the registration process. The guidance issued by the Commission staff may have, however, created a loophole for a person that has a significant amount of equity

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available at <http://www.sec.gov/comments/s7-18-07/S71807-57.pdf> [hereinafter 2007 NASAA Reg. D comment letter].

<sup>5</sup> Revisions of Limited Offering Exemptions in Regulation D, Release No. 33-8828, 72 Fed. Reg. 45,116 (Aug. 10, 2007), available at <http://www.sec.gov/rules/proposed/2007/33-8828fr.pdf>.

<sup>6</sup> See 2007 NASAA Reg. D comment letter, *supra* note 4; Letter from Joseph P. Borg, NASAA President and Director, Alabama Securities Commission to Nancy M. Morris, Secretary, SEC (Apr. 2, 2007) (regarding Securities Act Release No. 33-8766 and Investment Advisers Act Release No. 2576), available at <http://www.sec.gov/comments/s7-25-06/s72506-610.pdf>.

<sup>7</sup> Dodd-Frank Act, *supra* note 2, at § 413.

<sup>8</sup> Compliance and Disclosure Interpretations, SEC Division of Corporation Finance, Questions 179.01 and 255.47, available at <http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm>.

in a home and who would not otherwise qualify as an accredited investor. An unscrupulous securities salesperson might encourage a 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. In this scenario, the staff's guidance would allow the exclusion of the value of the investor's primary residence and the related indebtedness from the calculation of the investor's net worth. The cash proceeds of the mortgage would, however, be included in the investor's net worth and may therefore allow the investor to satisfy the net worth test. Such a result is extremely troublesome given that the investor is no more sophisticated for having taken out a mortgage, such a mortgage is likely ill advised, and such tactics are currently advised by unscrupulous salespersons whose aim is to generate sales commissions.

Given the potential for abuse as explained above and in the interest of investor protection, NASAA urges the Commission to clarify that the exclusion of debt secured by an investor's primary residence does not extend to indebtedness incurred in order to invest in securities. Further, the Commission should encourage the staff to provide guidance to issuers and broker-dealers that subscription agreements should include questions that require an investor to acknowledge that they have not incurred any indebtedness secured by the primary residence in order to invest in the securities offered.

**3. NASAA recommends the adjustment of the net worth standard for “qualified clients” in SEC Rule 205-3 to parallel the exclusion of an investor’s primary residence from the accredited investor definition.**

The definition of “qualified client” in SEC Rule 205-3 also includes a net worth test.<sup>9</sup> The qualified client test allows clients of an investment adviser who are presumably “financially experienced and able to bear the risks associated with performance fees to have the opportunity to negotiate compensation arrangements which they and their advisers consider appropriate.”<sup>10</sup> Performance based fees are often collected from investors who invest in pooled investment vehicles in private offerings under Rule 506 of Regulation D. Investment advisers to private pooled investment vehicles typically require that the investors satisfy both the accredited investor and qualified client tests in order to collect performance based fees in accordance with Rule 205-3.

The “qualified client” test has been a more stringent test than the accredited investor definition, allowing the collection of performance based fees from clients that have a net worth of at least \$1,500,000. The Dodd-Frank Act did not mandate the adjustment of this net worth test to exclude the value of a client's primary residence, which has the curious result that an investor may qualify as a qualified client but not as an accredited investor depending on the value of the investor's primary residence. Because the value of an individual's primary residence does not indicate an individual's level of investment sophistication, the Commission should commence rule-making to adjust the qualified client definition in Rule 205-3 to also exclude the value of a client's primary residence from the net worth test.

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<sup>9</sup> 17 C.F.R. §275.205-3.

<sup>10</sup> Exemption To Allow Registered Investment Advisers to Charge Fees Based Upon a Share of Capital Gains Upon or Capital Appreciation of a Client's Account, Investment Advisers Act Release No. 996, 50 FR 48556, 1985 SEC LEXIS 2547 (Nov. 26, 1985).

Should you have any questions regarding the comments in this letter, please contact the undersigned; Rex Staples, General Counsel for NASAA, at [rs@nasaa.org](mailto:rs@nasaa.org) or (202) 737-0900 x.107; or Heath Abshire, Securities Administrator for the State of Arkansas and Chair of NASAA's Corporation Finance Section at [habshire@securities.arkansas.gov](mailto:habshire@securities.arkansas.gov) or (501) 324-9260.

Sincerely,

A handwritten signature in black ink, reading "David S. Massey". The signature is written in a cursive style with a long horizontal flourish extending to the right.

David S. Massey  
NASAA President and  
Deputy Securities Commissioner, North Carolina Department of the Secretary of State