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Via e-mail to: rule-comments@sec.gov

U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090
Attention: Elizabeth M. Murphy, Secretary

Reference: S7-04-11 February 17, 2011

Dear Ms. Murphy,

Thank you for the opportunity to provide comments on the SEC's proposed rules relating to the net worth standard for accredited investors. I have worked as the controller of several foreign and domestic funds of private equity funds with foreign and U.S. corporate and public pension plans and other accredited investors that were advised by a foreign investment adviser.

1. General comments

I strongly encourage the Commission to review existing academic research on the ability of investors with a net worth that exceeded the preexisting statutory threshold to make sound investment decisions and of the information that is voluntarily provided in private placement memorandums. The Commission could also use its new authority to conduct consumer testing with investors with varying amounts to net worth and review anecdotal evidence from enforcement cases. I doubt that net worth is a suitable proxy for the ability (including the negotiation power) to obtain material information that is necessary to make an informed investment decision (including to know the estimated impact of fees) and the knowledge to make a sound investment decision.

Knowing the complexity of the total fee burden (management and performance fees) of private equity funds, knowing the information that is typically voluntarily included in private placement memorandums or private equity funds and in limited partnership agreements, and knowing the additional information that is typically actively requested by prospective investors (such as public or corporate pension plans), I am highly skeptical that investors know the estimated total impact of fees or the risk through committing more capital to investments than is available from investors. While a high net worth standard may be suited to reflect a natural person's ability to bear losses, the amounts of assets under management of a pension plan is not suited as a proxy for the ability of the beneficiaries of the retirement benefits to bear losses. The beneficiaries cannot make the investment decisions of the plans themselves. They have to rely on the fiduciaries that administrate the plan. However, pension plans often do not have in-house specialist knowledge to perform an investment due diligence for complex investments, such as alternative assets or derivatives, and often even their consultants or investments advisers only claim to have such knowledge, but do not ask for information that is vital to assess the impact of fees or certain risks or negotiate protections and minimum diversification standards in limited partnership agreements.

However, it is questionable whether the general purpose items that need to be included in a registration statement under the Securities Act and the Securities Exchange Act would be suitable for individual asset classes and investment funds and whether typical registration statements would be too long so that investors loose the overview. I believe that mandatory minimum disclosures that differentiate between different asset classes would be a good thing. I do not think that the agencies that supervise U.S. or European pension plans can be relied upon to review a sample of investment due diligence material of pension plans in order to make an assessment of the pension plan fiduciaries ability to perform an adequate investment due diligence that allows them to assess the costs (i.e. fees), risks and potential return of investments. The beneficiaries of the retirement plan typically do not have the ability to review investment due diligence records and investment decisions and public accountants typically only audit the financial statements of pension plans, but do not audit a sample of investment due diligence records and investment decisions. Pension plans are a huge player in the private capital market and their beneficiaries are often not rich and do not have the ability to bear significant losses because they depend on the benefits to make a living during their retirement.

2. Answers to specific questions asked in the release

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?*

That depends on how the Commission interprets the intent of Congress to include the net worth of a person as one of the factors that qualifies a person as an accredited investor. A review of the conference reports of the House and the Senate from 1933 and of comments made in the congressional record may help to ascertain the intent of Congress to include the net worth of a person as one of the factors.

If the intent of the net worth was to allow to exclude persons from the protections of full and fair disclosure of the Securities Act of 1933 because they have a higher ability to bear losses due to being rich, then it makes sense to deduct all debts (regardless of whether they are secured by the value of real estate property). A high amount of assets that is financed by debt does not make a person richer and does not increase the person’s ability to bear losses and to have sufficient funds to make a modest living after the person’s retirement.

If the intent of the net worth standard was to serve as a proxy for the person’s experience in making investment decisions, then it does not make sense to deduct all debts (regardless of whether they are secured by the value of real estate property). Any investment, regardless of whether it was financed by debt, increases the person’s experience in making investments. However, the total amount of investments does not necessarily indicate of how many individual investments and past investment decisions it is comprised of.

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?*

That depends on whether the purpose behind the net worth factor is to serve as a proxy for the person's ability to bear losses. The use of "excluding the equity of the primary residence of such natural person, calculated by …" would not be appropriate. I suggest using "excluding the net value of the primary residence of such natural person, calculated by …". If I remember correctly, the Commission uses terms, such as net assets or net asset value and may be even net value in its rules under the Advisers Act and under the Investment Company Act.

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?*

Yes.

Again, that depends on whether the purpose behind the net worth factor is to serve as a proxy for the person's ability to bear losses. If the indebtedness secured by the primary residence exceeds the value of the primary residence at the time of investment, then the person's ability to bear losses is lower. In the case of such an interpretation of legal intent, the part of the indebtedness secured by the primary residence that exceeds the fair market value of the primary residence should not be excluded from the net worth calculation.

However, this would force investors and issuers to incur the burden and cost to perform a valuation of the primary residence (usually by a specialist) in order to determine the net worth before each investment. When weighing the cost of regulation against the degree of perfection of the net worth calculation as a proxy for the ability to bear losses or of investment experience, excluding the value of the primary residence (regardless of its value) and of any debt that is secured by that primary residence may be the least burdensome and most cost effective solution.

4. *Is another interpretation of Section 413(a) superior to those we discussed?*

Yes. I suggest subtracting all indebtedness that is secured by the primary residence, regardless whether it exceeds the fair market value of the primary residence, in order to avoid the cost and burden of having to determine the fair market value of the primary residence through a valuation by a property specialist. That way, a prospective investor will simply count all his other assets and ignore the primary residence and its debt and will not need to determine the value of his or her primary residence.

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?*

The rule should not include a static or dynamic reference to the definition of the primary residence under the federal income tax code. Having to research U.S. tax law may be burdensome to foreign investors who are used to their own rules. While using a definition of the term primary residence that is similar to the definition in U.S. tax law may be fine for U.S. investors, foreign investors that have multiple residences should be allowed to use the principles of the OECD model tax convention for bilateral tax treaties for the avoidance of double taxation and the OECD commentary to that model tax convention. I suggest that the Commission uses a definition that is similar to the OECD principles.

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?*

No, the Commission should not require inclusion of debt secured by a primary residence if the proceeds of the debt are used to invest in securities. I do not think that such a standard is workable without undue burdens for prospective investors and issuers. It will be hard to make a determination, whether the proceeds of debt that is secured by a primary residence have been used to invest in securities or have been used to buy other goods or services. As we say in Austria, money does not carry a bow. This means that money is difficult to allocate and it is difficult to trace (although banknotes do carry serial numbers).

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?*

A large amount of the net worth, other than the primary residence is usually represented by deposits in bank accounts, by securities in securities accounts with banks or brokers, by life insurance policies or by secondary residences. In Europe most banks provide monthly statements for checking or savings accounts. Most brokers and bank provide securities portfolio statements with current valuations semi-annually or quarterly. I recommend reflecting the timing of the availability of such valuations in the rules. Statements that include information that is needed for a net worth calculation may be up to 183 days old. In addition, particularly in the placing of partnership interests of private equity funds, considerable time may pass between the signing of a subscription agreement for the partnership interests by the investor and a closing during which those prospective partners are formally admitted as new partners to the limited partnership. The delay between subscription and closing may take several months since there is a lot of paperwork and this creates legal costs. If the rules are too prescriptive there may be unintended consequences, burdens and costs that are ultimately borne by investors. If the SEC wants to issue maximum delays, they should be very generous and should take current business practices and the availability of information into account. It may be an alternative to have no detailed rules other than excluding the value of the primary residence and any indebtedness that is secured by the primary residence from the calculation of net worth.

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?*

In my experience prospective investors in funds of private equity funds that were privately placed in the U.S. made a self-declaration that their net worth exceeded the statutory limit in the subscription agreements for the partnership interests. The calculation of their net worth by investors and the information and age of the information that investors used in that calculation was a black box for the issuer and any broker-dealers that helped to place those securities. I think the responsibility to calculate the net worth of a prospective investor should lie with the investor. Issuers and brokers should only be required to ask the investors to self-declare (i.e. provide a written certification) that they exceed the statutory net worth threshold to qualify as an accredited investor if the issuer wants to rely on an exemption that includes accredited investors.

It may be possible that investors knowingly provide a false self-declaration if they are told that they will not receive the securities unless they self-declare that they exceed a net worth threshold. If may even be the case that the investors tell the seller that they do not exceed the threshold or that they do not know and that an aggressive seller encourages to make the self-declaration anyhow. Issuers and brokers should be able to rely on self-declarations of investors about their net worth in good faith unless it can be proven that they knew or should have known that the prospective investor’s net worth was lower. However, in a classical fraud case, the fraudsters will most likely commit some other violation of the securities laws or of criminal law for which they can be prosecuted so that providing proof that the fraudster violated the registration or reporting rules is not essential. However, some interpretive guidance for investors how they can calculate their net worth that is not binding for issuers or brokers and that does not create any additional obligations for issuers or brokers could be useful for investors.

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) for offerings by issuers in which the investor held investments at the time the Dodd-Frank Act was enacted?*

The registration and reporting requirements of the Securities Act and the Exchange Act represent a significant burden and cost to smaller issuers. As a consequence, smaller issuers may not offer new securities (e.g. shares) to existing investors that do no longer qualify as accredited investors in order to avoid having to register the securities with the Commission and to incur ongoing reporting obligations. The dilutive effect of capital increases and the pricing of new securities is a major issue in company law and in the protection of minority shareholders. The Commission should be mindful that the federal securities law does not only apply to issuers from the states of the U.S., but also to foreign issuers and that company law varies from state to state and from country to country. The applicable company law may grant mandatory sellable subscription rights to existing shareholders in the case of the creation of new shares or it may not contain such protections.

I believe follow-on investments by existing investors (both in debt and in equity securities) should be possible using the private placement exemption and the SEC's applicable rules that implement the private placement exemption (i.e. no public offering). Those follow-on investments should not be limited to the offering of the same class of securities as those already held by the existing shareholders. While the offering of non-voting preference shares may not dilute the voting power of existing shareholders, it would still dilute their economic interest in the profits of the company if the preference shares have a right to get the first slice of profits. Treating existing holders of securities that qualified as accredited investors at their most recent acquisition of the securities of the issuer as if they would still be accredited investors in private placement rules seems like a workable solution (as long as the securities are not offered to the public). I do not think that limiting the amount is necessary unless the existing rules already contain limits for the size of the offering.

I appreciate the opportunity to comment on these matters and hope that my comments are useful in the rulemaking process. Please do not hesitate to contact me by e-mail if you have any follow-up questions.

Respectfully submitted,

Georg Merkl