



NASAA

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

750 First Street N.E., Suite 1140

Washington, D.C. 20002

202/737-0900

Fax: 202/783-3571

www.nasaa.org

March 10, 2011

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

Subject: Net Worth Standard for Accredited Investors, Release Nos. 33-9177; IA-3144; IC-29572; File No. S7-04-11

Dear Ms. Murphy:

The North American Securities Administrators Association, Inc. (“NASAA”)¹ appreciates the opportunity to comment on the above-referenced release (“Release”). NASAA is pleased with the updating of the definition of “accredited investor” in connection with the private offering rules adopted by the Securities and Exchange Commission (the “Commission”). NASAA has long advocated for adjusting the definition of “accredited investor” in light of inflation and has expressed concern at the length of time the thresholds contained in the definition have not been adjusted.² NASAA is hopeful that the study on the appropriate thresholds for accredited investor status required by Section 415 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”)³ will lead to further adjustments in the interest of greater investor protection in the near future. However, in the interim, NASAA encourages the Commission to move forward with revisions of the term “accredited investor” in the interest of investor protection, as contemplated by Section 413(a)(1)(A) of the Dodd-Frank Act, and sets forth below comments in response to this Release.

1. NASAA urges the Commission to include mortgage indebtedness in the calculation of an investor’s net worth to the extent the proceeds of the indebtedness were used to invest in securities.

Consistent with NASAA’s November 4, 2010 comment letter on the accredited investor definition under the Dodd-Frank Act, NASAA continues to urge the Commission to adopt rules

¹ 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.

² See, e.g., letter from Karen Tyler, NASAA President and Commissioner of the North Dakota Securities Department, to Nancy M. Morris, Secretary, Securities and Exchange Commission (Oct. 26, 2007) (regarding Securities Act Release 33-8828), available at [www://www.sec.gov/comments/s7-18-07/S71807-57.pdf](http://www.sec.gov/comments/s7-18-07/S71807-57.pdf) [hereinafter “2007 NASAA Reg. D comment letter”], and the additional letters cited therein.

³ Pub. L. No. 111-203, 124 Stat. 1376.

to specify that mortgage indebtedness secured by the primary residence shall not be excluded from the calculation of an investor's net worth to the extent the proceeds of the mortgage were used to invest in securities. As set forth in NASAA's November 4, 2010 letter, it is not uncommon for seniors and others to be advised to leverage home equity to invest in what would otherwise be unsuitable private placement securities, thereby circumventing the goal of the Dodd-Frank Act and the current proposed rulemaking to exclude equity in a primary residence from a natural person's net worth. The Commission has noted in the Release that it preliminarily does not believe that the potential for inappropriate sales practices necessitates adding significant complexity to the calculation of net worth.⁴

NASAA respectfully disagrees that a reasonable tracing of the use of proceeds from mortgage indebtedness would add significant complexity to the calculation of net worth and further suggests that the benefit of the protections against unscrupulous sales practices and manipulation under Regulation D outweighs any perceived burden. In fact, when the Commission proposed an investments owned standard in 2007, the amended definition of "accredited investor" it proposed specified that for purposes of calculating the amount of investments owned by the investor, "[t]here shall be deducted from the amount of such investor's investments the amount of any outstanding indebtedness incurred to acquire or for the purpose of acquiring the investments owned by such person." A similar exclusion for mortgage indebtedness secured by an investor's primary residence used to invest in securities is appropriate and not any more complex than the Commission's own prior proposal.

State regulators see the unfortunate consequences of unsophisticated investors that unwittingly leverage their primary residences to invest in risky private ventures. The implementation of rules that discourage this risky behavior at the outset will help ensure that private placement exemptions are better structured to protect those investors who may not be able to fend for themselves without the protections afforded by registration. Further, proactive prevention of manipulation and unsuitable sales is a far better policy than relying on post-sale regulatory enforcement actions and civil actions most often subject to FINRA arbitration.

2. As a corollary to including mortgage indebtedness used to invest in securities in the calculation of an investor's net worth, requiring the calculation of net worth to be made on a specified date (such as 60 or 90 days) before the sale of securities under Regulation D will assist in protecting against refinancing transactions intended solely to inflate net worth.

The Commission requests comments regarding whether the proposed rule should provide that the calculation of net worth be made as of a specified date before the sale of securities under Regulation D in order to prevent the borrowing against primary residence to attain accredited investor status. NASAA strongly supports this approach, and does not believe it would make the calculation of net worth unduly complex. While the economic downturn may have temporarily reduced the frequency of this activity, during the height of the real estate market it was not uncommon for investors to receive advice to mortgage their primary residence and withdraw equity in order to invest in various offerings. Placing the net worth calculation date 60 to 90 days before the date of sale will make this practice less attractive, thereby helping to ensure that

⁴ See Release at p. 13.

private placement offerings are not sold to investors who otherwise should be provided the protections afforded by the registration process.

3. NASAA supports the Commission’s proposal to limit the exclusion of mortgage indebtedness secured by the primary residence to the fair market value of the primary residence.

The Commission requests comments regarding whether it should 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. The Commission also seeks comments on whether the value of the residence should be alternatively calculated by netting out the debt secured by the residence up to the fair market value, as proposed, or whether solely the fair market value of the residence should be excluded from net worth, without netting out any associated debt.

NASAA believes it is a more fair and reasonable interpretation of the Dodd-Frank Act to exclude the debt secured by the residence only up to the fair market value of the residence, as proposed. As noted by the Commission, this approach appears to be more consistent with Congress’s intent, achieving the result of excluding a natural person’s equity in his or her primary residence from the net worth calculation. While it is tempting to urge that heightened investor protection supports the inclusion of indebtedness secured by the primary residence in the net worth calculation,⁵ we recognize and the Commission identifies that such an approach disproportionately impacts individuals that may have a large primary residence indebtedness that would otherwise be offset by the individual’s equity in the home. Accordingly, NASAA supports the Commission’s approach in excluding indebtedness only up to the fair market value of the primary residence.

4. NASAA continues to urge the adoption of an “investments owned” standard as an additional requirement of the accredited investor test.

The Commission indicated that it is not proposing to make revisions to the definition of “accredited investor” that are not required by the Dodd-Frank Act at this time, but may consider doing so in future rulemaking.⁶ Consistent with NASAA’s November 4, 2010 comment letter regarding the accredited investor standard,⁷ NASAA urges the Commission to consider for

⁵ We note that NASAA has repeatedly advocated for inflationary adjustments to the income and net worth standards in the accredited investor definition using 1982 as the benchmark, with a goal of rolling back the number of households meeting the thresholds to the 1.87% of the households that qualified in 1982, as estimated by the Commission’s Office of Economic Analysis. See 2007 NASAA Reg. D comment letter, *supra* note 2. Footnote 31 of the Release provides that 2007 data from the Commission’s Division of Risk, Strategy and Financial Innovation indicates that an estimated 9.04% of households qualified for accredited investor status in 2007, and 6.55% of those 2007 households would qualify based on the definition of net worth proposed in the Release. Consequently, while NASAA supports the Commission’s actions in moving forward with changes to better protect investors, NASAA believes additional changes are needed to further roll back the percentage of households qualifying as accredited investors closer to 1.87% of households as in 1982.

⁶ Release at p. 4-5

⁷ See letter from David S. Massey, NASAA President and Deputy Securities Commissioner, North Carolina Department of the Secretary of State, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (Nov. 4, 2010) (regarding Accredited Investor Standard, Title IV Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, File No. DF Title IV-Accredited Investor), *available at*

future rule-making the addition of an “investments owned” test as an additional criterion for determining accredited investor status in addition to the existing net worth or income standards. 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.

The Commission proposed the “investments owned” test as an alternative basis for determining accredited investor status back in 2007. NASAA recommends the adoption of an “investments owned” test as an additional basis, rather than an alternative basis, for determining accredited investor status. As NASAA has asserted in the past,⁸ the current definition of accredited investor bears little correlation, if any, to investor sophistication. In the Commission’s 2007 release, *Revisions of Limited Offering Exemptions in Regulation D* (Release No. 33-8828; IC-27922; File No. S7-18-07), the Commission opined that an investments-owned standard will add another, potentially more accurate method to assess an investor's need for the protections of registration under the Securities Act of 1933. We concur with the assessment that considering an investor’s presumed level of investment decision-making sophistication by looking at past investing experience through an “investments owned” standard is a more accurate method to assess an investor’s need for the protections of registration than mere net worth or income standards. Consequently, we urge that the standard be an additional criterion, rather than an alternative criterion, to the accredited investor standard for individuals.

5. NASAA continues to recommend that the net worth standard for “qualified clients” in SEC Rule 205-3 be adjusted to parallel the exclusion of an investor’s primary residence from the accredited investor definition.

In our November 4, 2010 letter to the Commission, NASAA recommended that the Commission adjust the net worth standard for “qualified clients” in Rule 205-3 to parallel the exclusion of an investor’s primary residence from the accredited investor definition. In response to the Commission’s recent solicitation for comments on matters that may have an effect on the proposals contained in the Release,⁹ NASAA is resubmitting these comments.

The definition of “qualified client” in SEC Rule 205-3 also includes a net worth test.¹⁰ 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.”¹¹ 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.

<http://www.sec.gov/comments/df-title-iv/accredited-investor/accreditedinvestor-11.pdf> [hereinafter “2010 NASAA Accredited Investor comment letter”].

⁸ See 2007 NASAA Reg. D comment letter, *supra* note 2.

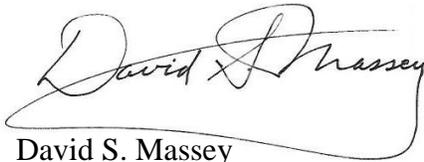
⁹ See Release at p. 19.

¹⁰ 17 C.F.R. §275.205-3.

¹¹ 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).

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. Thank you for considering our comments on the proposals contained in the Release. Should you have any questions regarding the comments in this letter, please contact Rex Staples, General Counsel for NASAA, at rs@nasaa.org or (202) 737-0900 or A. Heath Abshure, Commissioner of the Arkansas Securities Department and Chair of NASAA’s Corporation Finance Section, at habshure@securities.arkansas.gov or (501) 324-9260.

Sincerely,

A handwritten signature in cursive script that reads "David S. Massey". The signature is written in black ink and is positioned above the printed name and title.

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