Dear Ms. Murphy:

Thank you for the opportunity to comment on the proposed amendments to the accredited investor standards, which seek to change the definition of an “accredited investor.” I write on behalf of the Public Investors Arbitration Bar Association (“PIABA”)\(^1\) in general support to the above-referenced rule proposal. The proposed rule would be a step in the right direction to increase the net worth required for an individual to become an “accredited investor.” PIABA respectfully asks the Commission to adopt the proposed rule for a number of reasons but hopes that additional changes are made to this proposal.

PIABA supports the proposed change to the definition of “accredited investor.” Currently, an “accredited investor” is required to have a net worth of $1 million to invest in private offerings or other limited offerings. The proposal seeks to change the definition of an accredited investor by specifying that an accredited investor must have a net worth (individually or jointly with their spouse) of “more than $1,000,000…excluding the primary residence of such natural person.”

The purpose of providing exemptions from registration under Rules 504, 505, and 506 of Regulation D (17 CFR § 230.501 et seq.) is to allow smaller, private companies to raise capital without incurring the considerable expense and time of complete registration of the offering with the Commission. In similar regards, the Commission does not require complete registration of these offerings with the understanding that these private placements are only being offered to institutional and certain individual investors. One way risk is mitigated is by ensuring that the individual investors have a minimum net worth for them to be allowed to invest in private placements, which may provide some indication that they may have the financial means to withstand the risks inherent in these

\(^1\) PIABA is national, not-for-profit bar association comprised of attorneys, including law school professors and regulators, both former and current, who devote a significant portion of their practice to the representation of public investors in securities arbitrations.
securities. However, as more people become millionaires as the value of the dollar decreases with inflation, there are more people who are qualified to be “accredited investors,” yet many of these people do not have the sophistication to understand the risks associated with private placements to protect themselves sufficiently, nor the financial means to withstand the risk of loss of the investment. As a result, the Commission needs to raise the net worth threshold for accredited investors to protect the investing public better.

PIABA welcomes the proposed change to the definition that would eliminate the value of an investor’s home from their net worth. Many investors are being solicited to invest in private placements or limited offerings when their total net worth is $1 million. However, for a large number of these investors, their primary residence constitutes a considerable portion of their net worth (and sometimes a majority of their net worth). Most private placements and limited offerings are substantially more illiquid than a publicly traded security, and these private placements often carry with them the risk of total loss of investor funds. These investors should not be eligible to invest in private placements because they often do not have sufficient financial resources and reasonably cannot bear to lose their entire investment in private placements.

Moreover, there have been a recent string of private placements that have turned out to be purported Ponzi schemes. Examples include Medical Capital, Provident/Shale Royalties, and DBSI. Many clients who were solicited to invest in these products lost their entire investment in these products, and many could not afford to take on those substantial losses in these purported investment products. The change in the definition of an accredited investor would limit the number of investors that would be eligible to invest in these products and will help protect them from these speculative and illiquid products.

In particular, the Commission is considering excluding excess debt on a principal residence from the net worth calculation. The “value” to be excluded from net worth under the proposed rule is the “Fair market value of the primary residence less the amount of debt secured by the property up to Fair market value.” More simply put, the rule proposal seeks to ensure that an investor’s equity in a primary residence is excluded from the calculation but that additional indebtedness in excess of equity is realized. The Commission’s reasoning for ensuring that debt in excess of equity is accounted for is sound.

The Seattle-based real estate market information company Zillow recently released a statement provided to Bloomberg News and other news publications stating that as of the 4th quarter in 2010, upwards of 27 percent of mortgages in the United States were “underwater” – over 15 million mortgages. Under the proposed rule, this debt in excess of home equity would also be accounted for in the net-worth calculation. Since the basis for the accredited investor standard is to

provide some indication of an investor’s ability to withstand the risk of loss associated with such investments, ensuring that this excess debt is accounted for is critical. If an investor is upside-down on his mortgage, the investor is in a worse financial condition than if he had equity in excess of debt. Thus, in order to paint a complete picture of “net worth” for purposes of this rule, a potential private placement investor’s debt in excess of home equity must be taken into account.

This important interpretation in the operation of the proposed rule ensures that it makes logical sense, which the market will surely recognize. The current rule proposal specifically outlines what is to be excluded from the net-worth calculation – the fair market value of the primary residence less any debt on the residence up to the fair market value. Thus, the rule does not exclude debt in excess of equity and should state so clearly. PIABA believes it is in the interest of all public investors that the definition of net-worth in the proposed rule both exclude equity in the primary residence and explicitly include, on the debt side of the ledger, debt in excess of equity so as to prevent any confusion or abuse of this standard.

While PIABA does support the rule change, PIABA believes that the proposed rule could go further. PIABA believes that the threshold to be considered an “accredited investor” should be raised from $1 million to at least $2 million. It also would make sense to change the rule to provide an increasing threshold over time based on an index, such as the Consumer Price Index. A larger percentage of investors could be considered “accredited” 10 or 20 years down the road, but considering the rate of inflation this $1 million threshold may be misleading and an inappropriate standard in 10 or 20 years. In light of this, PIABA supports the rule to the extent that the Commission is required to re-examine the threshold every four years.

In sum, PIABA supports the proposed rule but hopes that FINRA and the Commission would make some additional changes in order to protect the investing public better. I would like to thank you once again for the opportunity to comment on this rule proposal.