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March 31, 2011

U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Attention: Elizabeth M. Murphy, Secretary

Re: File No. S7-04-11
Release No. 33-9177
Net Worth Standard for Accredited Investors

Ladies and Gentlemen:

This letter is submitted on behalf of the Federal Regulation of Securities Committee, the Middle Market and Small Business Committee and the State Regulation of Securities Committee (the "***Committees***" or "***we***") of the Business Law Section (the "***Section***") of the American Bar Association ("***ABA***") in response to the request by the Securities and Exchange Commission (the "***Commission***") for comments on its January 25, 2011 proposing release referenced above (the "***Proposing Release***"). The comments expressed in this letter represent the views of the Committees only and have not been approved by the ABA's House of Delegates or Board of Governors and therefore do not represent the official position of the ABA. In addition, this letter does not represent the official position of the Section.

I. Overview

We appreciate the opportunity that the Commission has afforded us to comment on these proposed rules. Section 413(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "***Dodd-Frank Act***") mandated that the Commission adjust the net worth standard for an "accredited investor" under the Securities Act of 1933, as amended (the "***Securities Act***"). Pursuant to the Proposing Release, the Commission is now seeking to implement the mandated statutory changes.

We support the Commission's proposed revision of the net worth standard to exclude the value of a primary residence of a natural person. We suggest, though, that the Commission change the language of the final rule implementing the statutory changes to clarify the accredited investor test under the Commission's Securities Act rules. We do not believe that other changes the Commission has proposed or for which it sought comment are necessary at this time in order to implement the statutory mandate.

II. Proposed Language for the Net Worth Standard for Accredited Investors

Section 413(a) of the Dodd-Frank Act requires the Commission to adjust the net worth standard for an accredited investor, so that the individual net worth of any natural person, or the joint net worth with the spouse of that person, at the time of the purchase, is "more than $1,000,000 . . . excluding the value of the primary residence of such natural person." Previously, the applicable standard required a minimum net worth of more than $1,000,000, but permitted the primary residence to be included in calculating net worth. The relevant rules for these purposes are Securities Act Rules 501(a)(5) and 215(e).

We support the Commission's proposal to revise the accredited investor net worth standard in a manner consistent with Section 413(a), and agree with the Commission's proposal that net worth should be calculated by excluding only the investor's net equity in the primary residence.

However, we propose an alternative formulation of the applicable rule language, to clarify the application of the accredited investor net worth standard. Our proposed language would read as follows:

> Any natural person whose individual net worth, or joint net worth with that person's spouse, at the time of purchase, exceeds $1,000,000. For purposes of calculating a natural person's net worth:
>
> (A) The fair market value of such person's primary residence shall not be included in determining such person's net worth.
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> (B) Any outstanding indebtedness that is secured by the person's primary residence shall not be treated as a liability of such person, except to the extent that the amount of the outstanding indebtedness exceeds the fair market value of such person's primary residence; <u>provided</u>, <u>however</u>, that if such person would not be subject to personal liability in the event of a default in the payment of such indebtedness, by reason of an anti-deficiency or similar statute or constitutional provision, contractual provision, or otherwise, then such excess indebtedness shall not be treated as a liability in the computation of such person's net worth.

To the extent that a person would not be subject to personal liability as a result of a default in the payment of an obligation secured by his or her primary residence, such indebtedness should not be treated as a liability of such person in the computation of his or her net worth.[1] We believe that the language proposed above would be consistent with the statutory mandate in Section 413(a) of the Dodd-Frank Act and would provide a more clear and complete explanation of the basis for calculating the accredited investor net worth standard.

III. Other Definitional Issues Related to the Accredited Investor Net Worth Standard

A. "Primary Residence"

We do not believe that it is necessary or desirable for the Commission to define specific terms, other than as have been mandated by Section 413(a) of the Dodd-Frank Act. We agree with the Commission's view that amendments to the applicable rules are not necessary to define the term "primary residence." We are not aware of any prior issues arising from the lack of a definition of the term in the Commission's rules, and believe that term has been interpreted by issuers and practitioners in accordance with its common and generally understood meaning. Nothing in Section 413(a) of the Dodd-Frank Act mandates the need for the term to be specifically defined in the Commission's rules.[2]

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[1] For example, Cal. Civ. Proc. Code § 580b (West, Westlaw through 1989 amendment) provides:

> No deficiency judgment shall lie in any event after a sale of real property or an estate for years therein for failure of the purchaser to complete his or her contract of sale, or under a deed of trust or mortgage given to the vendor to secure payment of the balance of the purchase price of that real property or estate for years therein, or under a deed of trust or mortgage on a dwelling for not more than four families given to a lender to secure repayment of a loan which was in fact used to pay all or part of the purchase price of that dwelling occupied, entirely or in part, by the purchaser.
>
> Where both a chattel mortgage and a deed of trust or mortgage have been given to secure payment of the balance of the combined purchase price of both real and personal property, no deficiency judgment shall lie at any time under any one thereof if no deficiency judgment would lie under the deed of trust or mortgage on the real property or estate for years therein.

Thus, a mortgagee foreclosing on a mortgage granted by an investor in California to purchase the investor's primary residence could not ordinarily obtain a deficiency judgment against the investor should the proceeds of the foreclosure sale realize less than what is due on the mortgage.

[2] We support the Commission's proposal to change the term "principal residence" as used in Rule 501(e)(1)(i) of Regulation D to "primary residence" to conform the language to the terminology of the Dodd-Frank Act.

B. Proceeds of Debt Secured by Primary Residence Incurred to Invest in Securities

We note that the North American Securities Administrators Association ("NASAA") has recommended that the Commission not permit the exclusion of debt secured by a primary residence from the calculation of net worth if the proceeds of the debt have been used to invest in securities.[3] While we understand NASAA's concern that unscrupulous sales practices could result in a manipulation of a natural person's accredited investor status, we do not support a definition of accredited investor that disregards the fair market value of a person's primary residence, but includes as a liability all of the indebtedness secured by the residence. For one thing, such a definition would result in a basic disequilibrium between the calculation of assets and liabilities. Importantly, the NASAA recommendation may result in the disqualification of a large number of persons whose interest in investing in a transaction may have nothing to do with unscrupulous sales practices. Although the Commission has, in some instances, crafted its rules to minimize the likelihood of abuse, we do not believe that it would be appropriate for the Commission to treat the accredited investor standard in this way. For example, according to the NASAA proposal, a person having a net worth of $2 million, exclusive of a house worth $3 million, would not be an accredited investor if his or her mortgage obligation were to exceed $1 million. Not only would the investor, in fact (other than by reason of the proposed Commission definition), have a net worth of $3 million ($2 million plus the $1 million equity in his or her residence), but the application of the test proposed by NASAA would exclude such investor from the ability to participate in many "all accredited" offerings, and limit both the investor's investment options as well as the capital formation efforts of smaller businesses that rely upon private financing.

Moreover, because loan proceeds are fungible, we do not believe that a test based on the "application" of loan proceeds is practicable. Any attempt to trace the use of loan proceeds and to distinguish between permissible and impermissible uses of loan proceeds would create an unworkable accredited investor standard. The NASAA recommendation would also potentially penalize investors who, of their own volition and without the encouragement of an unscrupulous broker-dealer or an issuer conducting an offering in reliance on Rule 506, elect to place a mortgage on a previously debt-free primary

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[3] Letter from David Massey, NASAA President and Deputy Securities Commissioner, North Carolina Department of the Secretary of State, to Elizabeth Murphy, Secretary, United States Securities and Exchange Commission (Nov. 4, 2010) (available at http://www.sec.gov/comments/df-title-iv/accredited-investor/accreditedinvestor-11.pdf).

residence in order to purchase securities or other assets that can be included in calculating their net worth, solely by reason of tax or other considerations, without any consideration as to whether such a transaction would permit the investor to qualify as an accredited investor. In lieu of the NASAA recommendation, we believe the Commission should determine whether, following implementation of the new rules, there appears to be abuse of the primary residence liability exclusion. If such abuse does exist, we believe it can be addressed under the Commission's existing Securities Act rules, as well as under the broker-dealer rules of the Commission, FINRA and state securities regulators.

IV. Timing Considerations

The Commission is also soliciting comments as to whether the proposed amendments should contain a timing provision in order to prevent investors from inflating their net worth by purchasing assets with the proceeds of indebtedness secured by their homes with the intent to qualify as accredited investors. In this regard, the Commission suggests that the rules could provide that the net worth calculation must be as of a date 30 or 60 days before the sale of the securities.

We believe that no such timing provision is necessary. We agree with the Commission's preliminary view based on the concern that imposing any timing provision would complicate the calculation of the net worth standard, particularly given the fact that, in many situations, the date of sale may not be known sufficiently in advance. We do not believe that any investor protection purposes would be served by the imposition of a timing provision, and we believe that any such provision would unnecessarily complicate the process. For these reasons, we suggest that the Commission not adopt any further amendments to the applicable rules to impose a date prior to sale for determining the net worth calculation.

V. Transition Considerations

In connection with a series of questions posed in Question 9 of the Proposing Release, we believe that the Commission should provide transitional relief for investors who previously qualified as accredited investors before the enactment of Section 413(a) in order that they may continue to qualify for purposes of subsequent "follow-on" investments. We do not believe that existing investors should be foreclosed from being able to participate in follow-on financings due to a loss of their accredited investor status as a result of the exclusion of their primary residence.

Follow-on funding situations may be based on a contractual obligation to make one or more future investments upon the occurrence of certain milestones or events ("mandatory obligation") or they may occur where the investor has the discretion whether to make a further investment ("discretionary investment"). Discretionary investments may be based on a statutory or contractual right (*e.g.*, pre-emptive rights) or may be structured as a contractual penalty (a typical provision in venture capital and private equity fund offerings). Discretionary investments may also occur in the absence of a mandatory obligation or statutory or contractual right, where an investor seeks to participate in a subsequent offering in order to maintain his or her proportionate interest in the investment.

We do not believe that the Commission needs to take any action with respect to the status of investors subject to a mandatory obligation to make a future investment. In these circumstances, it has been the Commission's long-standing position that the purchase and sale decision occurs at the time of the original investment (when the investor qualified as an accredited investor).

In the case of follow-on discretionary investments, Section 413(a) creates a situation in which an investor would be accredited, but for the change in the definition that was enacted after the original investment. Specifically, we believe that this is a situation in which the Commission should give transitional relief. If an investor would be disqualified from participating in the follow-on offering solely because his or her primary residence no longer can be taken into account in determining his or her accredited investor status, we believe the Commission should provide relief so that the investor qualifies to participate in the follow-on offering. The investor would be treated as though he or she were accredited, and therefore would not be counted in the 35 non-accredited investor limitation and would not have to receive the information required to be delivered to non-accredited investors. We recommend that this relief apply to a formerly accredited investor who no longer meets the definition of accredited investor solely because the net value of his or her primary residence is no longer part of the net worth calculation.

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The Committees appreciate the opportunity to comment on the Proposing Release, and respectfully request that the Commission consider the recommendations set forth above. We are prepared to meet and discuss these matters with the Commission and the Staff and to respond to any questions.

Very truly yours,

/s/ Jeffrey W. Rubin
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