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Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Proposal for Revision of Accredited Investor Definition with respect to Trusts

Gentlepersons:

This comment derives from the Staff's decision not to grant the no-action relief sought by an earlier version of the attached draft request on behalf of an umbrella organization (our "Client") for physicians' practice groups affiliated with a major hospital. In response to the Staff's decision, we recommend a revision of the definition of "accredited investor" in Rule 501(a) of Regulation D under the Securities Act of 1933.

In our draft request letter we sought an extension of the position taken in the *Trans-Resources* no-action letter (available May 27, 1997) to cover situations in which physicians' practice foundations for which our Client serves an umbrella organization have established irrevocable rabbi trusts or voluntary employee benefit Associations ("VEBAs) with less than $5 million in assets and wish to cause such rabbi trusts or VEBAs to invest as accredited investors in a newly organized investment fund established by our Client. We argued that, in view of the fact that the foundations that established the rabbi trusts or VEBAs for the exclusive benefit of their employees (and have unfettered investment discretion with respect to those vehicles) are themselves accredited investors, it should be permissible to treat such a rabbi trust or VEBA as an accredited investor regardless of whether its beneficiaries themselves qualify as accredited investors.

We were ultimately advised, however, that the Staff had concluded that, although the Staff's *Trans-Resources* response did not state that the accredited investor status of the sole beneficiary of the rabbi trust treated in *Trans-Resources* was a factor in the Staff's response (even though that factor had been stressed in the related no-action request letter), in fact that status on the part of the beneficiary had been a critical factor in granting the requested no-action treatment. In addition, we were advised that the treatment we requested could not be granted as an extension of the position taken in *Herbert S. Wander* (available November 25, 1983) with respect to an irrevocable inter-vivos trust because in that case the trust instrument had provided that the settlor of the trust would (during his life) receive back the principal amount he had placed in the trust, plus a fixed rate of return, prior to the availability of distributions from the trust to any other beneficiary. In that connection we were advised that the return-to-the-settlor aspect of the

Wander request had been critical in persuading the Staff that the settlor could be treated as the sole "equity owner" of the trust, allowing the trust to qualify as an accredited investor under Rule 501(a)(8). In sum, the Staff concluded that, in view of the current specification in Rule 501(a)(7) of the circumstances under which a trust that is not managed by a bank may be treated as an accredited investor on a stand-alone basis (including a requirement that such a trust have assets in excess of $5 million), as well as the nature of Commission interpretive pronouncements in the area, the Staff could not extend the existing authority to cover the circumstances described in our no-action request.

While we understand the rationale for the Staff's decision, we also understand that the Staff and the Commission believe that an overhaul of Regulation D, including the definition of accredited investor, is overdue, and we were advised that the Staff would welcome a suggestion as to how the Commission might cure this problem while still adhering to the policy that accredited investors have characteristics that support the conclusion that they are prepared to fend for themselves in making decisions to invest in privately offered securities.

We believe the best, and an extremely straightforward, approach would be to add to the definition of accredited investor a component derived from the definition of "qualified purchaser" in section 2(a)(51) of the Investment Company Act of 1940. As is well known, the section 2(a)(51) definitions, supplemented by Commission rules 2a51-1, 2a51-2 and 2a51-3, are used to determine whether a private investment fund qualifies for the exemption from investment company status set forth in section 3(c)(7) of the Investment Company Act, which requires that all the security holders in such a fund be qualified purchasers, as well as for certain other purposes under the Investment Company Act. As set forth in section 2(a)(51)(A)(iii), one of the kinds of entities that can qualify as a qualified purchaser is a trust (not formed for the specific purpose of purchasing the securities offered) "as to which the trustee or other person authorized to make decisions with respect to the trust, and each settlor or other person who has contributed assets to the trust, is [a qualified purchased as set forth in the other portions of section 2(a)(51)(A)]."

The analogous addition we propose to the definition of accredited investor would confer accredited investor status upon a trust (i) whose investment decisions are made by an accredited investor (as otherwise defined in Regulation D) and (ii) whose settlors and other contributors were accredited investors at the time of contribution. In order to take exactly the same approach that is used in section 2(a)(51)(A)(iii), an additional requirement would be imposed that the trust in question not have been formed for the purpose of investing in the offered securities; however, because that requirement does not appear to be relevant to the fundamental policy of assuring that accredited investors have an appropriate level of sophistication, we believe its addition would add needless complexity (including predictable requests for the Staff to interpret the concept of "formed for the purpose") and that the Staff and the Commission should consider carefully whether the addition of such a factor would be useful in protecting investors.

We believe adherence to the suggested standard would accord with the policies supporting the accredited investor concept and that, drawing as it would upon an analogous definition established by Congress, the adoption of such a standard would simultaneously advance a Congressionally sanctioned policy judgment and enhance the definitional coherence of the securities laws (particularly since private investment funds that utilize the section 3(c)(7) Investment Company Act exemption almost always make their offerings to U.S. investors under Regulation D rule 506).

We appreciate the invitation to submit this comment and would be pleased to discuss it further with the Staff.

Very truly yours,

Edwin C. Laurenson

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Re: Grantor Trusts as Accredited Investors under Rule 501(a)(8) of Regulation D

Ladies and Gentlemen:

We represent the a corporation (the "Client") determined to be exempt from taxation under section 501(c)(3) of the Internal Revenue Code of 1986 (the "Code") that serves as an umbrella service organization for physicians' practice foundations in various areas of medical practice (the "Foundations") that are affiliated with a large teaching hospital (the "Hospital") affiliated with a medical school (the "Medical School"). The Foundations are all also nonprofit corporations that have been determined to be exempt from taxation under section 501(c)(3) of the Code.

Other than interns and residents, each physician practicing at the Hospital is a member of the Medical School faculty and an employee of the Foundation that covers that physician's area of medical practice (a "Foundation Physician"). In recognition of the privilege of practicing at the Hospital and serving on the Medical School faculty, including related research opportunities, Foundation Physicians typically accept significantly lower compensation for their practice of medicine (pursuant to maxima imposed by the Medical School) than they could otherwise earn in the private practice of medicine, as well as other restrictions on their medical practices.

As part of an overall reasonable compensation package that complies with the Medical School's principles, certain Foundations have established non-qualified employee benefit plans ("Plans"), providing, for example, for deferred compensation and retirement benefits. The Foundations frequently use "rabbi trusts" ("Trusts") as funding vehicles for the Plans. Each Trust is treated as a "grantor trust" under the provisions of sections 671 through 679 of the Code, the assets of which are subject to claims of the creditors of the establishing Foundation in a bankruptcy or

insolvency proceeding with respect to that Foundation but are otherwise reserved exclusively for the payment of the benefits that may be provided by the related Plan. Each Trust has an independent trustee (either an individual or a qualified bank or trust company) (a "Trustee"), but all investment decisions with respect to the assets held in a Trust are exclusively the province of the Foundation that established that Trust. In particular, the beneficiaries of a Plan have no say concerning the manner in which the assets of the related Plan Trust are invested. As a result, neither contributions to a Plan Trust by a Foundation nor earnings on the corpus of a Plan Trust are taxable to the Plan's beneficiaries prior to distribution of benefits to a beneficiary.

In addition, certain Foundations have established voluntary employee benefit associations ("VEBAs"), which are tax-exempt entities described in section 501(c)(9) of the Code, to provide for the payment of eligible out-of-pocket health care expenses and health insurance premiums incurred by Foundation Physicians, including after they retire. As in the case of the Plan Trusts, each VEBA is organized as a trust, is irrevocable, is funded entirely by the establishing Foundation (and earnings on the Foundation's contributions) and has an independent Trustee, and in all cases investment decisions with respect to assets held in the VEBA are made by the Foundation that established that VEBA. Likewise, as provided generally under section 501 of the Code, contributions to and earnings by a VEBA are not potentially taxable to a VEBA's beneficiaries until distributed.

In order to assist the Foundations that have established Plans and VEBAs in the investment of the assets held in those Plan Trusts and VEBAs, the Client has established an Investment Fund in the form of a limited liability company (the "Fund"), of which the Client is the manager. Acting under the direction of the Client as manager, the Fund may establish any number of investment portfolios with differing investment objectives and policies, but in the immediately foreseeable future the Client intends to establish only a series whose objective is to emulate, to the extent feasible, the investment philosophy and use the same investment guidelines as those followed by the endowment fund and/or pension fund of the Hospital, as managed by the Hospital's investment committee. Other than a small interest held by the Client itself, interests in the Fund, which will elect to be taxed as a partnership, may be held exclusively by Plan Trusts and VEBAs established by Foundations (or by the Client itself, but the Client has not established and does not expect to establish either a Plan or a VEBA).

Accordingly, the Fund intends to offer interests in the initial series (and may offer interests in other investment portfolios) to such Plans and VEBAs. Any such offering will be made exclusively to accredited investors, as defined in rule 501(a) of Regulation D under the Securities Act of 1933 (the "Securities Act"), pursuant to rule 506 under Regulation D under the Securities Act. In addition, the Fund will be excluded from the definition of "investment company" under the Investment Company Act of 1940 (the "Investment Company Act") pursuant to section 3(c)(1) of that statute.[1]

[1] We are of the view that, since the Fund has been established and will be managed by a qualifying nonprofit organization and interests in the Fund will be exclusively offered to and held by vehicles established and managed

Clarification Sought

As we discuss further below, we believe the currently outstanding no-action and interpretive authority relating to the definition of "accredited investor" with respect to investing vehicles with the characteristics of the Plan Trusts and the VEBAs both leaves open ambiguities that should be clarified and could be deemed to require the establishment of accredited investor status on the part of beneficiaries, which we believe should not be necessary. Accordingly, the purpose of this letter is to seek the Staff's concurrence in our understanding that the accredited investor status of the Plan Trusts and the VEBAs may be based upon the accredited investor status of the Foundation that established such an employee benefit vehicle, without regard to the accredited investor status of the vehicle's beneficiaries.

Discussion

Two portions of the Regulation D definition of "accredited investor," as set forth in rule 501(a) under the Securities Act, would appear to potentially apply to the Plan Trusts and the VEBAs. The first, paragraph (7), covers "Any trust, with total assets in excess of $5,000,000, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in §[506(b)(2)(ii)]." Utilization of this portion of the accredited investor definition by Plan Trusts and VEBAs that have total assets in excess of $5 million is not problematic so long as, as required by paragraph 506(b)(2)(ii), the person who directs the purchase (in this case, the Foundation that established the Trust or the VEBA) "alone or with his purchaser representative(s) has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective

by qualifying nonprofit organizations to provide tax-advantaged benefits for their employees, the nonprofit exemptions in the Securities Act and the Investment Company Act, particularly as augmented by the Philanthropy Protection Act of 1995, should be deemed to provide exemptions under both statutes to both the Fund and the contemplated offerings of interests therein. See section 3(a)(4) of the Securities Act and section 3(c)(10) of the Investment Company Act. However, it is a characteristic of the Plans and VEBAs under discussion in this letter that the level of benefits to which the beneficiaries of such vehicles are entitled will be affected by the investment results achieved by the Plans and the VEBAs. In that connection we are familiar with the Staff's position that it is a condition to the applicability of the nonprofit exemptions that "participants will not invest assets that are attributable to a retirement plan providing for employee contributions or variable benefits." See, for example, *Daughters of Charity National Health System, Inc.* (available April 3, 1998), text at note 6; *Mercy Investment Program, Inc.* (available June 12, 2003), note 4. We believe this condition, if well taken, should as a matter of logic and policy apply to non-qualified employee benefit plans only when a beneficiary may elect a benchmark to measure his benefit entitlement or express a preference (even though nonbinding) as to how funds held in a related rabbi trust might be invested. Nevertheless, we have been advised in previous (oral) Staff inquiries that the variability of benefits under the Plans and the VEBAs based upon their investment results could be deemed to fall afoul of this condition. While we differ from the Staff's views concerning the unavailability of the nonprofit exemptions under the circumstances described in this letter, this letter does not seek to challenge or change those views.

Separately, we are not seeking the Staff's concurrence in our opinion that the offering of interests in the Fund exclusively to accredited investors in the manner indicated in this letter will qualify for the rule 506 exemption under the Securities Act and that the offering of interests in, and operation of, the Fund in the manner indicated will qualify for the section 3(c)(1) exemption under the Investment Company Act.

investment, or the issuer reasonably believes prior to making any sale that such purchaser comes within this description."

It is not the case, however, that all the Plan Trusts and VEBAs that may invest in the Fund have total assets in excess of $5 million. Accordingly, with respect to such a Trust or VEBA (an "Under $5 million Plan"), we have advised the Fund, based upon existing authority in no-action letters and interpretive positions issued by the Staff, that the only other potentially applicable portion of the definition of accredited investor is paragraph (8): "Any entity in which all the equity owners are accredited investors." As the subsequent discussion will demonstrate, existing no-action and interpretive authority is sufficient to conclude that this portion of the definition applies when both the settlor and all the beneficiaries of an Under $5 million Plan are accredited investors. However, the Client is not confident that all beneficiaries of the Plan Trusts and VEBAs that are Under $5 million Plans are accredited investors, and it will in any case impose significant administrative burdens upon the Foundations that have established Under $5 million Plans if they are required to determine the accredited investor status of all Plan or VEBA beneficiaries each time such a Foundation wishes to arrange for an Under $5 million Plan to make an investment in the Fund. Accordingly, this letter seeks the Staff's interpretive confirmation that the availability of the paragraph (8) definition depends, in this context, upon the accredited investor status of the Foundation that established and directs the investment of an Under $5 million Plan, and not upon the accredited investor status of an Under $5 million Plan's beneficiaries.

We find our initial support for this view in Staff interpretations, first promulgated in the early 1980s, to the effect that the beneficiaries of a conventional trust cannot normally be considered its "equity owners" but that, in the case of "non-conventional" revocable grantor trusts with respect to which the settlor retains investment authority, it may be appropriate to consider the settlor of a trust to be the trust's equity owner (with the consequence that qualification to utilize the paragraph (8) definition would depend upon the accredited investor status of the settlor and the accredited investor status of the other trust beneficiaries would be irrelevant).[2]

This interpretation was extended to irrevocable grantor trusts with less than $5 million in total assets in *Herbert S. Wander* (available November 25, 1983) and, arguably, to irrevocable employer-established rabbi trusts with less than $5 million in total assets in *Trans-Resources, Inc.* (available May 27, 1997). While *Trans-Resources* describes a closely analogous situation to that of the Plan Trusts and the VEBAs, however, several aspects of both the Staff's response and the related request letter differ sufficiently from the circumstances treated in this request to require, we believe, further review by and written clarification from the Staff.

Our first concern is based upon the observation that in *Trans-Resources*, despite a lack of specific citation in the Staff response, the request letter placed substantial emphasis upon both

[2] See the answer to question 30 in the *Interpretive Release on Regulation D*, Release No. 33-6455 (March 3, 1983).

the financial wherewithal and the sophistication of the sole beneficiary of the plan in question. As a result, in light of the standard concluding statements in the Staff's *Trans-Resources* response that the position taken there was based upon the representations in the request letter and that any different facts or conditions might require a different conclusion, after consultations with the Staff we have not been able to conclude that currently available interpretive authority fully supports the view that the accredited investor status of a rabbi trust's or VEBA's beneficiaries is irrelevant to the trust's qualification as an accredited investor under paragraph (8) of rule 501(a).

At a minimum in a situation such as that dealt with in this letter, however, in which the investment decisions are entirely remitted to the employer that established the trusts – without any provision for even an expression of preference by the beneficiaries as to how the corpus of the trust is to be invested – we believe that, as a matter of policy, the accredited investor status of the beneficiaries of such a trust should be irrelevant to a determination of the trust's accredited investor status.[3] Indeed, as previously noted, the Staff took the position more than 25 years ago that beneficiaries of a conventional trust should not generally be regarded as the "owners" of the trust for Regulation D purposes. Accordingly, we are of the view that the accredited investor status of the beneficiaries of the Under $5 million Plans should be irrelevant to the determination of the accredited investor status of those Plans under paragraph (8) of rule 501(a).

Turning to the *Trans-Resources* response letter, the Staff "noted" the following with respect to the trust that was the subject of that letter (with comparisons to the present request noted in brackets):

"(1) the [T]rust is a grantor trust for federal income tax purposes [same];

[3] We are aware that a non-qualified plan may permit an employee beneficiary to specify a benchmark that will be used to measure the employer's payment obligation under the plan, that such a plan may be nonexclusively funded by a rabbi trust, as exemplified by the plan and trust described in *The Goldman Sachs Group, Inc.* (available March 8, 2005), and indeed that the beneficiaries under such plans typically have the right to vary the applicable benchmark from time to time. Although the employer that established such a plan and related rabbi trust is not obligated to make an investment that corresponds to the benchmark selected by the employee to fund the employer's obligations to the employee (and, in fact, must not be so obligated if the employee is to be free of tax liability until he or she actually receives deferred compensation under the plan), the employer may as a matter of prudence make a hedging investment in the instrument that the employee selects as a benchmark. While we believe that the analysis for which we argue in this letter would continue to apply to such an arrangement, our request in this letter is confined to circumstances in which a benefit plan's beneficiaries are given no option to make choices or express investment preferences that could affect the level of benefits to which they are entitled under the applicable plan. We also note that the Plans and VEBAs dealt with in this request differ from the plans described in the *Goldman Sachs Group* letter in that Goldman Sachs's obligations under those plans were not limited by and did not depend upon the investment results achieved by the related rabbi trusts, whereas the payment obligations of the Foundations that have established the Plans and the VEBAs are confined to the assets available for the purpose (including, of course, investment gains thereon) in the related trusts.

"(2) the Trust is an irrevocable trust with $3,500,000 in assets [*i.e.*, less than $5 million in assets, as is the case with respect to the Under $5 million Plans that are the subject of this letter];

"(3) the Trust was established by a grantor corporation that is an accredited investor under Rule 501(a)(3) [same];

"(4) any assets held by the [T]rust are subject to the claims of the grantor corporation's general creditors in the event of bankruptcy or insolvency of the grantor corporation [same];

"(5) each of the trustees having fiduciary duties regarding investment decisions is an accredited investor under Rule 501(a)(3) [same, except that the Foundations exercising investment discretion do not serve as Trustees] and [a] sophisticated person within the meaning of Rule 506(b)(2) [see the discussion of this factor below]; and

"(6) the trust agreement provides that the trustees shall have investment powers over the assets of the [T]rust [different because investment discretion is lodged in the Foundations and not the Trustees]."

We believe the bracketed comparisons to the present request demonstrate, subject to the further discussion of factor (5) below and assuming the lack of relevance of the accredited investor status of the beneficiaries, that this request is on all fours with the Staff's *Trans-Resources* response. However, we do not believe the reference in factor (5) of the *Trans-Resources* response to the sophistication requirement contained in rule 506(b)(2) was well taken, and we request that the Staff reconsider the applicability of that standard under these circumstances.[4]

Our basis for this requested deletion of the reference to the rule 506(b)(2) sophistication requirement is that the requirement's presence in factor (5) of the Staff's *Trans-Resources* response appears to have been based on a mixed application of criteria contained in paragraphs (7) and (8) of rule 501(a). We submit, however, that paragraph (8) alone, which refers exclusively to the accredited investor status of all "equity owners" and contains no sophistication requirement, provides the actual basis for the *Trans-Resources* response.

Accordingly, we respectfully request that the Staff indicate concurrence with our conclusion that a Plan Trust or a VEBA that is a Under $5 million Plan may be treated as an accredited investor under paragraph (8) of rule 501(a) so long as its investments are exclusively directed by the

[4] Our reason for this request is not that we think the Foundations that have established Under $5 million Plans cannot meet the sophistication requirement (either alone or together with a purchaser representative). Rather, we believe the Client should simply not have to conduct the investigation necessary to demonstrate that such Foundations meet those criteria when the applicability of the criteria is not based upon a justified interpretation of Regulation D.

Foundation that established the Plan Trust or VEBA and that Foundation is itself an accredited investor, without regard to the accredited investor status of the plan beneficiaries.

If you have questions or wish to discuss this request, please contact me at 212-547-5657 or at elaurenson@mwe.com.

Very truly yours,

Edwin C. Laurenson