Kirkpatrick & Lockhart Nicholson Graham LLP

1800 Massachusetts Avenue, N.W.
Suite 200
Washington, DC 20036-1221
202.778.9000
Fax 202.778.9100
www.klng.com

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Cary J. Meer

202.778.9107
Fax: 202.778.9100
cmeer@klng.com

Via Federal Express

Mr. Jonathan G. Katz
Committee Management Officer
Securities and Exchange Commission
100 F Street, N.W.
Washington, D.C. 20549

Re: Request for Comments
File Number 265-23

Dear Mr. Katz:

A large multinational financial institution that we represent recently brought to our attention an anachronism in Regulation D's definition of "accredited investor" that they believe should be addressed by the Advisory Committee on Smaller Public Companies ("Advisory Committee").

Specifically, we suggest that the Advisory Committee recommend to the Commission including unincorporated governmental entities or instrumentalities, agencies, or departments thereof with more than $5 million of total assets in the definition of "accredited investor." Such entities do not currently fit within the "accredited investor" definition and are, thus, denied investment opportunities reserved for many classes of similarly situated entities that do fit into the existing definition of "accredited investor." Our client believes that the omission of these entities is inconsistent with current private offering concepts and is, perhaps, nothing more than an historical accident. By way of example, we cite the City of Sarasota, Florida, which has a total annual budget exceeding $150 million, sophisticated investment management personnel and advisors and it, yet, is denied certain investment opportunities solely because it is not an incorporated entity. A precisely identical municipal entity that happened to be incorporated (perhaps as a result of a long ago political structure) would unquestionably be regarded as an "accredited investor." Moreover, an employee benefit plan established by that same unincorporated entity with over $5 million in total assets and managed and advised by the same personnel is an "accredited investor." To distinguish on the basis of incorporation is a distinction without a difference.

Background

The SEC adopted Regulation D in 1982 to simplify and clarify existing exemptions, to expand the availability of those exemptions, and to achieve uniformity between federal and state

exemptions. The stated goal was to facilitate capital formation consistent with the protection of investors.[1]

The definition of accredited investor in Rule 501(a) includes, among others, institutional investors, private business development companies certain charities, trusts and employee benefit plans and, significantly, employee benefit plans with total assets in excess of $5 million established and maintained by states and their political subdivisions, instrumentalities, agencies and departments. An unincorporated governmental entity is obviously similar in many respects to an investor that already fits within the "accredited investor" definition. And those governmental entities that happen to be incorporated are already treated as accredited investors.

It is worth noting that, when the Commodity Futures Trading Commission ("CFTC") adopted Rule 4.7 under the Commodities Exchange Act ("CEA"), exempting commodity pool operators ("CPOs") and commodity trading advisors ("CTAs") from compliance with the disclosure document requirements and certain other requirements otherwise applicable to registered CPOs and CTAs if the commodity pool or commodity interest advice is offered solely to "qualified eligible persons" or "QEPs,"[2] it borrowed the definition of accredited investor from Regulation D. However, the CFTC explicitly added unincorporated governmental entities to that definition. Under CFTC Rule 4.7(a)(3)(xii), a "qualified eligible person" includes "a governmental entity (including the United States, a state, or a foreign government) or a political subdivision thereof, or a multinational or supranational entity or an instrumentality, agency or department of any of the foregoing" if "otherwise authorized by law to engage in such transactions."[3] The CFTC indicated that it intended to define QEP status by means of "objective criteria that such persons possess either the investment expertise and experience necessary to understand the risks involved . . . or have an investment portfolio of a size sufficient to indicate that the participant has substantial investment experience and thus a high degree of sophistication with regard to investments as well as financial resources to withstand the risk of their investments."[4]

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1 SEC Release No. 33-6389, 1982 SEC LEXIS 2167, *1 (Mar. 8, 1982).

2 When the rule was originally adopted, the rule referred to both "qualified eligible participants" and "qualified eligible clients" but the definitions were substantially identical. *See* Commodity Exchange Act, 7 U.S.C. §4.7(a)(1)(ii) and (b)(1)(ii) (CCH 2003).

3 These governmental entities must also meet the "portfolio requirement" under Rule 4.7(a)(1)(v), in the same manner as others who would fall within the "accredited investor" definition. Rule 4.7(a)(3)(xii) excludes governmental plans because they are covered by another category in the definition of "qualified eligible person." *See* Rule 4.7(a)(3)(iv).

4 57 F.R. 3148 at 3151.

Reasons for the Proposal

Rule 506 of Regulation D allows for up to 35 non-accredited investors *per offering*. The structure of the safe harbor poses problems both for unincorporated governmental entities (and their instrumentalities, agencies and departments) as well as for issuers (such as private funds) that continuously offer their securities relying on Regulation D. First, if a non-accredited investor redeems its interest in a private fund issuer that relies on Regulation D, its space is no longer available for another non-accredited investor who wishes to invest in the same offering after such redemption. Since most private fund offerings are continuous, it may be virtually impossible for the private fund to make a new offering so as to get 35 more non-accredited investor spots. As a result, the private fund issuer has an incentive to favor non-accredited investors with more money to invest. Second, many issuers do not market investment products designed for large, institutional investors to unaccredited investors because of compliance and integration concerns and the highly specific, although not always applicable, information delivery requirements. As a result, unincorporated governmental entities are denied access to numerous investment opportunities provided by private funds making an offering pursuant to Regulation D.

It is, of course, an option for such entities to incorporate and, thereby (and with no other change in status, sophistication or size) become "accredited investors." This is not, however, a simple or easily achieved "fix" for various geographical, political, and tax-related reasons. For example, an unincorporated governmental entity, instrumentality, agency, or department may be part of a larger administrative unit, such as a state, county or other governmental department. Geographically, such entity may not have defined boundaries. To incorporate, an unincorporated governmental entity (or one of its instrumentalities, agencies or departments) would have to, among other things, adopt a legal charter from its state government (or other supervising entity, if any exists), elect a governing body, if applicable, and define its boundaries, geographically or in business terms.[5] As such, it is unlikely an unincorporated municipality will become incorporated merely to achieve accredited investor status. It is simply not a feasible option.

Proposal

On behalf of our client, we respectfully suggest that the Advisory Committee recommend to the Commission that it include in the Rule 501(a) definitions of "accredited investor" a new subsection, which tracks the language used by the CFTC in its definition of qualified eligible person in CFTC Rule 4.7(a)(3)(xii), as follows:

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[5] *See* Neal McLain, *Towns and Townships*, 22 Telecom Digest 88, *6-7 (Oct. 19, 2002), available at http://massis.lcs.mit.edu/archives/reports/towns-and-townships.

"If otherwise authorized by law to engage in such transactions, a governmental entity (including the United States, a state, or a foreign government) or political subdivision thereof, or a multinational or supranational entity or an instrumentality, agency, or any department of any of the foregoing with more than $5 million of total assets."

We would welcome an opportunity to discuss this matter and the proposed definition with the Advisory Committee. If you have any questions or we may supplement this proposal in any way, please contact me at (202) 778.9107 or Beth Clark at (202) 778-9432.

Sincerely,

Cary J. Meer