SUTHERLAND

SUTHERLAND ASBILL & BRENNAN LLP
1275 Pennsylvania Avenue, NW
Washington, DC 20004-2415
202.383.0100 Fax 202.637.3593
www.sutherland.com

March 11, 2011

VIA ELECTRONIC DELIVERY

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

Re: **Comments on Net Worth Standard for Accredited Investors**
File Number S7-04-11; Release Nos. 33-9177; IC-29572; IA-3144

Dear Ms. Murphy:

We are submitting this comment letter on behalf of certain insurance company clients that issue privately placed insurance products to high net worth investors. Although the change to the net worth standard for accredited investors was effective upon adoption of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the Securities and Exchange Commission (the "Commission") was required by Section 413(a) of the Dodd-Frank Act to revise its rules under the Securities Act of 1933 (the "Securities Act") accordingly. In connection with fulfilling its obligation under the Dodd-Frank Act, we appreciate the Commission specifically requesting comments regarding whether some type of transition rules should be adopted to facilitate subsequent investments by an investor that previously qualified as accredited but would be disqualified by the changes effected by the Dodd-Frank Act. It is with regard to this issue that our clients are concerned.

Summary of Issue

In the release cited above, the Commission did not propose any special rules for transition to the new accredited investor net worth standards, which were effective upon enactment of the Dodd-Frank Act. The Commission did seek comments, however, on whether some form of transition or "grandfathering" rules might be appropriate to facilitate subsequent investments by an investor who previously qualified as accredited, but was disqualified by the change effected by the Dodd-Frank Act. The Commission gave a few examples of possible scenarios that may deserve some type of relief, such as where an investor may suffer dilution of his or her ownership percentage or other rights if he or she is unable to continue to invest in a company or fund. The Commission notes that these existing investors may have previously "spent a substantial amount of time and money performing due diligence on the company or fund before his or her previous investments and may be familiar with the issuer as an existing investor." Accordingly, the Commission specifically asked whether it should "adopt any transition or other rules providing that an investor who previously qualified as an accredited investor before enactment of Section 413(a), or adoption of the proposed amendments, may continue to qualify as such for purposes of subsequent or 'follow-on' investments." Our clients submit that the Commission should adopt a "grandfathering" provision allowing an existing contract owner of a privately placed insurance contract who previously qualified as an accredited investor before enactment of Section 413(a) of the Dodd-Frank Act to continue to qualify as an accredited investor for purposes of subsequent purchase payments.

Private Placement Insurance Contracts

Overview. Insurance contracts are unique instruments that utilize a particularly long-term investment strategy. This strategy may include, and may in fact be dependent on, the ability to invest additional amounts in the insurance contract over the life of the contract. Accordingly, our clients believe that any existing contract owners who previously qualified as accredited investors before enactment of the Dodd-Frank Act, but no longer qualify as accredited investors, may find their investment objectives, as well as their retirement and estate planning goals, thwarted by an inability to continue to invest in an insurance contract they already own.

Private Placement Market for Insurance. As background, many insurance companies issue insurance contracts in the private placement market. Although most of these contracts are variable life insurance contracts, some are variable annuity contracts and others are non-variable insurance contracts that, despite some aspect of fixed return, do not meet the exclusion from the definition of a security in Section 3(a)(8) of the Securities Act. But for the private placement exemption, all of the insurance products we are referring to would be required to be registered under the Securities Act. (In this letter, we refer to all privately placed insurance contracts as "Private Placement Insurance Contracts.") Private Placement Insurance Contracts are often sold to corporate or bank investors, but may also be sold to high net worth individuals. We briefly describe each of these types of Private Placement Insurance Contracts in the following paragraphs.

Variable Insurance Contacts. Variable insurance contracts provide for values that vary directly with the investment performance of the funding vehicle to which the contract owner's payments are applied. Contract value is invested in the insurer's separate account, which typically offers the contract owner a number of investment options. These investment options may be part of a managed or "one-tier" separate account (*i.e.*, the portfolio management occurs at the separate account level) or a "two-tier" separate account which invests in underlying registered mutual funds or unregistered investment vehicles, such as hedge funds (*i.e.*, the portfolio management occurs at the underlying vehicle level). Where more than one investment option is offered, each investment option may be in a distinct separate account or alternatively each investment option may be in a separate division or "subaccount" of a separate account. Separate accounts supporting variable insurance contracts would be investment companies under the Investment Company Act of 1940 (the "Investment Company Act") but for the exclusions in either Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act.

Guarantees under Variable Insurance Contracts. Variable insurance contracts often offer a number of guarantees backed by the insurance company that are separate from the performance of the underlying funding vehicles. For example, variable life insurance contracts provide a very significant guarantee in the form of a life insurance death benefit, which is guaranteed to be paid regardless of contract value provided that the contract has not lapsed. Variable life insurance death benefits are not taxed at death and thus are important planning vehicles for individuals interested in providing for their dependents and heirs after their death. Variable annuity contracts also typically guarantee death benefits (albeit less generous ones) regardless of fluctuations in contract value; variable annuity death benefits are taxed in the same manner as withdrawals and thus do not enjoy the same treatment as variable life insurance death benefits. There are also various optional features that insurance companies may offer in these variable insurance contracts, many of which are designed to protect against investment and longevity risks during a contract owner's lifetime. The insurance company guarantees these amounts (subject to the relevant terms and conditions) regardless of the performance of the underlying investment vehicles.

Charges and Fees on Variable Insurance Contracts. Variable life insurance and variable annuity contracts impose a variety of charges and fees to compensate the insurance company for these guarantees and for administering and selling the contract. These charges may be asset-based charges assessed daily, monthly, and/or quarterly, or may be based on a percentage of the owner's purchase payments, such as surrender charges. Surrender charges may apply for a period of years under the contract, and such charges may be substantial in the early years of, or throughout, the surrender charge period. Under variable life insurance, surrender charges can apply for a more extended period (for example, 15 years). Any surrender (partial or full) of a contract prior to expiration of the surrender charge period would incur a potentially significant penalty. Further, as gains in a variable insurance contract are deferred until withdrawn, an investor surrendering his or her contract would also incur tax on any gains in the contract, and may in some cases incur penalty taxes if taken before age 59½.

Additional Investments. As noted above, variable insurance contracts are long-term investments and, accordingly, most permit additional purchase payments to be made over the life of the contract. Many investors anticipate at the time of purchase that they will continue to invest in the insurance contract in the future. Additional purchase payments may be made for various reasons – for variable annuities, they are often planned investments pursuant to a strategy to adequately fund retirement needs or, in the case of variable life insurance, they may be needed to maintain insurance coverage until the death of the owner. Life insurance coverage may lapse entirely if contract value becomes insufficient to cover cost of insurance and other charges.

Non-Variable Insurance Contracts. Non-variable life insurance and annuity contracts that are deemed to be securities under the Securities Act may also rely on the private placement exemption under the Securities Act. Typically, these products provide a rate of interest that will be credited to the owner's account during the accumulation or pay-in period. During the accumulation period of a non-variable insurance contract, payments are allocated to the insurance company's general account, which is invested in accordance with state law. Accordingly, there is no separate account that would be deemed to be an investment company under the Investment Company Act that would need to rely on the exclusion in either Section

3(c)(1) or Section 3(c)(7) of the Investment Company Act. These products may be deemed to be securities for various reasons, such as because they contain certain risk-shifting features that could result in significant loss of principal.

Concerns for Existing Investors

Our clients are concerned that owners of existing Private Placement Insurance Contracts may be extremely disadvantaged by an inability to invest additional premium payments, if such owners previously qualified as accredited but would be disqualified by the changes effected by the Dodd-Frank Act. Because of the higher thresholds required to meet the definition of a "qualified purchaser" necessary to avoid registration pursuant to Section 3(c)(7) of the Investment Company Act, the Private Placement Insurance Contract owners that may be affected by the changes effected by the Dodd-Frank Act should only be those investing in a Private Placement Insurance Contract that has a separate account relying on the exclusion provided by Section 3(c)(1) or that does not have a separate account at all (*i.e.*, those contract owners that needed to satisfy only the "accredited investor" definition to purchase the contract initially).

Existing owners of Private Placement Insurance Contracts that would be unable to make additional purchase payments face the follow potential implications:

- *Potential Lapse.* If contract value becomes too low to cover ongoing cost of insurance and other charges, life insurance contracts may lapse, unless additional purchase payments are made. Lapse of a contract would mean termination of the owner's insurance coverage entirely. Such an owner would need to obtain new insurance coverage in order to put himself or herself back in the same position as before the lapse. Because life insurance is subject to underwriting and the investor would be older than when they initially purchased the existing contract, he or she may be unable to obtain life insurance at this stage of their life or such life insurance may only be available at a much higher cost. Life insurance contracts, in particular, are often purchased with an expectation that periodic purchase payments will be made over the life of the contract.

- *Inability to Pursue Original Investment or Retirement Goals.* An owner of a Private Placement Insurance Contract who does not meet the new accredited investor definition, even if he or she does not face a lapse situation, may have intended to continue investing in this tax-deferred investment vehicle pursuant to an investment or retirement plan. An inability to continue investing may thwart those long-term goals.

- *Implications of Exchanges.* An owner wishing to continue to invest in his or her Private Placement Insurance Contract who does not meet the new accredited investor definition may be forced to exchange his or her existing contract for another available insurance contract in order to continue his original investment/retirement/estate plan. Exchanging an insurance contract for another may subject the owner to potentially significant surrender charges on the existing contract and such an owner will likely face a new surrender schedule on the new contract (starting over the period of time when surrender charges are imposed on withdrawals). Such a new surrender charge period may impact the investor's anticipated plan for taking withdrawals during retirement and would further "lock up" his or her money. In addition, the investor would lose all of the guarantees under the existing contract, which could be significant. As noted above, for life insurance contracts, new coverage at the same level may be more expensive, if available at all. Similarly, insurance contracts may offer other guarantees that "lock in" minimum values or guaranteed annuitization rates, which would be lost in an exchange.

Recommendation and Analysis

In light of the above concerns, the Commission should adopt a "grandfathering" provision allowing an existing contract owner of a Private Placement Insurance Contract who previously qualified as an accredited investor before enactment of Section 413(a) of the Dodd-Frank Act to continue to qualify as an accredited investor for purposes of subsequent purchase payments.

We do not believe that such treatment should be viewed as inconsistent with the purposes of Section 413(a) of the Dodd-Frank Act in these special circumstances. All new investors in Private Placement Insurance Contracts would be subject to the new accredited investor definition for all purchase payments. Only existing owners that already made the decision to purchase, and conducted the due diligence regarding the issuing insurance company, underlying investment vehicles (if any), and the terms of, a Private Placement Insurance Contract would be impacted. Such owners should not have their long term goals thwarted, nor should they be in a position where they could lose their insurance coverage, or be forced to surrender the contract in order to purchase another insurance contract (potentially to their detriment).

We also submit that there should not be a limit imposed on the amount of subsequent purchase payments such owners of Private Placement Insurance Contracts are permitted to make. Assessing the amount of additional investment necessary to keep a contract in force and/or to meet various retirement and estate planning goals is not an exercise we believe can be handled in the abstract and will be specific to each contract owner. We believe such contract owners should be free to make those decisions on their own, especially for variable life insurance where owners should have the latitude to determine if and when to make additional purchase payments, and how much of an additional investment it would be prudent to make, in order to protect their insurance coverage.

The Commission asks whether such a transition or grandfathering approach is unnecessary because the Section 4(2) private placement exemption may be available for sales to such an existing investor. Although there should be strong arguments that such sales fit within the Section 4(2) exemption, there can be no assurance that a court or regulator would agree. For that reason, insurance companies typically seek the safety and assurance of operating fully within the confines of the Regulation D safe harbor.

The Commission also asks whether it should provide that an investor who previously qualified as an accredited investor, but no longer qualifies as a result of Section 413(a), would not count towards the 35 non-accredited investor limitation of Rules 505(b) and 506(b) for offerings by issuers in which the investor held investments at the time the Dodd-Frank Act was enacted. Insurance companies issuing Private Placement Insurance Contracts typically sell their products exclusively to accredited investors and do not take advantage of the 35 non-accredited investors in Rules 505 and 506 of Regulation D. Accordingly, their private placement memorandum may not have all the information that would be required for sales to non-accredited investors. Having to update that information for just a few investors would be a unwarranted burden on the issuing insurance companies.

Conclusion

We appreciate the opportunity to comment on the Commission's proposal and respectfully ask that the Commission provide the relief requested above. If you have any questions or if additional information would be helpful, please contact Steve Roth at 202.383.0158 (steve.roth@sutherland.com) or Mary Thornton Payne at 202.383.0698 (mary.payne@sutherland.com).

Respectfully Submitted,

SUTHERLAND ASBILL & BRENNAN LLP

BY: Stephen E. Roth

Stephen E. Roth

Mary Thornton Payne

Mary Thornton Payne