



SIFMA

Securities Industry and
Financial Markets Association

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**Re: Proposed Amendments to NASAA Statement of Policy for Direct
Participation Programs**

Dear Mr. Cassidy:

The Securities Industry and Financial Markets Association (“SIFMA”)¹ appreciates the opportunity to provide comments in response to the Notice of Request for Public Comments (the “Notice”) issued by the Direct Participation Programs Policy Project Group (the “Project Group”) of the North American Securities Administrators Association. (“NASAA”), dated September 26, 2006. As described in the Notice, the

¹ The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

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Project Group proposes to revise the suitability standards in the NASAA Guidelines and Statements of Policy as to Asset Backed Securities, Commodity Pool Programs, Equipment Programs, Mortgage Programs, Oil and Gas Programs, Omnibus Guidelines, Real Estate Investment Trusts, and Real Estate Programs (collectively, the "NASAA Guidelines").

Specifically, the Project Group proposes to (i) exclude from the calculation of a potential investor's net worth any and all retirement or pension plan accounts or benefits; (ii) limit a potential purchaser's investment in an issuer, its affiliates and other investments with similar investment objectives to no more than 10% of the purchaser's net worth; and (iii) increase the combined \$45,000 income and net worth requirement to \$70,000, and the net worth figure from \$150,000 to \$250,000 (hereinafter the "Proposal").

I. Executive Summary

SIFMA commends the Project Group for undertaking to modernize the suitability standards in NASAA Guidelines. SIFMA believes the proposed increases to the income and net worth dollar thresholds are reasonable to compensate for inflation. SIFMA, therefore, supports this aspect of the Proposal.

SIFMA has serious concerns, however, about the potential impact of the remaining proposed revisions. Although clearly well-intended, SIFMA believes that the proposed amendments to exclude retirement assets from the calculation of an investor's net worth, and to limit investment concentration to 10% of the purchaser's net worth are unduly restrictive and could have significant adverse consequences for investors, including:

- Effectively precluding many investors from continuing to realize the financial benefits and diversification options currently available through Direct Participation Programs ("DPP") investments.
- Increasing investor risk by creating a higher suitability standard for participation in publicly registered DPPs than currently exists for unregulated privately placed investments. Investors no longer eligible under the new standard therefore might turn to private offerings that lack the same protections as DPPs.
- Imposing a "one size fits all" methodology to suitability determinations that fails to consider the investor's unique profile, financial strength, liquidity needs and risk tolerance.

Rather than creating new suitability standards, a better approach is to utilize existing, long-established broker-dealer rules that have served investors well. Currently, NASD and NYSE impose and rigorously enforce strict suitability and supervisory requirements on broker-dealers that purchase or sell alternative investments, including

DPPs. Thus, while we appreciate the Policy Group's concerns, the investor protection objectives are being met through stringent regulation already in place. SIFMA therefore urges the Project Group to withdraw the proposed amendments to modify the definition of investor net worth and to impose a concentration limitation. SIFMA's detailed comments are provided below.

II. Proposed Amendment to Net Worth Definition

SIFMA opposes the proposed revisions to exclude from the calculation of an investor's net worth "any and all retirement or pension plan accounts or benefits." SIFMA believes that this expanded definition would effectively create an entry barrier for many investors who have made provisions for their retirements through 401(k)s, IRAs, and the like. The expanded definition would also limit access to public investors seeking the benefits of alternative investments, including receipt of regular cash distributions and capital appreciation without the volatility inherent in the public market place. Because alternative investments generally are designed to perform largely independent of the stock market or interest rate trends, DPPs can add diversification to a portfolio otherwise composed of stocks and bonds. By limiting access to registered DPPs, this revision would greatly diminish an investor's ability to hedge more traditional holdings with a diversified mix of asset classes.

Ironically, the Proposal imposes stricter limitations on potential DPP investors than currently exists under SEC Regulation D for "accredited investor" participation in private unregistered offerings. Under Regulation D, there is a \$1,000,000 net worth threshold that includes all items owned by the investor, including a person's home, home furnishings and automobiles. Since the greatest percentage of investor net worth typically is comprised of real estate and retirement assets, a net effect of the proposed new definition would be to create a lower threshold for an investor to purchase an unregistered private offering as an "accredited investor" than to qualify as a registered DPP investor. Consequently, investors seeking portfolio diversification, but no longer eligible to purchase DPPs under the new definition, may find themselves turning to private offerings that lack the disclosure and regulatory oversight applicable to registered DPPs. Though designed to protect investors, the proposed amendments could potentially increase investor financial risk.²

In all events, SIFMA believes that the proposed new definition of net worth is fundamentally flawed because it utilizes a "one size fits all" methodology to investor suitability determinations that ultimately disserves investors. Whether a particular

² The SEC recently proposed amendments to SEC Rule 509, which would require an accredited natural person to own not less than \$2.5 million in investments (in addition to the existing accredited investor standard). The new definition, however, would only apply to private investment vehicles which rely on Section 3(c)(1) of the Investment Company Act of 1940 (or Section 4(6) of the 33 Act). The accredited investor standard otherwise remains the same.

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investment is suitable for an investor will necessarily depend on the specific investor's unique needs and circumstances. Under the newly proposed definition, however, many investors automatically would be precluded from participating in potentially beneficial investment options irrespective of their age, risk tolerance, investment objectives, extent of retirement assets, or liquidity needs.

While SIFMA fully appreciates the Policy Group's objective in safeguarding investor retirement savings -- a goal shared by SIFMA -- we do not believe that the proposed revisions are the appropriate solution. Instead, we strongly recommend that NASAA adopt the suitability standards already embodied within NASD Conduct Rule 2810. Currently, this rule prohibits broker-dealers from participating in a public offering of a DPP unless suitability standards have been established by the program and are fully disclosed in the prospectus.

NASD Rule 2810(b)(2) requires that broker-dealers purchasing or selling an interest in a DPP must "have reasonable grounds to believe, on the basis of information obtained from the participant *concerning his investment objectives, other investments, financial situation and needs*, and any other information known by the member or associated person that:

- a. The participant is or will be in a *financial position appropriate to enable him to realize to a significant extent the benefits described in the prospectus*, including the tax benefits where they are a significant aspect of the program;
- b. The participant has a fair market net worth sufficient to sustain the risks inherent in the program, including loss of investment and lack of liquidity; and
- c. *The program is otherwise suitable for the participant . . ."*

NASD Rule 2810 therefore guides securities professionals to make suitability determinations based on individually informed judgments about an investor's unique circumstances and needs. By contrast, the new definition, together with the proposed maximum concentration amendments, would indiscriminately restrict investment choices and make it difficult for securities professionals to make recommendations that truly serve investor needs. Accordingly, and in the interests of regulatory consistency, SIFMA urges the Policy Group to reconsider the proposed amendments to the definition on investor net worth.

III. Proposed Maximum Investment Concentration

SIFMA also objects to the proposed revisions that would impose a cap on DPP investments which may be sold to a particular investor, based on a percentage of such investor's net worth. The proposal does not differentiate between an investor with a net worth of \$100,000 and a net worth of \$1,000,000. As proposed, the new language would

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read "the maximum investment in the [DPP] program and *affiliates and other investments with similar investment objectives* may not exceed 10% of the participant's net worth."

Like the proposed revisions to the definition of net worth, SIFMA believes that the imposing of a bright-line concentration limitation on DPP investments is an inappropriate test for suitability. As previously noted, NASD rules already adequately address the issue of investment suitability and appropriately place the responsibility for evaluating the type and concentration level of investments reasonable for a particular investor on the broker-dealers who are most familiar with the potential investor's specific financial circumstances and investor's overall investment portfolio. Consequently, member firms that sell DPPs generally establish firm-wide limitations on the amount of any investor's portfolio that may be dedicated to DPP investments limits based upon their due diligence efforts with respect to DPPs mandated by NASD rules, their perception of the marketplace and direction of the economy in general.

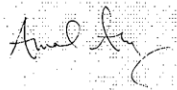
Furthermore, the "similar investment objective" standard is far too vague. Since most DPPs have capital preservation as a primary objective, all DPP investments could conceivably be characterized as having a similar investment objective, thus capping the amount that potential investor may invest in DPPs at an artificially low amount.

IV. Conclusion

SIFMA shares the Policy Group's concerns about investor suitability and potential for concentration (particularly by retirees or near retirees). However, for the reasons set forth above, SIFMA cannot support the proposed revisions to exclude retirement assets from the calculation of an investor's net worth, and to limit investment concentration to 10% of the purchaser's net worth.

SIFMA appreciates the opportunity to provide comments on the proposed revisions to the NASAA Guidelines. If you have any questions or require further information, please feel free to call me at 212.618.0568

Sincerely,



Amal Aly
Vice President and
Associate General Counsel