



SIDLEY AUSTIN LLP
787 SEVENTH AVENUE
NEW YORK, NY 10019
(212) 839 5300
(212) 839 5599 FAX

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July 28, 2009

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

Re: File No. S7-09-09: Comments on Proposed Amendments to Rule 206(4)-2

Dear Ms. Murphy:

On May 20, 2009, the Securities and Exchange Commission (the "Commission") proposed amendments to Rule 206(4)-2 under the Investment Advisers Act of 1940, as amended (the "Advisers Act").¹ Among other things, the Proposal provides that advisers to pooled investment vehicles that have custody of client funds or securities would not be subject to the Proposal's account statement delivery requirement, *provided, that*, the pool is subject to audit: (i) at least annually and distributes its audited financial statements to all investors within 120 days of the end of its fiscal year; and (ii) upon liquidation and distributes its audited financial statements to all investors promptly after the completion of such audit (the "Audit Exception").²

We support the Commission's efforts to provide additional safeguards under the Advisers Act when an adviser has custody of client assets. We believe, however, that it is appropriate to make an amendment to the Audit Exception, as it would apply to an adviser to a "fund of funds"³ to correct what appears to be an inadvertent oversight.

Under Rule 206(4)-2, as currently in effect, an adviser to a pooled investment vehicle is not required to comply with such rule's account statement delivery requirement if the pool is audited at least annually and audited financial statements are distributed to investors within 120 days, or 180 days in the case of a fund of funds, of the pool's fiscal year end.⁴ Distributing audited financial statements within the 120 day period applicable to "non-fund of funds" is not practicable for a fund of funds, since such a fund

¹ Custody of Funds or Securities of Clients by Investment Advisers, Advisers Act Release No. 2876 (May 20, 2009) (the "Proposal").

² See proposed Rule 206(4)-2(b)(3).

³ Defined in Rule 206(4)-2(c)(4) as "a limited partnership (or limited liability company, or another type of pooled investment vehicle) that invests 10 percent or more of its total assets in other pooled investment vehicles that are not, and are not advised by, a related person . . . of the limited partnership, its general partner, or its adviser."

⁴ See Rule 206(4)-2(b)(3).

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typically requires audited financial statements for all, or substantially all, of its underlying fund investments. Frequently, an underlying fund will take up to 120 days to distribute its audited financial statements to investors, including the fund of funds. Often, this will make it impracticable for a fund of funds to distribute audited financial statements to its investors within 120 days of its fiscal year end; indeed, in cases where a fund of funds and a significant number of its underlying funds share the same fiscal year end, it is a practical impossibility for the fund of funds to distribute audited financial statements to its investors within the 120 day period. As discussed below, the Commission has repeatedly noted the audit timing challenges faced by funds of funds when adopting past amendments to Rule 206(4)-2 and when issuing interpretive advice.

In 2005, in connection with other rulemaking activity, the Commission amended rule 206(4)-2 to allow additional time for completion of audit work on behalf of advisers to funds of funds (the "2005 Adopting Release").⁵ The amendment extended, from 120 to 180 days, the time within which an adviser to a fund of funds may distribute the fund's audited financial statements. In adopting the amendment, the Commission noted that "[s]ome advisers to private funds of funds (including funds of hedge funds) have encountered difficulty in obtaining completion of their fund audits prior to completion of the audits for the underlying funds in which they invest, and as a practical matter will be prevented from complying with the 120-day deadline."⁶ The Commission initially proposed to extend the period for all investment advisers, but recognized that such extension would leave the advisers to funds of funds in the same situation, *i.e.*, the underlying hedge funds would use the entire 180 day period, and the advisers to the funds of funds would have no time to prepare financial statements for the funds of funds after they received the financial statements from underlying hedge funds.⁷ In essence, the Commission recognized that, as a practical matter, any deadline for the delivery of audited financial statements of a fund of funds must be later than the deadline applicable to the underlying funds in which funds of funds typically invest.

In response to a request for interpretive guidance subsequent to the action of the United States Court of Appeals for the District of Columbia Circuit vacating the rulemaking adopted pursuant to the 2005 Adopting Release,⁸ the staff of the Commission indicated that it would not recommend enforcement action to the Commission against an adviser to a fund of funds relying on the annual audit exception of Rule 206(4)-2 if the audited financial statements of the fund of funds are distributed to investors in the

⁵ Registration Under the Advisers Act of Certain Hedge Fund Advisers, Advisers Act Release No. 2333 (Dec. 2, 2004). Included in the 2005 Adopting Release was a rule requiring certain private investment pools to register with the Commission under the Advisers Act.

⁶ *Id.* at Section VIII.B.1.

⁷ *Id.* at n. 375.

⁸ See *Goldstein v. SEC*, 451 F.3d 873 (D.C. Cir. 2006). While the Court's action was motivated by elements of the 2005 Adopting Release unrelated to Rule 206(4)-2, it called into question the amendments to Rule 206(4)-2 that were contained in the 2005 Adopting Release.

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fund of funds within 180 days of the fund of fund's fiscal year end.⁹ Again, in light of the audit timing challenges faced by advisers to funds of funds, the Commission recognized the appropriateness of providing such advisers with an extended period of time under Rule 206(4)-2 for distributing audited financial statements.

Historically, the Commission has recognized the practical difficulty faced by advisers to funds of funds in obtaining completed audits for such funds prior to completion of the audits for the underlying funds. Responding to this difficulty, the Commission has provided advisers an extended period of time under Rule 206(4)-2 for distributing audited financial statements of funds of funds. The audit timing challenges faced by advisers to funds of funds are no less prevalent today than they were when the Commission first recognized the need to provide special relief; we therefore respectfully request that the Commission amend the Proposal to: (i) include a provision, similar to the one currently in Rule 206(4)-2(b)(3), that permits an adviser to a fund of funds to dispense with the account statement delivery requirement, *provided, that*, the fund of funds prepares and distributes, at least annually, audited financial statements to all of its investors within 180 days of the end of its fiscal year; and (ii) restore the definition of "fund of funds" currently set forth in Rule 206(4)-2(c)(4).

We do not believe that providing additional time for advisers to funds of funds to distribute audited financial statements detracts from the safeguards that the Proposal intends to provide. In particular, the Proposal would still require advisers to funds of funds that have custody of client assets to obtain an annual surprise examination regardless of whether the adviser complies with the Audit Exception. Unless the Audit Exception provides a deadline for the delivery of audited financial statements of funds of funds that is later than the deadline applicable to the underlying funds in which such funds of funds typically invest, the Audit Exception will, as a practical matter, be unavailable to advisers to funds of funds.

We appreciate the Commission's consideration of the matters set forth above.

Very truly yours,

Sidley Austin LLP

⁹ American Bar Ass'n, SEC No-Action Letter, (Aug. 10, 2006).