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September 14, 2004

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549-0609

RE: File Number S7-30-04: Proposed Registration Under the Advisers Act of Certain Hedge Fund Advisers

Dear Mr. Katz:

On July 20, 2004, the U.S. Securities and Exchange Commission (“Commission”) proposed a new rule requiring investment advisers to certain private investment pools (“hedge funds”) to register with the Commission under the Investment Advisers Act of 1940, as amended (“Advisers Act”).¹ This letter of comment on the Proposed Rule is respectfully submitted by Committee I of the International Bar Association (“IBA”). The IBA is a voluntary organization comprised of 16,000 individual lawyers and 190 Bar Associations and Law Societies. Committee I (Investment Companies and Mutual Funds) currently has over 1,000 members from over 120 countries, who specialize or are interested in the legal aspects of investment companies and other pooled investment vehicles. We are grateful for the opportunity to comment on the Proposed Rule and to provide our suggestions with respect to the applicability of the Rule to offshore investment advisers.

EXECUTIVE SUMMARY

The Commission has requested comment on whether a “threshold of assets under management” test should apply to offshore advisers of offshore private funds prior to requiring their registration with the Commission. We believe that it should. As described more fully below, we believe that the Commission should not require that an offshore investment adviser “look through” a private fund that it manages for purposes of the “private adviser” exemption contained in Section 203(b)(3) of the Advisers Act if less than 25% of the value of *any class* of equity interests in the private fund is held by “U.S. residents.” Since the term “U.S. resident” is not defined in the Proposed Rule, we also request the Commission acknowledge that the definition of “U.S. Person” contained in Regulation S of the Securities Act of 1933, as amended (“Securities Act”) is a permissible (but not exclusive) “safe harbor” for this purpose.

We support the Commission’s position not to require investment advisers to offshore publicly offered mutual funds or closed-end funds, which are already subject to regulation in a foreign

¹ *Registration Under the Advisers Act of Certain Hedge Fund Advisers*, 69 Fed. Reg 45172, at 45172 (proposed July 28, 2004) (to be codified at 17 C.F.R. 275.203(b)(3)-2) (hereinafter, the “Proposed Rule”).

jurisdiction, to register with the Commission simply because more than fourteen of such fund's investors are resident in the United States. We would also request that the Commission revise the definition of "private fund" in the Proposed Rule to include foreign funds that offer securities privately to U.S. investors in reliance upon the Commission's interpretation of Section 7(d) of the Investment Company Act of 1940, as amended ("Investment Company Act") while offering securities publicly to non-U.S. investors.

SIGNIFICANT PARTICIPATION TEST

As the Commission noted in its 2003 Report on the "Implications of the Growth of Hedge Funds",² most investment advisers to hedge funds do not register under the Advisers Act; rather they rely on the "*de minimis*" exemption from registration for investment advisers with 14 or fewer clients.³ Under current Commission rules, each hedge fund counts as one client.⁴

The Proposed Rule would require hedge fund advisers whose principal office and place of business is located outside the United States (*i.e.*, "offshore") to "look through" the hedge funds they manage, whether or not those funds are located offshore, and count investors that are "U.S. residents" as their clients for purposes of relying upon the "private adviser" exemption contained in Section 203(b)(3) of the Advisers Act. An offshore investment adviser would be required to register with the Commission if it manages or has managed assets for more than 14 investors (or advisory clients) that are U.S. residents in the previous twelve months.

You have requested comment on whether a "threshold of assets under management" test should apply to offshore advisers of private funds prior to requiring their registration with the Commission.⁵ We believe that it should. We would urge the Commission to adopt an exemption to the Proposed Rule for those offshore investment advisers that manage offshore private funds in which equity participation by U.S. residents is not "significant." The Commission should look to the "significant participation test" promulgated under the regulations of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") in drafting the definition of "significant" in our proposed exemption for offshore advisers of offshore private funds under the Proposed Rule.

In general, hedge funds have often restricted the amount of investment that they will accept from U.S. pension plans, and fund managers have relied on the 25% limitation on benefit plan investors, as outlined in the U.S. Department of Labor's Plan Assets Regulations,⁶ in order to

² Staff Report to the U.S. Sec. and Exch. Com., *Implications on the Growth of Hedge Funds*, (2003).

³ *Id.* at x. See Section 203(b)(3), which exempts a private adviser from registration if it (i) had fewer than 15 clients during the preceding 12 months; (ii) does not advise any investment company registered under the Investment Company Act; and (iii) does not hold itself out to the public in the U.S. as an investment adviser.

⁴ Currently, Rule 203(b)(3)-1(a)(2) permits an investment adviser to consider as a single client, "a corporation, general partnership, limited partnership, limited liability company, trust..., or other legal organization" to which investment advice is provided based on the organization's investment objectives rather than the individual investment objectives of an underlying investor.

⁵ Proposed Rule, at 45183.

⁶ 29 C.F.R. Section 2510.3-101 (the "Plan Assets" Regulations). This regulation describes the circumstances under which the assets of an investment entity such as the typical unregistered "hedge" fund could be treated as plan assets subject to regulation under Title I of ERISA or Section 4975 of the Internal Revenue Code ("IRC").

avoid the regulation of both fund operations and fund managers under ERISA.⁷ In a similar fashion, the Commission could exempt an offshore investment adviser of an offshore private fund from the registration provisions of the Advisers Act if such adviser limits the amount of investment coming from U.S. residents in a hedge fund managed by such adviser.

Generally speaking, we would propose that an offshore investment adviser should not be required to register if less than 25% of the value of *any class* of equity interests in the private fund is held by U.S. residents (“25% threshold”). In determining whether “U.S. resident” ownership is less than the 25% threshold, the value of any equity interests held by any person who has discretionary authority or control with respect to the entity’s assets or who provides investment advice for a fee, or any affiliate of such a person, will be disregarded. A determination of whether “U.S. resident” ownership is less than the 25% threshold must be made after each “acquisition” of an equity interest in the private fund. We believe that this percentage based-test will ensure the regulation of those advisers whose conduct significantly affects U.S. residents.

The Commission acknowledges in the Proposed Rule that it does not want to require offshore advisers to offshore publicly offered mutual funds or closed-end funds to register with the Commission “simply because more than fourteen of their investors are now resident in the United States.”⁸ We believe that this concept should also apply to offshore advisers of unregistered funds that are offered on a private placement basis. We note that offshore advisers managing privately offered hedge funds may already be subject to a significant degree of regulation in their home jurisdiction. U.S. investors in such a fund generally “would not have reasons to expect the full protection of the U.S. securities laws.”⁹

In addition, a threshold test would contribute to the Commission’s interest of: (i) collecting census information about the hedge fund industry in the U.S. or affecting the U.S. markets; (ii) preventing hedge fund related fraud on U.S. citizens; and (iii) limiting the “retailization” of hedge funds in the U.S. While we acknowledge that our proposal would cast a narrower net over those “unscrupulous persons” who may desire to use a hedge fund as a vehicle to defraud U.S. investors, the offshore fund would continue to be governed by the regulatory authority in the fund’s home jurisdiction.¹⁰

It should be noted that the principles of international comity would dictate that in cases where the U.S. jurisdictional interest is not as great as that of another jurisdiction it would be appropriate to defer to that foreign jurisdiction to enforce and protect the rights of its own citizens or of other

⁷ Unregistered funds are treated as containing “plan assets” if equity participation by benefit plan investors is “significant;” that is, if 25% or more of the value of any class of equity interests in the fund is held by benefit plan investors. This 25% rule and the Plan Asset Regulations apply to any sort of unregistered collective investment entity, whether partnership or corporate, and whether or not organized or operating in the United States.

⁸ Proposed Rule, at 45183; it is important to note that one of the original goals of the Advisers Act was a “census of the Nation’s (*i.e.*, U.S.) investment advisers.”

⁹ Id., at 45184.

¹⁰ Id., at 45180. In addition, an investment adviser that raises a “significant” amount of assets from U.S. residents under our proposal would be subject to registration, the Commission’s regulatory scrutiny and to the enforcement of the anti-fraud provisions of the U.S. federal securities laws, which would continue to apply to the investment adviser even if not registered under the 25% threshold test.

persons who are under the protection of its laws.¹¹ We believe that a percentage of assets test would provide the Commission with substantial jurisdictional control over foreign funds that have a significant, but less than a majority, portion of their interests held by U.S. persons, without establishing a precedent of imposing substantive U.S. regulation on foreign issuers who have less significant U.S. contacts. The Commission should, in our view, defer to the regulators of those foreign issuers to protect the interests of investors, most of whom would not be U.S. investors. As a practical matter, the Commission would find it difficult to police such a large potential universe of funds, and we would suggest that the Commission should rely on the good offices of foreign regulators to enforce their own laws in such cases.

As such, we believe that offshore investment advisers of offshore private funds should only be required to register with the Commission in cases where the 25% threshold is met or exceeded. The 25% threshold test seeks to ensure that the provisions of the Advisers Act apply only in cases where the Commission has a significant interest in their application. Our proposal would also alleviate any burden imposed by the Proposed Rule on investment advisers that do not offer the investment funds they manage to a significant number of U.S. residents.

As an alternative to our proposal, we would urge the Commission to work with The International Organisation of Securities Commissions (“IOSCO”) to create a separate registration system or registry for offshore advisers of unregistered investment funds to accomplish the Commission’s goal of collecting basic reliable “information on hedge fund advisers and the hedge fund industry.”¹² The Commission and IOSCO could develop a registry that would require investment advisers of unregistered investment funds that are sold to U.S. residents to submit basic information to an on-line system, including information about the number of hedge funds they manage, the amount of assets under management in such hedge funds, the number of employees and types of clients the adviser has as well as the identity of persons that control the adviser. This alternative would accomplish the Commission’s goal of obtaining “information that is reliable, current, and complete” in a format that is susceptible to analysis by the Commission’s Staff.¹³

DEFINITION OF “U.S. RESIDENT”

The Rule Proposal states that if an investment adviser has its principal office and principal place of business outside the U.S., the investment adviser is not required to count clients that are not U.S. residents. The Rule Proposal contains no definition of the term “U.S. resident.” The Commission staff has on other occasions relied on the definition of “U.S. Person” in Regulation S under the Securities Act (“Regulation S”) as a non-exclusive “safe harbor” for these purposes.¹⁴ Regulation S includes within the meaning of “U.S. person” any natural person resident in the United States. There is no definition of what it means to be “resident” in the U.S. in the federal

¹¹ When considering the jurisdictional reach of the U.S. securities laws, the U.S. courts have looked to balance their interest in remedying harms having a substantial effect on investors within the United States, even if those harms had been perpetrated abroad, with the principles of international comity. With little Congressional guidance concerning the scope of the antifraud provisions of the U.S. federal securities laws, U.S. courts have developed two general tests, the “conduct test” and the “effects test”, in prescribing the limits of U.S. jurisdiction over transnational securities transactions. See Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 993 (2d Cir. 1975), *cert. denied*, 423 U.S. 1018 (1975); see also Leasco Data Processing Equip. Corp. v. Kerman, 468 F.2d 1326 (2d Cir. 1972); IIT v. Vencap, Ltd., 519 F.2d 1001 (2d Cir. 1975).

¹² Id., at 45177.

¹³ Id., at 45178.

¹⁴ See Murray Johnstone Holdings Ltd., SEC No-Action Letter (pub. avail. Oct. 7, 1994).

securities laws, and the Commission has provided little guidance on this issue.¹⁵ We are not proposing that the Commission adopt an exclusive definition of the term “U.S. resident”; indeed we believe that flexibility here is essential due to the various concepts of residency that arise under the tax or immigration laws of the U.S. or of other countries and that may be appropriate under various circumstances.¹⁶ However, we also believe that it would be useful for the Commission to acknowledge that the definition of “U.S. person” under Registration S would be an acceptable “safe harbor” for determining who is a “U.S. resident.”

ADVISERS TO OFFSHORE PUBLICLY OFFERED FUNDS

We agree with and appreciate the Commission’s approach of not requiring investment advisers to offshore publicly offered mutual funds or closed-end funds to register with the Commission simply because more than fourteen of the fund’s investors are resident in the U.S. We note that many offshore funds that are publicly offered have some U.S. shareholders. The Commission has previously stated that, under certain circumstances, a foreign investment company not registered under the Investment Company Act could make a “private offering” in the U.S., coincident with a public offering of that fund’s shares abroad, without violating Section 7(d) of the Investment Company Act.¹⁷ Following longstanding Commission and Staff guidance, a foreign fund that is conducting a public offshore offering also may make, under certain circumstances, a private U.S. offering in reliance on Section 3(c)(1)¹⁸ or Section 3(c)(7)¹⁹ of the Investment Company Act and Rule 506 of Regulation D under the Securities Act of 1933, consistent with the U.S. public offering prohibition in Section 7(d). As noted above, these foreign funds are currently subject to regulation in a foreign jurisdiction, and the limited number of U.S. investors in such funds would have no reason to expect the full protection of the U.S. federal securities laws.

¹⁵ A natural person’s residency, rather than citizenship, determines his or her status under Rule 902 of Regulation S. *See Goodwin Procter & Hoar*, SEC No-Action Letter (pub. avail. Feb. 28, 1997) (“Goodwin Procter Letter”) (concluding that it would be appropriate for a foreign fund to count as U.S. resident beneficial owners those natural persons who would be considered “U.S. Persons” under Regulation S).

¹⁶ For example, a foreign government-related individual, such as a diplomat or an employee of an international organization, may be considered a U.S. Person under Regulation S by reason of residence in the United States; however, such a person may not be considered a U.S. resident under the rules and regulations of the IRC. The purpose of this requested flexibility would not be to facilitate circumvention of necessary regulation, but rather to accommodate persons who may be considered U.S. residents under various provisions of law, but who would not expect the protection of the U.S. federal securities laws when they invest in a non-U.S. fund simply because they have some temporary contact with the U.S.

¹⁷ *See Goodwin Procter Letter*, supra note 15; *see also Touche, Remnant & Co.*, SEC No-Action Letter (pub. avail. Aug. 27, 1984) (“Touche Remnant Letter”).

¹⁸ *See Touche Remnant Letter* (the SEC staff has applied Section 3(c)(1) along with Section 7(d) of the Investment Company Act with the result that non-U.S. investment funds may have up to one hundred U.S. beneficial owners).

¹⁹ *See Goodwin Procter Letter*, supra note 15 (following Touche, Remnant doctrine, the Commission has confirmed that an offshore (non-U.S.) fund may rely on the Section 3(c)(7) exception and that it may have non-U.S. participants who are not qualified purchasers); *see also Statement of the Commission Regarding Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions or Advertise Investment Services Offshore*, International Series Release No. 1125 (pub. avail. Mar. 23, 1998) (in which the Staff’s positions in the Goodwin Procter and Touche Remnant Letters were endorsed by the Commission).

With respect to these foreign funds, we would also request that the Commission review the definition of “private fund” in the Proposed Rule in light of a recent position in a Staff no-action letter issued to the France Growth Fund.²⁰ In the France Growth Fund Letter, the Staff suggested that a non-U.S. investment company would not meet the requirements of Section 3(c)(7) of the Investment Company Act unless all of its shareholders, regardless of whether they are U.S. Persons, were “qualified purchasers” at the time that they invested in the company.²¹ Under such an interpretation, many foreign funds that sell to non-“qualified purchasers” outside the U.S. could be deemed to be investment companies for all purposes under the Investment Company Act. If such an interpretive position were to be authorized by the Commission, these foreign funds would be excluded from the definition of “private fund” under the Proposed Rule.²² We would urge the Commission to confirm, at a minimum, that the definition of “private fund” under the Proposed Rule would include foreign funds that may be relying on the Goodwin Procter Letter but that have non-U.S. participants who are not “qualified purchasers.”

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Again, we appreciate the opportunity to comment. If we can answer any questions or be of further assistance, please contact me at 202.261.3356.

Sincerely,

/s/ Robert W. Helm

Robert W. Helm
Vice-Chair

cc: Officers of IBA Committee I (Investment Funds and Trusts):

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²⁰ See *France Growth Fund*, SEC No-Action Letter (pub. avail July 2003), fn. 7 (“France Growth Fund Letter”).

²¹ Id.

²² The Proposed Rule would define a “private fund” by reference to, among other things, whether the private fund would be subject to regulation under the Investment Company Act but for the exception provided in Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act.