FRIED FRANK

March 9, 2007

VIA ELECTRONIC MAIL

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: File Number S7-25-06: Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles

Dear Ms. Morris:

We are respectfully submitting our comments to the rules proposed by the Securities and Exchange Commission ("SEC") on December 27, 2006 that would (1) prohibit investment advisers to pooled investment vehicles from making false or misleading statements or otherwise defrauding investors or prospective investors in those pooled investment vehicles and (2) revise the definition of accredited investor as it relates to natural persons in connection with the offer and sale of interests in certain privately offered investment pools (collectively, the "Proposed Rules").[1] This letter addresses certain issues regarding the Proposed Rules which are explained in more detail below and summarized as follows:

- Our concern that the proposed antifraud rule for advisers to pooled investment vehicles could be used as an indirect means for imposing substantive requirements on registered hedge fund advisers through the SEC's compliance inspection program.

- Our view that the SEC also should propose a rule easing the restriction on general solicitation for private placement offerings of interests in pooled investment vehicles that rely on Section 3(c)(7) of the Investment Company Act of 1940 ("3(c)(7) Funds"), as well as for those private investment vehicles relying on Section 3(c)(1) of the Investment Company Act of 1940 ("3(c)(1) Funds") if the new accredited investor standards are adopted.

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[1] *Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles*, Advisers Act Release No. 2576 (Dec. 27, 2006) ("the Proposing Release").

- Our view that an employee of a 3(c)(7) Fund or a 3(c)(1) Fund or its investment adviser should be permitted to invest in the vehicle if he or she is a "knowledgeable employee" as defined in Rule 3c-5 under the Investment Company Act without meeting the applicable accredited investor standard.

I. Background

A. The Advisers Act Antifraud Rule

As part of the Proposed Rules, the SEC has proposed new Rule 206(4)-8 under the Investment Advisers Act of 1940 (the "Advisers Act"). Rule 206(4)-8, an antifraud rule proposed under Section 206(4) of the Advisers Act, would prohibit investment advisers to investment companies and other pooled investment vehicles from (1) making false or misleading statements to investors in those vehicles or (2) otherwise defrauding investors in those vehicles. The proposed rule would apply to both registered and unregistered advisers and their dealings with both existing and prospective investors.

B. The Accredited Investor Standard

Section 5 of the Securities Act of 1933 (the "Securities Act") generally requires that any U.S. securities offering be registered with the SEC and that purchasers receive a prospectus containing certain information about the issuer and the securities being offered. Interests in private pooled investment vehicles, however, are offered without registration in reliance Section 4(2) of the Securities Act or on Regulation D promulgated thereunder. Among other conditions, Regulation D generally provides that offers and sales of securities may only be made to "accredited investors."

The term "accredited investor" is defined under Rule 501(a) of Regulation D to include any natural person who (1) has an individual net worth, or joint net worth with that person's spouse, at the time of his or her purchase in excess of $1,000,000 or (2) had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year. As part of the Proposed Rules, the SEC has proposed changing the "accredited investor" standard for natural persons who invest in certain types of 3(c)(1) Funds. Specifically, the SEC would require that those natural person investors in a 3(c)(1) Fund meet a new "accredited natural person" standard which would consist of both the current income or net worth test for "accredited investors" and a requirement to own at least $2.5 million in investments at the time of purchasing securities issued by a 3(c)(1) Fund (the "Proposed Accredited Investor Rules").

II. The Advisers Act Antifraud Rule

We generally support the SEC's proposed Rule 206(4)-8. We believe that the proposed rule would provide important clarification regarding the SEC's existing ability to bring actions for fraudulent conduct by investment advisers with respect to investors and prospective investors in funds managed by those advisers. We also believe that the investor

protection efforts by the SEC are important for the health and reputation of the hedge fund industry as a whole.

We also wish to express our general concern, however, that Rule 206(4)-8 not be used by the SEC staff as an indirect means for imposing substantive requirements on hedge fund advisers, particular those who are registered with the SEC. More specifically, we are concerned that the SEC's examination staff may look to Rule 206(4)-8 as a basis for implying that hedge fund advisers must comply with certain substantive requirements that are not otherwise specified in the Advisers Act or rules thereunder. Recent speeches by the SEC staff, examination request lists, and deficiency letters suggest that a registered adviser must comply with a number of requirements not specified in the Advisers Act or rules thereunder, including, for example, that a registered adviser must specifically:

- maintain a written business continuity plan;
- establish a brokerage or best execution committee that meets regularly and maintains minutes of the committee's meetings;
- maintain (1) a record of every material regulatory/compliance breach at the adviser; (2) a gifts and entertainment log; (3) a list of all trade errors, including a summary of each error, its ultimate disposition and the conditions of any financial settlement; and (4) an inventory of compliance risks; and
- create a "privilege log" for every e-mail withheld from SEC examiners based on legitimate claims of attorney-client privilege.

We believe that the SEC's examination process serves an important purpose in maintaining the integrity of the investment advisory industry. We also appreciate the difficult task SEC examiners sometimes face in determining whether an investment adviser is in compliance with applicable regulations and rules and is not otherwise engaging in illicit conduct. If the SEC staff believe, however, that investment advisers should engage in practices and undertakings not otherwise specifically required by the Advisers Act and the rules thereunder, then the SEC should propose rules to address these perceived regulatory gaps. By engaging in the rulemaking process, we believe that the SEC will enhance its credibility with the investment advisory industry, provide fair notice to investment advisers regarding the specific requirements applicable to them and allow the investment advisory industry to provide insightful comments to the SEC that may enhance and facilitate the inspection process.[2]

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[2] We are aware that certain industry groups have recently expressed similar concerns to the SEC. *See, e.g., ICAA Letter to SEC Staff Re: Email Retention, Production, and Surveillance* (Nov. 19, 2004), available at www.icaa.org/public/letters/compendiums/letterscompendium-2004.pdf and *Letter of the Association of the Bar of the City of New York, Committee on Investment Management Regulation to the U.S. Securities and Exchange Commission* (May 11, 2005), available at www.sec.gov/rules/petitions/petn4-503.pdf.

III. Easing the Prohibition on General Solicitation

Regulation D contains a number of conditions, including that offers and sales generally must be made only to "accredited investors" and that offers and sales cannot be made using any form of "general solicitation or general advertising." Rule 502(c) under the Securities Act describes "general solicitation or general advertising" to include "any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio" and "any seminar or meeting whose attendees have been invited by any general solicitation or general advertising." Through enforcement actions and no-action letters, the SEC and the SEC staff have also stated that "general solicitation or general advertising" can occur in connection with materials posted on a publicly-available website, mass mailings and e-mail messages sent to previously unknown persons and broadcasts over television and radio.[3] Finally, the SEC staff has provided guidance stating that a general solicitation will not occur where a pre-existing, substantive relationship exists between an issuer or its broker-dealer and an offeree.[4]

In its 2003 report titled "Implications of the Growth of Hedge Funds," the SEC staff made a number of recommendations regarding the regulation of hedge funds and their investment advisers.[5] These recommendations included a suggestion that the SEC consider eliminating or easing the restriction on general solicitation for private placement offerings of interests in 3(c)(7) Funds. The staff observed that the policy justification for such a restriction in the case of 3(c)(7) Funds appears to be lacking. In particular, the staff noted that 3(c)(7) Funds may only sell interests to "qualified purchasers," which presumably ensures a higher minimum level of investment sophistication on the part of offerees. By contrast, the staff expressed a reluctance to eliminate or ease the restriction on general solicitation for interests in 3(c)(1) Funds because investors in a 3(c)(1) Fund typically must meet only the lower standard of an "accredited investor." The staff further stated that eliminating or easing the general solicitation requirement for 3(c)(1) Funds "could increase the level of risk of investment interest by less wealthy investors."

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[3] See, e.g., *In the Matter of Gerald Klein & Associates, Inc. and Klein Pavlis & Peasley Financial,Inc*, Securities Act Release No. 8585 (July 8, 2005); *In the Matter of CGI Capital, Inc.*, Securities Act Release No. 7904 (Sept. 30, 1999); *In the Matter of Harry Harootunian and Professional Planning & Technologies, Inc.*, Exchange Act Release No. 32981 (Sept. 29, 1993); *In the Matter of PriorityAccess, Inc., Endpoint Technologies, Inc., and Roger Shearer*, Securities Act Release No. 8021 (Oct. 3, 2001); *H.B. Shaine & Co.*, SEC No-Action Letter (May 1, 1987); and *Woodtrails-Seattle, Ltd.*, SEC No-Action Letter (Aug. 9, 1982).

[4] The SEC staff has issued a series of no-action letters outlining conditions necessary to establish or demonstrate a pre-existing, substantive relationship and providing generally that a pre-existing, substantive relationship must be established at least 30 days before an investor can make an investment in a hedge fund. *See, e.g., Bateman Eichler, Hill Richards, Inc.*, SEC No-Action Letter (Dec. 3, 1985); *E.F. Hutton Co.*, SEC No-Action Letter (Dec. 3, 1985); *IPONET*, SEC No-Action Letter (July 26, 1996); and *Lamp Technologies* (May 29, 1997; May 29, 1998).

[5] *Implications of the Growth of Hedge Funds, Staff Report to the United States Securities and Exchange Commission* ("2003 Staff Hedge Fund Report"), available at www.sec.gov/spotlight/hedgefunds.htm.

We agree with the SEC staff's recommendation that SEC eliminate or ease the restriction on general solicitation for interests in 3(c)(7) Funds, and we urge the SEC to propose a rule to this effect in connection with any adoption of the Proposed Accredited Investor Rules. More specifically, we suggest that the SEC propose a rule that would distinguish between general solicitation[6] on the one hand and general advertising[7] on the other hand. We further suggest that the proposed rule permit general solicitation.[8]

Hedge funds and their investment advisers currently are perceived, often in a pejorative light, as being secretive and unwilling to provide transparency about their operations. We believe that the restriction on general solicitation and the corresponding limitations placed on hedge fund advisory personnel contributes significantly to this perception. Moreover, we believe that the restriction on general solicitation leads to inefficient capital raising and causes hedge fund advisory personnel to engage in time consuming and ritualistic exercises to meet current SEC staff guidance necessary to satisfy requirements for contacting potential investors. At the same time, a continued restriction on general advertising would prevent the mass marketing of hedge fund interests. Accordingly, we urge the SEC to ease the general solicitation restriction for private placements by 3(c)(7) Funds. In summary, we advocate a balanced approach that will provide greater flexibility and allow advisory personnel for 3(c)(7) Funds to provide information about their respective funds and to facilitate the ability to contact potential investors.[9]

We also urge the SEC to similarly ease the restriction on general solicitation for those 3(c)(1) Funds that would be subject to the new accredited investor standard if the SEC adopts the Proposed Accredited Investor Rules. We believe that the policy reasons stated above for easing the restriction on 3(c)(7) Funds applies equally to 3(c)(1) Funds. Moreover, in the 2003 Staff Hedge Fund Report, the SEC staff implied that any elimination or easing of the restriction for 3(c)(1) Funds may not be appropriate due to the lower investor qualifications generally imposed on potential 3(c)(1) Fund investors by the "accredited investor" standard. However, the Proposed Accredited Investor Rules would significantly raise this standard. In fact, the adopting release states that the new accredited investor standard is designed to help ensure that investors are capable of evaluating and bearing the risks of their investments.

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[6] General solicitation would include, for example, advisory personnel for a 3(c)(7) Fund speaking with the press about their fund, providing information about their fund on websites, and contacting potential investors who advisory personnel reasonably believe meet the criteria for investing in their fund.

[7] General advertising would include, for example, advertisements in newspapers, broadcasts on television and the radio, mass mailings and mass e-mails.

[8] We also suggest that the SEC simultaneously clarify that a "general solicitation" is not a "public offering" for purposes of Section 3(c)(7) of the Investment Company Act provided that sales are only made to persons who satisfy the applicable qualifications for investment in a 3(c)(7) Fund.

[9] We also note that hedge fund advisers who are not registered with the SEC may be limited in their ability to take advantage of a modification to the restriction on general solicitation due to Section 203(b)(3) of the Advisers Act which generally requires an investment adviser to register with the SEC if it holds itself out generally to the public as an investment adviser.

The SEC staff also suggested in the 2003 Staff Hedge Fund Report that eliminating or easing the restriction for 3(c)(1) Funds may not be appropriate because it may increase the level of risk of investment interest by less wealthy investors. We believe that the staff's concern is misplaced. While an easing of the restriction may increase the level of investment interest by less wealthy investors, we do not believe that an increase in interest will necessarily result in actual investments by investors who do not otherwise meet the applicable investment standards. The ultimate responsibility and liability for the admission of investors meeting the applicable investment standards rests with the 3(c)(1) Fund and its agents (*i.e.*, the fund's investment adviser and its personnel). Therefore, it has been, and will continue to be, incumbent on a 3(c)(1) Fund and its advisory personnel to have in place sufficient procedures to ensure that only persons meeting the accredited investor standard are permitted to invest in the fund. For these reasons, we believe that the SEC should ease the restriction on general solicitation for 3(c)(7) Funds, as well as any 3(c)(1) Fund that may be subject to the new accredited investor standard.

IV. Modification of the Applicable Investment Standard for Employees

In the Proposing Release, the SEC requests comment on whether employees of private investment vehicles or their investment advisers (collectively "Pool Employees") should be subject to the same natural person accredited investor standard as non-Pool Employees. We believe that Pool Employees should not be subject to the same standard. Rather, we believe that Pool Employees should be permitted to invest in a private investment vehicle if they meet the standard for "knowledgeable employees," as defined in Rule 3c-5 under the Investment Company Act. We are concerned that, absent the adoption of this standard for Pool Employees, many Pool Employees will not be eligible to invest in a 3(c)(1) Fund managed by their advisory firm.[10] Paradoxically, because the proposed "natural person accredited investor" standard would only apply to certain 3(c)(1) Funds, a Pool Employee may be eligible to invest in a 3(c)(7) Fund by meeting the current "accredited investor" standard and being a "knowledgeable employee," but would not be eligible to invest in a 3(c)(1) Fund by not meeting the proposed "natural person accredited investor" standard. We believe that incorporating a "knowledgeable employee" category into the proposed "natural person accredited investor" standard would eliminate this anomaly.

We further suggest that the SEC consider amending the existing "accredited investor" standard to include a "knowledgeable employee" category for both 3(c)(1) Funds and 3(c)(7) Funds. We have encountered situations in which certain persons who otherwise meet the "knowledgeable employee" standard do not meet the current "accredited investor" standard. For example, it may be the case that a portfolio manager for a 3(c)(7) Fund, particularly a

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[10] We are aware that private investment vehicles could sell their interests to Pool Employees who do not meet the accredited investor standard by, for example, (1) making an offering pursuant to Section 4(2) of the Securities Act or (2) relying on Rule 506 of Regulation D, which allows for 35-non accredited purchasers, provided that the Pool Employees meet knowledge and sophistication requirements and receive certain specified information. Nevertheless, these additional options may be impractical due to the uncertainty of the conditions that must be satisfied to comply with Section 4(2) and the additional information requirements necessary to satisfy Rule 506.

younger portfolio manager, has not yet amassed sufficient personal wealth or achieved an income level sufficient to satisfy the net worth or income requirements to meet the existing "accredited investor" standard. As a result, certain persons who are otherwise knowledgeable employees may not be able to invest in a 3(c)(7) Fund because they do not meet the existing "accredited investor" standard. We therefore request that the SEC amend the current "accredited investor" standard by adding a "knowledgeable employee" category for both 3(c)(1) Funds and 3(c)(7) Funds.

Finally, we request that the SEC reevaluate the SEC staff's previous guidance regarding persons who may fall within the definition of a "knowledgeable employee."[11] Rule 3(c)(5) generally defines a "knowledgeable employee" to include, among others, non-executive employees of a 3(c)(1) Fund or a 3(c)(7) Fund and its investment adviser who, in connection with their regular functions or duties, participate in the investment activities of the fund or any other 3(c)(1) Fund or 3(c)(7) Fund or investment company the investment activities of which are managed by the investment adviser, provided they have been performing these functions and duties for, or on behalf of, the fund or the investment adviser, or substantially similar functions or duties for, or on behalf of, another company for at least 12 months. The SEC staff previously concluded that the "knowledgeable employee" definition is intended to encompass persons who actively participate in the management of a fund's investments, and not employees who merely obtain information about the investment activities of a fund. The SEC staff then concluded that the following persons generally do not fall within the definition of a "knowledgeable employee": marketing and investor relations professionals, research analysts, attorneys, brokers and traders, and financial, compliance, operational and accounting officers for the advisory firm.

We believe that the SEC staff has interpreted the definition of a "knowledgeable employee" too narrowly. We understand that the definition of a "knowledgeable employee" is intended to permit investments in a 3(c)(1) Fund or a 3(c)(7) Fund by those employees of the fund or its advisory firm who by virtue of their involvement in the management of a fund's investments have sufficient knowledge and expertise in financial and business matters to evaluate the merits of an investment in a 3(c)(1) Fund or a 3(c)(7) Fund. While we agree with the SEC staff's previously articulated view with regard to certain categories of potential "knowledgeable employees," we believe that the following persons also should be viewed as "knowledgeable employees": (1) research analysts and other employees who investigate, structure and/or negotiate potential investments for the fund;[12] (2) attorneys who, as part of their duties, provide advice with respect to, or who participate in, the preparation of offering documents, and the negotiation of related agreements and respond to question or give advice concerning ongoing fund investments, operations and compliance matters; and (3) traders

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[11] *See American Bar Association Section of Business Law*, SEC No-Action Letter (Apr. 22, 1999).

[12] We note that private equity firms typically do not employ persons with the title of "research analyst," but have employees who actively participate in identifying, structuring and negotiating potential investments, a critical role in the investment process at a private equity firm which is analogous to a research analyst at a hedge fund firm. We believe that persons engaged in these activities at a private equity firm should also be viewed as "knowledgeable employees."

who place trades on behalf of the fund. We believe persons in these categories typically are required to have advanced education degrees and significant industry experience, and they typically have in-depth knowledge of the fund and the adviser firm's investment operations. Accordingly, we believe that persons in these categories have sufficient knowledge and expertise in financial and business matters to evaluate the merits of an investment in a 3(c)(1) Fund or 3(c)(7) Fund. Therefore, we request that the SEC provide guidance affirming that such persons also may be viewed as "knowledgeable employees."

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We would be pleased to respond to any inquiries regarding the views set forth in this letter or other aspects of the Proposed Rules. Please feel free to contact us at (212) 859-8000.

Sincerely,

Terrance J. O'Malley

Terrance J. O'Malley

Jessica Forbes

Jessica Forbes