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March 9, 2007

Via Electronic Filing

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number S7-25-06

Dear Ms. Morris:

We are writing in response to the Commission's request for comments on proposed new Rules 216 and 509 (the "Proposed Rules")[1] under the Securities Act of 1933, as amended (the "Securities Act"). The Proposed Rules would create a new category of "accredited investor" that would apply to offers and sales by private investment funds ("private funds") relying on the § 3(c)(1) exemption from registration under the Investment Company Act of 1940, as amended (the "Investment Company Act"). We appreciate the opportunity to comment on the Proposed Rules.[2]

We recognize the Commission's important role in regulating the activities of private funds and the Commission's desire to protect investors. However, we believe that certain aspects of the Proposed Rules are not the best means for achieving the Commission's objectives of protecting investors in private funds[3] and providing clear and objective standards regarding

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1 PROHIBITION OF FRAUD BY ADVISERS TO CERTAIN POOLED INVESTMENT VEHICLES; ACCREDITED INVESTORS IN CERTAIN PRIVATE INVESTMENT VEHICLES, Securities and Exchange Commission Proposing Release No. 33-8766, IA-2576, proposed December 27, 2006 (hereinafter referred to as the "*Proposed Rules*"). Page references to the Proposed Rules herein are to the Proposed Rules as released in Commission Proposing Release 33-8766, IA-2576.

2 The opinions expressed herein represent those of the undersigned and not necessarily those of our clients.

3 Proposed Rules at 4.

investor sophistication[4] and will unnecessarily burden both the private fund industry and investors.

If the Commission determines that the Proposed Rules should be adopted, we respectfully submit that the Proposed Rules should be revised to better balance the Commission's role in protecting investors with the impact on the overall private fund industry and investors. We also suggest that the Commission amend the Proposed Rules to provide exemptions in the circumstances discussed below. We ask that the Commission consider the following issues and recommendations prior to final adoption of the Proposed Rules.

I. Summary of Issues and Recommendations

- The Proposed Rules should be amended to distinguish between hedge funds and other private funds (e.g., private equity funds) and, if adopted, should apply only to hedge funds since the Commission's prior concerns and extensive analysis were limited to hedge funds.

- The Proposed Rules should include limited grandfathering for existing investors so that they can continue to invest in private funds in which such investors were already committed as of the effective date of the final rule and pledge funds to which investors were committed as of such effective date.

- Co-investment vehicles formed for the purpose of investing in specific deals should be exempted from the scope of the Proposed Rules.

- Defined key employees of private fund sponsors should be added as a category of "accredited natural person."

- The Commission should reconsider excluding personal real estate from its proposed definition of investments.

- To the extent private fund sponsors will need to rely on Rule 701 as a means for allowing employees to participate in offerings, the Commission should consider issuing guidance clarifying the application of Rule 701 in the private fund context.

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4 Proposed Rules at 21.

II. Scope of Proposed Rules: Hedge Funds Compared to Other Private Funds

The Proposed Rules are intended to protect investors and potential investors in hedge funds and similar funds.[5] The Commission is concerned about the increasing number of investors eligible to participate in such private funds, and the inability of investors to appreciate or protect themselves from the increased risks, lack of transparency and complexity presented by such funds.[6] These concerns echo the Commission's stated concerns when it adopted the Hedge Fund Registration Rule,[7] except that rule specifically excluded private equity fund sponsors and venture capital fund sponsors from the registration requirement. The adopting release for the Hedge Fund Registration Rule noted that the Commission had developed a substantial record of fraud associated with hedge funds and stated "[private equity funds, venture capital funds, and similar funds that require investors to make long-term commitments of capital] are similar to hedge funds in some respects, but the Commission has not encountered significant enforcement problems with advisers with respect to their management of private equity or venture capital funds."[8] We believe that private equity and venture capital funds do not raise any new issues since the time they were excluded from coverage under the Hedge Fund Registration Rule.

While we appreciate that drawing a clear line between hedge funds and private equity and venture capital funds is not simple, we believe crafting such a distinction is important and would ultimately better serve investors and the private fund industry. To that end, we have outlined several factors, some of which the Commission has noted previously,[9] that we believe could be

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5 Proposed Rules at 4.

6 Proposed Rules at 17.

7 REGISTRATION UNDER THE ADVISERS ACT OF CERTAIN HEDGE FUND ADVISERS, Securities and Exchange Commission Adopting Release No. IA-2333, File No. S7-30-04, 69 Fed. Reg. 72054, adopted December 2, 2004 (hereinafter referred to as the "*Hedge Fund Registration Rule*"). Page references herein are to the adopting release published in the Federal Register. The U.S. Court of Appeals for the District of Columbia Circuit subsequently vacated the Hedge Fund Registration Rule in *Goldstein v. Securities and Exchange Commission*.

8 Hedge Fund Registration Rule at 72074.

9 See Hedge Fund Registration Rule at n.224 (regarding characteristics of private equity funds) and n.225 (regarding characteristics of venture capital funds). See also IMPLICATIONS OF THE GROWTH OF HEDGE FUNDS, STAFF REPORT TO THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION, available at

(Continued...)

used (alone or in combination with one another) to distinguish hedge funds from private equity and venture capital funds. We do not believe that the overly technical definition of "business development company" under the Investment Advisers Act of 1940 (and the proposed definition of "venture capital fund" under the Proposed Rules) adequately encompasses the typical range of private equity funds and certain venture capital funds and would unduly constrain such funds in their investments operations.

A. Investors' Redemption Rights

Typically, private equity and venture capital fund investors have no unilateral redemption rights and only limited redemption rights in the event that changes in law or adverse regulatory events require an investor to withdraw from the private fund. Furthermore, redemption rights arising due to legal or regulatory issues are generally subject to the private equity or venture capital fund sponsor's consent. Hedge funds, on the other hand, typically provide investors with unilateral redemption rights after a limited lock-up period (e.g., one or two years). Therefore, we recommend that a private fund providing investors with unilateral redemption rights be classified as a hedge fund.

B. Nature of Investment Strategy

Private equity funds and venture capital funds employ distinct investment strategies from hedge funds. Private equity funds and venture capital funds generally concentrate their investments in unregistered securities and illiquid investments whereas hedge funds typically concentrate their investments in liquid portfolios of publicly-traded securities. Private equity funds and venture capital funds usually are restricted from investing more than a small percentage (e.g., 25%) of their capital in publicly-traded securities whereas hedge funds have no such restrictions. Private equity funds generally make long-term investments in operating companies, often taking control of such companies and becoming extensively involved in their management. Venture capital funds generally make long-term investments in companies in the start-up or early stages of development. Hedge funds typically do not participate in the long-term management or operation of companies. Therefore, we recommend that a private fund that principally invests (e.g., 55% or more of a fund's assets) in publicly-traded securities (other than investments for purposes of obtaining control) should be classified as a hedge fund.

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www.sec.gov/spotlight/hedgefunds.htm, at 7-8 (discussing features of private equity funds and venture capital funds).

III. Grandfathering Provisions

In response to the Commission's request as to whether the Proposed Rules should include any grandfathering provisions, we believe grandfathering provisions should be incorporated as outlined below.

A. Clarification of the Meaning of Time of Investment

Based on previous Commission interpretations, we would expect that whether a person is an accredited natural person as of the time of investment means, in the private fund context, whether an investor is an accredited natural person at the time such investor makes an initial commitment to a private fund (i.e., when the person purchases the security).[10] The Proposed Rules provide that they do not "grandfather current accredited investors who would not meet the new accredited natural person standard so that they could make future investments in private investment pools, even those in which they are currently invested."[11] Given this language, we request confirmation that, once the final rule is adopted, private fund sponsors will not need to revisit the status of existing investors who have made initial commitments before calling down additional capital from such investors over time as most private equity and venture capital funds operate. If our interpretation is not what the Commission intended in crafting the Proposed Rules, we recommend that the Proposed Rules be revised since our interpretation reflects the common understanding of how private equity and venture capital funds operate and a contrary finding would cause substantial disruption in existing private funds.

B. Treatment of Investors in Pledge Funds

In pledge funds, an investor's status as an accredited investor is determined at the time the investor makes a commitment, and the investor pays a management fee on its commitment amount beginning on such date. However, the investor has the right to opt into or out of each underlying investment made by the pledge fund so the investor is not technically obligated to invest in each investment at the time of the investor's initial commitment. As a

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[10] See, e.g., PRIVATELY OFFERED INVESTMENT COMPANIES, Securities and Exchange Commission Adopting Release IC-22597, File No. S7-30-96, adopted April 3, 1997 (stating that a § 3(c)(7) fund needs to make the determination of whether an investor is a qualified purchaser only at the time of the investor's commitment to the fund).

[11] Proposed Rules at 25.

practical matter, most investors commit to each investment. We recommend that the Proposed Rules clarify that the time of investment, in the context of a pledge fund, means at the time an investor makes an initial commitment to a pledge fund. As an alternative, we recommend that the Proposed Rules provide an exception allowing an investor who, as of the effective date of the final rule, has already made a commitment to a pledge fund and has been paying a management fee on such commitment amount to participate in such pledge fund even if such investor would not qualify as an accredited natural person. To disallow participation by such an investor would be unfair since the investor would have already been paying management fees for the opportunity to participate in investments sourced by the private fund sponsor during the entire commitment term.

IV. Breadth of Private Investment Vehicle Definition

As drafted, the definition of private investment vehicle covers all § 3(c)(1) vehicles (except for those within the venture capital fund exception), including co-investment vehicles designed to make one-time investments in operating companies.[12] Regulating these types of investment vehicles does not further the Commission's stated objective of protecting investors since these vehicles are created for administrative convenience to facilitate cooperation among various deal parties, including possibly key employees with respect to the proposed investment, rather than to attract pool investors. Furthermore, since investors in co-investment vehicles could invest directly in the underlying operating company without violating any of the Commission's rules, it seems senseless to prohibit such investors from making the same investment indirectly simply because of the vehicle chosen. Therefore, we recommend that the Commission narrow the scope of the Proposed Rules to exempt an investment vehicle formed for the purpose of making an investment in one portfolio company if the investment vehicle is not itself an operating company (or a holding company for an operating company).

V. Employees of Private Fund Sponsors

We believe that while the four options noted in the Proposed Rules available to private fund sponsors to compensate pool employees[13] may permit some employees who would not meet

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[12] Such vehicles might meet the definition of investment company under § 3(a) of the Investment Company Act because, for example, the vehicle owns a minority interest in an operating company or, if it holds a majority interest in an operating company, may be deemed an "investment company" under the special situation investment company doctrine.

[13] Proposed Rules at 26.

the new accredited natural person definition to receive securities issued by private funds, those options are inadequate for a number of reasons. First, many private fund sponsors avoid relying on the provision in Rule 506 of Regulation D allowing up to 35 non-accredited investors to participate in an offering since reliance on such provision triggers extensive and technical disclosure requirements that represent a significant burden on private fund sponsors, especially to accommodate so few persons. Second, many private fund sponsors are reluctant to rely on § 4(2) of the Securities Act since such offerings lack the certainty provided by safe harbors such as Rule 506 and the ease of perfecting a uniform state exemption. Third, as discussed below in Section VII of this letter, Rule 701 is administratively cumbersome since Rule 701's application to private funds is not entirely clear and Rule 701 offerings are not treated uniformly by the states as exempt transactions. Finally, requiring private funds to rely on contractual arrangements in employment agreements and other compensation plans is an ad-hoc solution for an issue that could be addressed easily and universally through the adoption of a definition by the Commission.

A. Knowledgeable Employees

First, we recommend that the Commission add knowledgeable employees (as such term is defined under the Investment Company Act) to the definition of accredited natural person. Since knowledgeable employees are permitted to participate in § 3(c)(7) funds offered to qualified purchasers, who are required to satisfy a higher threshold than the new accredited natural person definition, we believe that the rationale is stronger for allowing knowledgeable employees to participate in private funds (i.e., § 3(c)(1) funds), with their lower investor qualification standards.

B. Other Employees of Private Fund Sponsors

The knowledgeable employee definition covers only executive officers, directors, general partners and those persons making investment decisions, omitting a second tier of employees of private fund sponsors who are not within the definition of knowledgeable employee but who are nonetheless sophisticated enough to invest in private funds sponsored by their employers and who currently invest in private funds under the existing Regulation D accredited investor standard. The options discussed above, as well as the option of establishing an employees' securities company, present unnecessary administrative burdens on the private fund sponsor and result in disparate treatment of employees. We believe a more efficient way to address investments by employees is to include employees of private fund sponsors who either

meet the existing Regulation D accredited investor standard or Rule 506's sophistication requirements[14] in the definition of accredited natural person. This definition would provide certainty for private fund sponsors under federal and state registration exemptions and eliminate unnecessary administrative burdens. In addition, creating such a definition would not undermine the Commission's stated objectives for the Proposed Rules since private fund sponsors could achieve the same result, albeit with more administrative difficulty, by offering securities to their employees in a different manner. Such category of persons would by definition include only persons who have a higher level of knowledge and access to information regarding the private fund sponsor than the general investing public.

VI. Exclusion of Real Estate Assets

We believe the Commission should reconsider its stance on excluding personal real estate from its proposed definition of investments. For many knowledgeable and sophisticated individuals, real estate holdings, including personal residences, are an integral component of a well-diversified investment portfolio. In addition, excluding personal real estate from the definition of investments may create an incentive for certain investors to maintain an unusually high level of mortgage debt in order to meet the accredited natural person test because the proposed definition of investments excludes only indebtedness incurred to acquire or for the purpose of acquiring investments.

VII. Application of Rule 701

In the event the Commission adopts the Proposed Rules without broadening the class of employees deemed to be accredited natural persons, we believe the Commission should consider issuing interpretive guidance regarding the application of Rule 701 in the private fund context, including clarifying the points listed below.

- A private fund may rely on Rule 701 and any employee of a private fund sponsor (including the general partner, management company or upper-tier general partner of a private fund, each an "employer vehicle") is an employee of such private fund for purposes of the exemption.

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[14] Rule 506(b)(2)(ii) states: "Each purchaser who is not an accredited investor either alone or with his purchaser representative(s) has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment, or the issuer reasonably believes prior to making any sale that such purchaser comes within this description."

- Rule 701 is available whether an employee invests in a private fund directly or indirectly through an employer vehicle.

- A private fund may sell to its employees in any 12-month period securities with an aggregate sales price equal to 15% of commitments in the private fund (and any parallel funds), whether the employees invest directly in such private fund or indirectly through an employer vehicle.

- Financial statements of either the private fund or the employer vehicle would meet Rule 701's disclosure requirements, if triggered.

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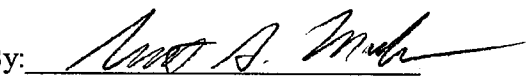
We appreciate the opportunity to respond to the Commission's request for comments and we hope that these comments and observations prove useful to the Commission. If you have any questions with respect to the matters raised in this letter, please contact either Scott A. Moehrke, Nabil Sabki or Nancy L. Kowalczyk.

Sincerely,

Kirkland & Ellis LLP

By: 
Scott A. Moehrke

cc: Nabil Sabki
Nancy L. Kowalczyk