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March 9, 2007

Via Electronic Delivery

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

Re: Release No. 33-8766; IA-2576 (File No. S7-25-06): Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles

Dear Ms. Morris:

We respectfully submit this comment letter in response to a request by the Securities and Exchange Commission (the "Commission") for comments regarding the above-referenced proposals to amend certain existing rules and create new rules (the "Rule Proposals") that would (i) prohibit investment advisers to pooled investment vehicles from making false or misleading statements or otherwise defrauding investors or prospective investors in such vehicles, and (ii) revise the definition of "accredited investor" as it relates to natural persons in connection with the offer and sale of interests in an issuer that would be an "investment company" under the Investment Company Act of 1940, as amended (the "Company Act"), but for the exclusion provided in Section 3(c)(1) of the Company Act (such an issuer, a "3(c)(1) fund") other than certain venture capital funds.[1]

Dechert LLP is an international law firm with a wide-ranging financial services practice that serves clients in the United States and worldwide. Among our clients are U.S. based and non-U.S. based hedge fund managers and investment advisers. In developing these comments, we have drawn on our long experience in the investment management industry generally, and the hedge fund and alternative investment fund industry in particular. Although we have discussed the matters addressed in the Release with some of our clients to varying extents, the comments that follow reflect views of the firm, and not necessarily those of any client of the firm.

In general, we support the Commission's proposal of an anti-fraud rule under the Investment Advisers Act of 1940, as amended (the "Advisers Act") to clarify the protection of investors in funds. However, we believe the Commission should consider

1 *See Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles*, Rel. Nos. 33-8766, IA-2576 (Dec. 27, 2006) (the "Proposing Release").

certain changes to the Rule Proposals with respect to sub-advisers and others who do not have direct contact with the investors in the funds they manage and have no or little control over the content or timing of disclosure provided to those investors, and also incorporate certain components into the analysis under proposed Rule 206(4)-8.

We do not wish to express a view on the policy issue of whether the definition of "accredited investor" should be more restrictive for individuals investing in 3(c)(1) funds. However, we believe there are several modifications the Commission should consider regarding the potential application of the "accredited natural person" standard in the form in which it is proposed in the Proposing Release, as well as certain other related matters, including:

(1) if an "investments" test is used, it should be in lieu of an income or net worth test, not in addition to it;

(2) the definition of "investments" should be the same for purposes of Section 2(a)(51) of the Company Act and the definition of "accredited natural person";

(3) all "knowledgeable employees" ought to be deemed to be "accredited investors" under Regulation D, for the purpose of investing in a private investment fund with respect to which a particular person is a knowledgeable employee;

(4) all "qualified purchasers" ought be deemed to be "accredited investors";

(5) Form D should be revised and rationalized to eliminate superfluous information when used by funds and provide the Commission instead with more useful information about funds that is not currently required; and

(6) existing investors should be grandfathered with respect to capital calls, variable insurance products and reallocations of existing investments.

A. The Anti-Fraud Rule

1. Application of Proposed Rule 206(4)-8 to Sub-Advisers and Others Without Direct Investor Contact.

Proposed Rule 206(4)-8(a)(1) would create liability for investment advisers to pooled investment vehicles for materially false or misleading statements or omissions to investors or prospective investors in such pooled investment vehicles. In many situations, an adviser to a fund may have no direct contact with the investors in that fund. As a result, such an adviser is unlikely to make any affirmative statements to those investors, so there is little risk, one assumes, that the adviser will make a statement that is materially false or misleading. However, there may be situations (such as underlying managers in a multi-manager fund) where descriptions or other materials prepared or approved by an adviser will be passed on to the investors in a fund. In some cases, the adviser may not have control over the final form in which those materials are presented, when they are presented or whether they are updated. The Commission should consider clarifying in the adopting release that no adviser will be liable under Rule 206(4)-8(a) for any statement which is modified or presented in a different context by a person other than the adviser, such as where the adviser is a sub-adviser or not the principal adviser in a multi-manager structure. Moreover, statements made by the adviser should be judged at the time when the adviser made or approved the statement, regardless of when the statement was made to the investor by another person.

More troubling is proposed Rule 206(4)-8(a)(2), since no affirmative statement is required for a violation. Under proposed Rule 206(4)-8(a)(2), an investment adviser to a pooled investment vehicle can be liable for acts, practices or conduct that are fraudulent or deceptive. In the investment management industry there are practices that one would not consider to be fraudulent *per se,* but could be considered a violation of Section 206 of the Advisers Act in the absence of sufficient disclosure. While the enforcement cases brought by the Commission in these contexts have often referenced Sections 206(1) and 206(2) of the Advisers Act, there is a lack of clarity whether those practices could result in a violation of Rule 206(4)-8(a)(2). Given the breadth of the proposed rule, as written, it might be construed to include cases that are now brought under Sections 206(1) and 206(2). A review of those cases shows that while the Commission orders cite Section 206(1) and 206(2) as the relevant provisions, the discussion usually focus only on the disclosure, or lack thereof, by an adviser and subsequent actions in violation of that disclosure.[2] This could greatly disadvantage sub-advisers who may not be in a position to make disclosures directly to the investors, but who engage in practices requiring sufficient disclosure in order for them to not be deemed fraudulent.

Accordingly, we respectfully request that the Commission, in considering both the language of the Rule Proposals as well as the guidance to be set forth in the adopting release:

(1) provide that no adviser will be liable under Rule 206(4)-8 for any statement which is modified or taken out of context by a person other than the adviser, and that such statement should be judged at the time when the adviser made or approved the statement, regardless of when the statement was disseminated to investors in a pooled investment vehicle; and

(2) clarify the analysis of potential liability of an adviser under Rule 206(4)-8(a)(2) with respect to such pooled investment vehicles in connection with

[2] A review of enforcement actions in areas such as trade allocations and cross-trading show that the Commission's focus tends to be on the failure of an adviser to disclose, whether partially or completely, or actions which directly contradict a disclosure. *See, e.g., In the Matter of Strong/Corneliuson Capital Management,* Release No. IA-1425 (July 12, 1994); *In the Matter of Renberg Capital Management,* Release No. IA-2064 (Oct. 1, 2002); *In the Matter of Edgar M. Reed,* Release No. IA-2069 (Oct. 25, 2002); and *In the Matter of Gintel Asset Management, Inc. et al.,* Release No. IA-2079 (Nov. 8, 2002).

practices that are not fraudulent *per se*, but require disclosure concerning such practices.

2. Analysis of Liability Under Proposed Rule 206(4)-8 Compared to Rule 10b-5 Liability.

There are two other potentially troubling aspects of proposed Rule 206(4)-8. The language of the rule largely tracks that of Rule 10b-5 under the Securities Exchange Act of 1934, as amended. The false or misleading nature of alleged misstatements or omissions is judged "in the light of the circumstances under which they were made…." Rule 10b-5 contains an important limiting component -- the requirement that the false or misleading statement or omission be made "in connection with the purchase or sale of a security." Thus, all statements before the purchase or sale are judged in their totality at the time of the purchase or sale. There is no such temporally limiting factor contained within proposed Rule 206(4)-8. Since typically not all information concerning a particular fund is provided in any single document or during any single meeting with an investor (and investors may request additional information over time), the potential scope for liability is much broader than under 10b-5 unless all statements and representations made during the course of the relationship and information otherwise available is taken into account.

Furthermore, as noted in the Proposing Release, the Commission would not need to demonstrate that an adviser acted with scienter in order to establish a violation of proposed Rule 206(4)-8. Without a limiting factor with respect to an adviser's state of mind, we believe that the proposed rule would have the effect of creating both uncertainty on the part of hedge fund advisers as well as the possibility of strict liability under Rule 206(4)-8 for innocent or minor violations of the strictures of Rule 206(4)-8. As a consequence, hedge fund advisers may choose to provide more limited information to investors, which would have the effect of limiting the frequency and quality of communications between the adviser and a fund's investors. This, in turn, would result in diminishing an investor's understanding of and ability to evaluate potential investments and to discourage meaningful, candid and informative discourse between fund advisers and investors. Moreover, we believe that the scienter standard provides an appropriate measure of the requisite state of mind due to the fact that the language of Rule 206(4)-8 strongly resembles that of Rule 10b-5.

Accordingly, we respectfully request that the Commission, in considering both the language of the Rule Proposals as well as the guidance to be set forth in the adopting release:

(1) address the overly broad scope of potential liability under Rule 206(4)-8 due to the lack of a temporally limiting factor such as is found in Rule 10b-5; and

(2) incorporate a scienter requirement as an essential element of a violation of Rule 206(4)-8.

B. Accredited Natural Person Standard

1. Replace the Income and Net Worth Tests with the Investments Test.

The Proposing Release describes a two-step process for determining investor qualifications for 3(c)(7) funds, first as accredited investors and second as qualified purchasers, and effectively seeks to extend this process to 3(c)(1) funds. We do not believe the costs associated with extending the two-step process to 3(c)(1) funds will be minimal. Moreover, the benefit to investor protection of the two-step process is at best negligible.

It is highly unlikely that an investor with $2.5 million in investments will have a net worth of less than $1 million. The test for investments already subtracts any debt used to acquire the investment. As a result, most investors will have a net worth nearing or greater than the amount of investment assets they own. For example, the investor may owe money on his principal residence or automobiles, but generally not substantially in excess of the value of the assets which secures the loan.

We therefore respectfully request that the Commission reconsider the utility and practicality of the net worth and income tests under the current definition of "accredited investor" in Rule 501(a) of Regulation D with respect to natural persons investing in 3(c)(1) funds in light of the proposed "accredited natural person" standard, and adopt a single test based upon either the amount of investments owned by a prospective investor, or the income and net worth of such prospective investor.

2. Keep the Definition of "Investments" Consistent for all Purposes.

The definition of "investments" should be the same for purposes of Section 2(a)(51) of the Company Act and the definition of accredited natural person. The predominant functional difference in the proposed test for "investments" from the test under Rule 2a51-1 is the manner in which spousal investments are considered in calculating the requisite total. We believe the costs of maintaining two different definitions of "investments," keeping track of the definition separately for purposes of both Section 3(c)(1) and Section 3(c)(7) and fostering that understanding in the hedge fund community, among both managers and investors, would outweigh any potential benefit from maintaining this dichotomy.

The Proposing Release states that the proposed method is "typical" of the division of marital assets, without any further evidence or elaboration, notwithstanding the departure from the existing definition of "investments" in Rule 2a51-1. The method of determining investments for purposes of the Rule Proposals and for purposes of Section 2(a)(51) ought to be similar (if not identical) in all other material respects. Such a divergence would create confusion among investors and funds, who must expend time and resources monitoring two differing sets of investment criteria. The definition of "investments" contained in the Rule Proposals is also inconsistent with prior Commission staff guidance.[3] This distinction will almost certainly lead to increased legal and compliance costs in order to maintain and monitor two different notions of "investments," increasing both the possibility of confusion and error as well as the costs and expenses of funds and investors, and without any significant benefit.

We respectfully request that the Commission revise the proposed "accredited natural person" standard to permit a natural person to include investments held by or with the person's spouse consistent with Rule 2a51-1, in determining whether such person owns the requisite amount of "investments."

3. <u>Deem "Knowledgeable Employees" to be "Accredited Investors" without Further Tests</u>.

A "knowledgeable employee" ought to be deemed to be an "accredited investor" with respect to the particular fund in respect of which he or she is deemed to satisfy the criteria of a "knowledgeable employee." We note that Rule 3c-5 under the Company Act allows certain "knowledgeable employees" to invest in a 3(c)(1) fund without such persons being counted towards the 100 investor limit provided in Section 3(c)(1) and invest in a 3(c)(7) fund without being a qualified purchaser. However, as noted in the Proposing Release, because these knowledgeable employees are not deemed to be "accredited investors," advisers to private investment vehicles wishing to enable knowledgeable employees who do not satisfy the standards of an "accredited investor" to invest in such vehicles generally must rely on Rule 506's provisions related to non-accredited investors. The policies behind permitting knowledgeable employees to invest in 3(c)(1) funds without satisfying the criteria of an accredited investor, such as access to information, mean that the additional criterion of an "accredited investor" serves no substantial purpose. But this same rationale indicates that not only would knowledgeable employees derive no substantial benefit or protection from receiving the information required by Rule 502(b), but that all "knowledgeable employees" should be deemed to be "accredited investors" with respect to the funds in relation to which they are knowledgeable employees.

Accordingly, we respectfully request that the Commission consider providing that persons satisfying the criteria of "knowledgeable employees" have also satisfied the criteria for "accredited investors" with respect to the fund or funds in relation to which they are deemed to be knowledgeable employees.

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3 *See American Bar Association Section of Business Law,* SEC No-Action Letter (pub. avail. April 22, 1999).

Another problematic situation relates to variable insurance products. These often permit an investor to reallocate policy values among various investment options. While as noted above these may well not be new "sales," existing investors should be explicitly grandfathered to avoid having their current allocation frozen to ensure compliance with the new definition. There would be a substantial disadvantage for investors in these products if they cannot reallocate and rebalance their investments over time, and there can be substantial tax disadvantages, surrender charges and cost of insurance coverage if the investor seeks to withdraw his or her policy value.

We request that the Commission include a grandfathering provision providing that investors satisfying the current standards for "accredited investors" need not satisfy the accredited natural person standard with respect to products in which they have invested prior to the effectiveness of the Rule Proposals to make additional payments or reallocate existing values.

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We appreciate the opportunity to comments on the Rule Proposals. Please feel free to contact George J. Mazin at (212) 698-3570 or David A. Vaughan at (202) 261-3355 if you would like to discuss any of our comments.

Very truly yours,

/s/ David A. Vaughan
Partner

/s/ George J. Mazin
Partner