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Via E-Mail
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Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Attention: Nancy M Morris, Secretary

Re: File Number S7-25-06.

Dear Secretary Morris:

We respectfully submit the following comments on the proposed rules of the Commission in Release No. 33-8766. Katten Muchin Rosenman LLP is a full service law firm with a substantial number of clients who would fit the definition of "private investment vehicle" included in proposed Rules 509 and 216 under the Securities Act of 1933 (the "33 Act").

We would in particular like to comment on the Commission's proposed Rules 509 and 216 under the 33 Act. These rules would add an additional requirement for a natural person to qualify as an "accredited investor" in offerings by certain private investment vehicles ("3(c)(1) Funds") that are deemed not to be "investment companies" by virtue of Section 3(c)(1) of the Investment Company Act of 1940 (the "Company Act").

"Accredited Natural Person." We believe that proposed Rules 509 and 216 are misguided, are not in the public interest and should not be adopted in any form. Inherent in the proposed rulemaking is the notion that 3(c)(1) Funds are by definition riskier and more difficult to understand than other forms of private investment. However, the Commission has not offered any factual support for these propositions.

There can be no generalization as to the risks or sophistication of the investment strategies followed by 3(c)(1) Funds. For example, a 3(c)(1) Fund may invest long only, with no leverage or use of derivatives and charge no performance fee. It may be an investment club, such as the Beardstown Ladies, whose members pool their money for investment. There are 3(c)(1) Funds with very high volatility and others with low volatility and varying Sharpe and

Sortino ratios[1]. Some 3(c)(1) Funds may offer monthly or quarterly liquidity, while some may offer no liquidity at all. In fact, "venture capital funds," which the Commission has excluded from the application of the proposed rule, may be much riskier and less transparent than many of the 3(c)(1) Funds to which the new "accredited natural person" standard would apply and may require more sophistication on the part of the investor to understand. The Commission has offered no factual support for distinguishing "venture capital funds" as defined in the proposed rules from other 3(c)(1) Funds or for distinguishing 3(c)(1) Funds from other private placements.

The Commission's stated concern that 3(c)(1) Funds require a higher level of investor sophistication serves as the basis for the "investments" tests proposed for "accredited natural persons." However, natural persons are free to engage in a variety of risky investment practices with no test of financial acumen or wherewithal. Any person may open a brokerage account and trade in "penny stocks," mutual funds with poor performance, a broad stock index or a sector index. Investors with much less than $1,000,000 in net worth can open margin accounts, engage in short sales and sell options that could expose them to significant risk of loss. Investors can also purchase real estate with no down payment and obtain variable rate or negative amortization mortgages. There are many potentially high-risk investments that are not 3(c)(1) Funds and yet they are available to natural person investors who do not meet any financial criteria. Many 3(c)(1) Funds offer a means of diversifying a portfolio and reducing overall risk. It is the purview of Congress and not the Commission to make such a radical change to the regulatory framework.

The "accredited investor" standard was originally adopted by the Commission to be a proxy for financial sophistication and ability to bear losses that would provide a clear safe harbor and regulatory certainty. If the Commission is going to adopt different proxies for different levels of financial sophistication required for different investments, such distinctions should be based on factual correlations that the standards indeed provide the requisite sophistication and evidence that the securities to which they apply actually require such sophistication. Any such evidence is lacking in the case of proposed Rules 509 and 216 and, because of the wide diversity of funds brought under one umbrella by the Commission in proposing to apply these rules to all 3(c)(1) Funds, we do not believe such evidence is likely to be developed.

Section 3(c)(1) provides a mechanism for addressing regulatory issues. It in no way defines the business of the many and varied vehicles that seek to resolve such issues through reliance on the section. The Commission's proposal to distinguish private investment vehicles that rely on Section 3(c)(1) from any other form of private investment for purposes of the 33 Act therefore appears arbitrary.

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[1] Sharpe ratio and Sortino ratio are two of the measures often used in portfolio management to measure risk-adjusted returns on an investment.

Even if there were such evidence, there should also be evidence that the proposed standards are a reasonable proxy for financial sophistication. The Commission has not offered any evidence that the proposed "investments" requirement are a reasonable proxy for the ability to understand a 3(c)(1) Fund.

We question whether the proposed rulemaking is consistent with the legislative intent of Congress in adopting Sections 3(c)(1) and 3(c)(7) under the Company Act. Section 3(c)(1) has been in the statute since its original adoption in 1940[2]. Congress determined in 1996 that in addition to the existing exclusion for vehicles with 100 or fewer beneficial owners (without regard to sophistication), it should, in fact, add a separate exclusion for vehicles that are offered only to sophisticated investors. Congress added the Section 3(c)(7) exclusion for vehicles offered in private placements to "Qualified Purchasers." At the time of adoption of Section 3(c)(7), Congress could have modified Section 3(c)(1) to include a sophistication standard, but did not. The proposed bifurcation of the accredited investor standards under the 33 Act appear to be an attempt by the Commission to use its rulemaking authority under the 33 Act to override the express provisions adopted by Congress in the Company Act.

For all of the foregoing reasons, we do not believe it appropriate to adopt different standards for private placements of securities in 3(c)(1) Funds from the standards for other types of private investments.

We thank you for this opportunity to comment.

Respectfully submitted,

Katten Muchin Rosenman LLP

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2 Although there have been amendments to Section 3(c)(1) since its original adoption, they are not germane to the issue being discussed.