December 23, 2010

VIA EMAIL

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: File Nos. S7-36-10 and S7-37-10

Re: Comments on Rules Implementing Amendments to the Investment Advisers Act of 1940 (Release No. IA-3110, the "Implementing Release") and Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers (Release No. IA-3111, the "Exemptions Release")

To the Securities and Exchange Commission:

Following are my comments[1] on the amendments proposed (the "Proposals") in the above-referenced releases (the "Proposing Releases"). My comments focus on a limited range of topics connected to the Proposals, primarily on:

- changes to Form ADV, including those in the Proposals and others you should consider with any revision of Form ADV, particularly now that a wider variety of advisers will be required to use the form to register or report; and
- other issues relating to registration and regulation of advisers registering for the first time or having to switch from SEC to state registration.

FORM ADV-RELATED COMMENTS

1) Clarify how to calculate assets for reporting custody in Item 9.

The Proposals explain how advisers should calculate regulatory assets under management (RAUM) for determining whether to register with the SEC or the states and for reporting in Item 5 of Form ADV Part 1. In general, I support the idea of distinguishing AUM from RAUM and efforts to make the calculation of RAUM clearer, more certain and, to the extent possible, more uniform among advisers.

However, in addition to addressing RAUM in Item 5, you should clarify how advisers must calculate assets for reporting custody in Item 9. Currently, there is no guidance in the Proposing Releases, the release adopting the latest custody rule and related Form ADV amendments,[2] or the SEC's custody "FAQs"[3] on how advisers should determine the amount

[1] My comments are offered both from my personal perspective as a long-time investor and user of financial services, as well as from my professional perspective as an investment management attorney with over 25 years of experience assisting registered investment advisers in meeting SEC requirements, including many of those addressed in the Proposing Releases. Please note, however, that the comments I offer are my own and do not necessarily reflect the views of any of my clients.

[2] See Release No. IA-2968 (December 30, 2009) at http://www.sec.gov/rules/final/2009/ia-2968.pdf.

[3] See Staff Responses to Questions About the Custody Rule at http://www.sec.gov/divisions/investment/custody_faq_030510.htm (updated as of December 2, 2010) (the "Custody FAQs").

of "funds and securities" to report in Items 9.A.(2) and 9.B.(2) of Part 1.[4] It may seem logical to carry over the Item 5 RAUM calculation methodology to Item 9 in the interest of consistency. However, this would not be the best course, in my view, given that Item 5 focuses on "portfolios" for which the adviser provides "continuous and regular supervisory or management services," whereas Item 9 focuses on "funds and securities" over which the adviser has "custody."

Three questions illustrate this point:

- What happens if an adviser has "custody" over funds and securities in an account for which the adviser does not provide "continuous and regular supervisory or management services"? Although that account would not be included in the adviser's RAUM for Item 5, it would presumably still be considered assets to which the custody rule applies and should be reported in Item 9.
- Similarly, what happens if the adviser has "custody" over funds and securities in an account where less than 50% of the total value of the account is securities, cash and cash equivalents? Again, the assets would not be included in the adviser's RAUM for purposes of Item 5. However, the adviser should presumably not be able to ignore those assets under the custody rule nor for reporting under Item 9.
- Finally, what should the adviser report in Item 9 if the adviser has "custody" with respect to all the assets in an account, but only a portion of the assets are "funds and securities"? For example, what if the account also includes commodities, insurance products, futures, real estate or other investments generally not considered "funds" or "securities"? If more than 50% of the value of the account consists of securities, cash and cash equivalents, the adviser is instructed to include the entire value of the account in its calculation of RAUM for purposes of Item 5.[5] However, it would be overstating the "funds and securities" over which the adviser has custody if the entire value of the account were reported in Item 9.

A straightforward approach to Item 9 as it now reads would require advisers to report advisory clients' "funds and securities" over which they or their related persons have "custody." However, as noted above, this may require advisers to report assets and accounts they do not include in their Item 5 RAUM calculation at all and/or to report only a portion of accounts that are included at full value in their Item 5 RAUM calculation. While this straightforward approach may best reflect the information the Commission wants to collect in Item 9, it is at odds with the instructions for and the approach advisers are familiar with from their experience with Item 5.

It is also unclear what date advisers should use to value assets reported in Item 9 or even whether advisers must pick the same date to value assets under both Item 5 and Item 9. According to the instructions for Item 5, advisers may value RAUM as of any date within 90 days prior to filing the Form ADV. Advisers should be afforded similar flexibility for Item 9, although the instructions are silent on this point.

The lack of SEC guidance on these issues and questions about consistency with Item 5 have already created confusion among advisers trying to understand their new Item 9 reporting obligations, which most will face for the first time in early 2011. I have addressed this and other Item 9 issues in a recent article published in *The Investment Lawyer*, which I would

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[4] Although the Proposing Releases include proposed revisions to the instructions in Item 9, none of them clarify the issues described here.

[5] The only assets the Item 5 instructions direct advisers to exclude are assets under the management of another person or which consist of real estate or businesses under the adviser's "management" but not as an investment.

commend to your reading for a more complete understanding of these points, aided by a hypothetical case study.[6]

To avoid this confusion, the Commission should add instructions to Form ADV clarifying how advisers should calculate “funds and securities” for purposes of Item 9 or, at a minimum, provide appropriate guidance addressing that in the Custody FAQs. Although it would be best to seek broader comment on exactly how the Item 9 calculations should be made, the following approach should be considered:

- The required methodology for calculating “funds and securities” under Item 9 should be the straightforward approach referenced above, counting the actual value of only “funds” and “securities” over which an adviser (or its related person) has “custody.” This should be supported by appropriate instructions explaining what this means relative to an adviser’s accounts and how it differs from calculations made for RAUM under Item 5.

2) Clarify how to count “clients” for reporting custody under Item 9.

A similar issue arises with respect to counting “clients” for purposes of Items 9.A.(2) and 9.B.(2) of Part 1.

First, it is unclear why Item 9 asks advisers to report the number of clients for which the adviser has custody, when it would be more logical and provide better information if advisers reported the number of accounts over which they have custody. Of course there will be cases where the number of clients an adviser has does not match the number of accounts it has, such as when one client has more than account with an adviser. This creates unnecessary confusion in reporting and in understanding the implications of the information reported.

Next, it is unclear exactly how the number of clients should be calculated in Item 9. Prior SEC Staff guidance allowed advisers to rely on the client counting rule, Rule 203(b)(3)-1, for counting clients in Item 5.[7] Even if this Item 5 guidance is updated to refer to a different client counting rule -- such as proposed Rule 202(a)(30)-1 -- there is still no guidance as to how clients should be counted for purposes of Item 9.

Counting “clients” is among the issues addressed in *The Investment Lawyer* article referenced under section 1 of this letter, explaining the confusion that could arise from the lack of guidance available. To rectify this, I would urge you to clarify how clients should be counted for purposes of Item 9 in the instructions to Form ADV or, at a minimum, in the Custody FAQs.

As to exactly how these issues should be resolved, again I believe it would be best to seek broader comment. However, the following approach should be strongly considered:

- Item 9 should be amended to request information about “accounts” and not “clients.” This provides better intelligence for regulatory purposes and completely avoids questions about whether 2 related clients should be counted as 1 or 2. Since nothing as significant as registration hinges on how many “accounts” an adviser has, there would be no incentive for counting 2 related accounts as anything except 2.

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[6] For your convenience, a copy of that article is attached at the end of this letter. In particular, I would urge you to read the “Reporting Custody in Item 9 of Form ADV Part 1“ and “Anomalies and Opportunities for Confusion” sections of that article.

[7] See Question II.9. in the Custody FAQs at http://www.sec.gov/divisions/investment/custody_faq_030510.htm.

- If instead Item 9 is left as is, advisers should be permitted to rely on the client accounting rule used for Item 5 (current Rule 203(b)(3)-1 or its successor) for counting clients under Item 9.

3) <u>Clarify other Item 9 instructions</u>.

As discussed in *The Investment Lawyer* article referenced above, there are various other areas of unclarity and potential for confusion in Item 9 as it currently exists that have already come to light, including:

- The potential for double counting between Items 9.A. and 9.B.
- Confusion about where related person custody should be reported, depending on whether custody derives from acting as the qualified custodian or other arrangements recognized as "custody."

To avoid these problems and provide better information for regulatory oversight, I would urge you to revise Item 9 along the lines outlined in my July 3, 2009 comment letter on the amended adviser custody rule:[8]

> Re-write Item 9 to ask the question "Do you have custody?" (referencing the custody rule and appropriate definitions) and then ask, "If so, check all that apply," listing the various ways custody could occur under the rule, something like:
> - act as qualified custodian maintaining official custodial accounts
> - have physical possession
> - have arrangement authorizing withdrawal, transfer or disbursement of funds or securities, other than fee deduction authority[9]
> - have fee deduction authority
> - have capacity giving legal ownership or access.

If desired, the number of accounts and assets associated with each category could also be requested. If an adviser has custody over assets for more than one reason, the assets could be reported in each applicable category, with appropriate instructions explaining that "double counting" could occur under these circumstances. Information could be requested for both the adviser and its related persons separately, without imputing the related person's custody to the adviser.

With this level of clarity and detail, SEC Staff could better discern the type and magnitude of custodial risk in its role as regulator. At the same time, advisers could more accurately discern which assets, accounts and arrangements should be reported where.

Other Item 9 issues from my July 3, 2009 comment letter are listed below and I urge you to consider them along with the revisions and updates to Item 9 included in the Proposals:

TOPIC AREA	COMMENT
Definition of "securities"	Please consider and clarify whether various types of alternative investments are considered "securities" within the phrase "funds and securities" as used in the custody rule and Item 9 of Form ADV, Part 1. One example is swaps. Since swaps are largely carved out of the 1933 Act, but not the Advisers Act, are securities-based swap agreements subject to the rule? This question will become even more important as various private fund advisers become required to register and/or report

[8] My July 3, 2009 comment letter is posted here: http://www.sec.gov/comments/s7-09-09/s70909-344.pdf.

[9] And other than authority to transfer assets to the client and between client accounts as contemplated by Questions II.4. and II.5. in the Custody FAQs.

	on Form ADV. There are probably other types of alternative investments, OTC and individually negotiated investments, derivatives and other less common investments that raise similar questions.
Meaning of term “funds”	Given the way the word “funds” is used in certain portions of Item 9, and the phrase “cash and bank accounts” is used in other parts, one could logically conclude that the word “funds” as it is used there is intended to mean “cash and bank accounts.” If this is not your intent, I would urge you to clarify this.
Definition of “control”	I have previously expressed my concern about the control definition found in Form ADV[10] -- which has now been inserted into the custody rule -- given that the definition is different than the control definition found in the Advisers Act itself. Having a term defined one way in the statute and another way in related rules and forms is extraordinarily confusing. Given that the concept of control is used throughout Form ADV Part 1, including in the definition of “related person” used in Item 9, I urge you to at least provide instructions on how an adviser can rebut the presumptions built into the control definition so advisers can correctly apply the rule and respond to the form in cases where the presumptions are not supported by the facts.
Definition of “related person”	I strongly oppose having one definition of “related person” for the custody rule (anyone controlling, controlled by or under common control with the adviser) and a different definition of “related person” in the Glossary of Form ADV (advisory affiliates, plus anyone under common control). One notable group included in the Glossary definition that would not be covered by the rule definition is the adviser’s employees (meaning “supervised persons” who are not controlling persons). Which definition applies to reporting “related person” custody in Item 9 of Form ADV Part 1? I would urge you to amend the form so that the Glossary definition matches the rule definition. Otherwise Item 9 will wind up calling for advisers to report “custody” of “related persons” who are not actually “related persons” under the custody rule. If instead you intend custody of employees (non-controlling supervised persons) to be covered by the custody rule,[11] I would urge you to amend the custody rule to reflect that.
Item 9.C. meaning of terms “qualified custodian,” “annual surprise examination,” “internal control report” and “independent public accountant”	I urge you to explicitly refer to the custody rule, Rule 206(4)-2, somewhere in the instruction below Item 9.C. -- or somewhere in the instructions to Item 9 generally -- so advisers responding to Form ADV will have a point of reference for understanding the meaning of key terms used in Item 9, such as: • “qualified custodian” • “annual surprise examination” (why is this not “independent verification”?) • “internal control report” and • “independent public accountant.” None of those terms appear in the Form ADV Glossary, even though they have very specific meanings that can only be understood by reference to Rule 206(4)-2.
Typos in rule references appearing in instructions	Lastly, there is a persistent typo in the instruction under Item 9.A. of Form ADV Part 1: The reference to Rule “206(4)(2)-(d)(5)” should read “206(4)-2(d)(5)”. The same typo appears in Section 7.A. and Section 9.D. of Schedule D. Hopefully these can be corrected as the form is updated in connection with the Proposals.

[10] See Section 17 in my May 9, 2008 comment letter at http://www.sec.gov/comments/s7-10-00/s71000-93.pdf.

[11] As alluded to in the circumstances addressed in Question II.2 of the Custody FAQs: http://www.sec.gov/divisions/investment/custody_faq_030510.htm.

4) Clarify Item 2 reporting (SEC registration eligibility).

In Item 2 of Form ADV Part 1, I urge you to clarify whether advisers must check every item that makes them eligible for SEC registration or whether they are permitted to stop at reporting only one. The current instructions explain that SEC-registered advisers must check "at least one" item among those listed in Item 2. However, it is unclear whether once an adviser has checked one box in Item 2 -- and therefore established its SEC registration eligibility -- it may choose not to check any other boxes even if they apply.

This is a question I am often asked by advisers attempting to respond to Item 2. If your intention is for advisers to report all their bases for SEC registration eligibility, a simple fix would be in order, for example, by adding the phase "check all that apply" (or similar wording) in the Item 2 instructions.

5) Avoid duplicative reporting of custodians and auditors.

In general, I support the Proposals to the extent they are aimed at avoiding duplicative reporting on Form ADV. Specifically, I support the following proposed changes to Form ADV Part 1:

- The proposed parenthetical in the instruction underneath Item 9.C. avoiding duplicative reporting of auditors already reported in Section 7.B.1. of Schedule D.
- The proposed parenthetical instruction underneath Item 9.D. avoiding duplicative reporting of custodians already reported in Section 7 of Schedule D.

6) Retain "investment company" reporting in Item 7.

Although I am generally in favor of avoiding redundancies, I question the proposed deletion of "investment companies" from Item 7. According to footnote 186 in the Implementing Release, the rationale for this proposed deletion is that it is duplicative of the information requested in Item 5, specifically, Items 5.D. and 5.G.(3). However, Item 7 is not duplicative of Item 5 since Item 7 is asking for information about the adviser's related persons, not clients, which is the focus of Item 5.

The proposed deletion could create a hole in reporting that is important to effective regulatory oversight. For example, an adviser may have an investment company related person posing conflicts of interest, even though the adviser is not providing the investment company with advisory services. This could occur, for instance, if an adviser providing financial planning services to individuals has corporate siblings that sponsor, manage, administer and/or distribute proprietary mutual funds. In that case, while the siblings might be reported in Item 7, the investment company itself would not be reported in either Item 5 (since the investment company is not a client) or Item 7 (if "investment companies" are deleted from the list). Nonetheless, the adviser might be recommending that its financial planning clients invest in those proprietary funds.

If the Commission believes it can adequately find and track this type of conflict of interest if only the siblings are reported, then the proposed deletion may be acceptable. However, if Item 7 really is aimed at giving the Commission the complete picture of the adviser's financial services affiliations where conflicts of interest might exist, then "investment companies" would be an appropriate inclusion on the Item 7 list.

In addition, note that information about an adviser's investment company clients is also requested in Item 2.A.(5) of Part 1. That information is more directly duplicative of the information requested in Items 5.D. and 5.G.(3) than is the information requested in Item 7. However, short of entirely restructuring Part 1 of the form, I would not propose that deletions be made to avoid this duplication because:

- Item 2 has a specific purpose of identifying SEC registration eligibility, which makes listing Item 2.A.(5) logical in that context.
- Item 5.D. requests percentage and AUM details not requested elsewhere.
- Item 5.G.(3) focuses specifically on types of services provided, which would be incomplete if portfolio management for "investment companies" were not listed, given the other types of entities that are listed and that are not covered in Item 2. Moreover, Item 5.G.(3) focuses specifically on "portfolio management" services for an investment company, whereas Item 2.A.(5) merely focuses on whether the registrant is an "adviser" to a registered investment company. Consequently, the information in those two items may not be duplicative for any particular adviser. For example, an adviser that acts as a manager of managers to a fund could conceivably check the box for Item 2.A.(5) because it serves as the fund's primary adviser, but not check the box for Item 5.G.(3) because it does not provide "portfolio management" services to the fund.

7) Clarify required timing of amendments to Schedules A and B.

The Implementing Release proposes changes to General Instruction 4 to Form ADV, which specifies when Other-Than-Annual Amendments must be made to Form ADV. Among others, amendments to the form are required promptly if information provided in response to Item 10 (Control Persons) becomes materially inaccurate. I urge you to clarify whether this is intended to trigger an Other-Than-Annual Amendment filing requirement if material changes occur to information provided on schedules associated with Item 10 (meaning Schedules A, B or Section 10 of Schedule D), or just when material changes occur to the check-the-box information provided in response to actual Item 10.

If the number of times I have been asked this question is any indication, this often confuses advisers trying to determine how and when to update their filings for changes to schedule information. If you intend material changes in schedule information -- such as executive officers added to or deleted from Schedule A or indirect owners added to or deleted from Schedule B -- to trigger a "prompt" Other-Than-Annual Amendment, a simple fix in the instructions would be immensely helpful, such as adding the phrase "including any associated schedules" (or similar wording) where appropriate in General Instruction 4.

8) Avoid other redundancies and discrepancies on Form ADV.

Even with the amendments in the Proposing Releases, there are still many areas where Form ADV asks for overlapping or duplicative information, sometimes using different wording or methods of reporting with no apparent rationale. As I have noted in prior comment letters, these overlaps are a perpetual source of frustration, confusion and unnecessary burden for advisers, with no commensurate benefit to advisory clients or regulators. I have outlined my comments on this point in Section 3 of my comment letter dated May 8, 2008, and therefore refer you there instead of reiterating these issues: http://www.sec.gov/comments/s7-10-00/s71000-93.pdf

I urge you to take this opportunity to eliminate as many of these unnecessary overlaps and discrepancies as possible, in addition to the ones referenced in the Proposing Releases.

9) Keep 90 days as the deadline for annual updates of Form ADV.

Many advisers perform their annual compliance program reviews in the time period immediately following their fiscal year end. Among other things, these reviews help them to update their Form ADVs, both Parts 1 and 2, with the aim of including appropriate revisions in their annual updating amendments.

Given the scope and nature of the work required by a typical annual review, and the subsequent work required to reflect that information appropriately in Form ADV, advisers should continue to have at least 90 days after fiscal year end to file their annual updating amendments. Accelerating the deadline for an adviser's annual updating amendment to Form ADV is not as important as accelerating the other types of filings referenced in the Implementing Release (such as Form 10-K) because:

- Form ADV is filed cyclically on an annual basis anyway brought current to the date of filing each time, with almost no information reported on a time-lagged basis back to fiscal year end;[12] and
- Other-Than-Annual Amendments are still required to be filed promptly between annual updates if material changes occur to information provided in response to key items.

10) Revamp entire Form ADV.

It is unfortunate that time constraints on implementing the adviser provisions of the Dodd-Frank Act will force the Commission to adopt piecemeal revisions to Form ADV yet again. I, for one, still strongly favor tearing up Form ADV from its roots and revamping it entirely in order to enhance its usefulness to investors, improve the efficiency to filers and provide regulators with better tools to fulfill their regulatory mission. I have outlined my views on this point in various prior comment letters, including:

- Section 13 of my May 9, 2008 comment letter: http://www.sec.gov/comments/s7-10-00/s71000-93.pdf
- My October 20, 2008 comment letter: http://www.sec.gov/comments/4-567/4567-6.pdf
- Section 2 of my July 3, 2009 comment letter: http://www.sec.gov/comments/s7-09-09/s70909-344.pdf

While the practical realities of Dodd-Frank may preclude a total overhaul of Form ADV at this juncture, I urge the Commission to initiate a project internally with the aim of revamping the form in its entirety at the earliest feasible time.

OTHER REGISTRATION AND RELATED COMMENTS

11) Provide private fund advisers having to register for the first time with the same registration "grace period" afforded to advisers switching to state registration.

The Proposing Releases go to great lengths to describe the proposed timing of registration and reporting by:

- advisers switching from federal to state registration, giving them a transition period of up to 90 days after the Dodd-Frank effective date to switch their registration; and
- exempt reporting advisers, giving them a period of 30 days after the Dodd-Frank effective date to file an initial report.

However, there is no clear discussion about the deadline applicable to private fund advisers currently not registered in reliance on Section 203(b)(3), who will not be exempt from registration under any provision after Dodd-Frank becomes effective on July 21, 2011, and will therefore have to register with the SEC for the first time. Without further clarification, it

[12] Instruction 5 to the Instructions to Part 1A states (or implies) that all information provided in Form ADV should reflect the adviser's business at the time it files its Form ADV, with the exception of ● RAUM, which advisers may value as of any date within 90 days of the date of filing (see Instruction 5.b.(4)), and ● certain items that newly-registered advisers may report on a prospective basis or skip the item altogether (see Instruction 5.a.).

appears that these advisers must be registered with the SEC by the Dodd-Frank effective date of July 21, 2011.[13] If that is the case, they would have to file their initial Form ADV far enough in advance to give the SEC time (up to 45 days) to act on their application by the July 21 deadline, not to mention take all the other steps that may be necessary to come into compliance by that date with all the SEC rules covering registered advisers, such as ● adopting a compliance program, ● appointing a CCO, ● meeting the books and records requirements, ● making arrangements to meet the custody rule, ● meeting the cash solicitation rule, ● adopting a proxy voting policy, ● and ensuring that their marketing materials meet the adviser advertising rule.

The Implementing Release acknowledges (in footnote 16) that having the proposed transition period start on July 21 for SEC-registered advisers switching to state registration would avoid requiring them to take steps to register with the states (specifically, responding to ADV items about SEC registration eligibility) before the statutory changes requiring them to switch come into effect on July 21. I would note that a similar rationale applies to unregistered advisers having to register for the first time, given that the statutory changes requiring them to register also will also not come into effect until July 21. If switching advisers are given a "grace period" after July 21 to file a Form ADV indicating their AUM status and completing their state registration, private fund advisers registering with the SEC should be too,[14] not only out of fairness, but out of recognition that spreading the filing period out over a longer stretch of time will give the SEC more opportunity to get the IARD updates completed and have every adviser registering or switching as a result of Dodd-Frank responding to the same Form ADV under the same set of laws.

Accordingly -- if you did not intend this already -- I urge you to afford private fund advisers registering with the SEC for the first time as a result of Dodd-Frank the same "grace period" after July 21 for filing their Form ADV and completing their registration as is afforded SEC-registered advisers switching to state registration.

12) The state registration transition period should be the usual 180 days.

The transition period for advisers switching to state registration should be 180 days, parallel to the current switching rule. Assuming that state registration can be accomplished within the proposed 90 days is optimistic at best, given the many requirements that often come into play with state registration (reviewing advisory contracts and organic documents, obtaining bonds, preparing balance sheets, completing IAR examinations, etc.). In 2011, this will be exacerbated by the fact that many new registrations will be filed all at once in a relatively short period, at the very same time that many states are facing budget and staff cuts. If 180 days is the usual rule, it seems ill-advised and counterintuitive to shorten the deadline to 90 days in these unusual and potentially overwhelming circumstances. It would be grossly unfair to hold it against advisers attempting in good faith to complete their registrations if the regulators were unable to process their applications in a timely and orderly fashion within the requisite time frame.

[13] This also raises the question whether if private fund advisers did register with the SEC before July 21, would they then have to file with the SEC again before August 21, 2011, pursuant to proposed Rule 203A-5?

[14] I would note that just as there is nothing barring private fund advisers from registering with the SEC voluntarily before July 21 (assuming they exceed the $25 million AUM threshold), there is nothing barring SEC-registered advisers from voluntarily registering with the states before July 21, even if they must also retain their SEC registration until the law changes on July 21. Indeed, at least one state (Texas) is encouraging SEC-registered advisers who have to switch to state registration to "dual register," meaning file and become registered with the state before withdrawing registration from the SEC on July 21. (See http://www.ssb.state.tx.us/Important_Notice/Notice_Regarding_IA_Switch.php.) Therefore, switching advisers and first-time registrants are similarly situated when it comes to being able to take steps prior to July 21 to get registered with the appropriate regulator that will oversee them after July 21. All the more reason that if one group is given a "grace period," the other should as well.

13) **Rethink which provisions and regulations apply to which advisers – SEC-registered, state-registered, exempt reporting and unregistered.**

In addition to amendments to Form ADV, the Implementing Release proposes to amend the pay-to-play rule, Rule 206(4)-5, to cover registered advisers, foreign private advisers and exempt reporting advisers to avoid application of the rule narrowing as a result of changes to Section 203(b) of the Advisers Act made by the Dodd-Frank Act. I agree that the proposed changes are necessary if Rule 206(4)-5 is going to continue covering essentially the same advisers it did prior to Dodd-Frank.

The Proposing Releases also propose a number of other technical and conforming amendments as a result of statutory changes effected by Dodd-Frank. There are, however, a few additional changes I urge you to consider as a result of revisions to Section 203(b) and other statutory changes, as explained below:

Performance Fees. With few exceptions,[15] Section 205(a)(1) of the Advisers Act, as amended by Dodd-Frank, prohibits SEC-registered advisers from charging performance fees. Rule 205-3 provides a limited exemption from that prohibition if the performance fee is charged only to "qualified clients." However, it is unclear how this will apply to private fund advisers no longer exempt from registration and therefore having to register with the SEC for the first time. If they will now be subject to the performance fees prohibition, what will happen if they have pre-existing contracts with non-qualified investors or clients? Must the fee arrangements be revised or the investors/clients terminated in some fashion in order for the adviser to remain in compliance?[16]

The last time certain private fund advisers were required to register (under the rule vacated by the 2006 *Goldstein* case), the Commission addressed this issue by adding a transition rule in paragraph (c) of Rule 205-3, essentially "grandfathering" certain pre-existing non-qualified investors and clients.[17] However, that rule itself appears to now require updating and I do not see anything in the Proposing Releases addressing this, even though "grandfathering" was proposed in other contexts.[18] I strongly urge you to clarify this so that similar grandfathering is available for performance fee arrangements in existence prior to July 21, 2011, for private fund advisers required to register for the first time as a result of Dodd-Frank.

Insider Trading Procedures. Similar issues arise under Section 204A of the Advisers Act, which requires advisers "subject to Section 204" to adopt and enforce written insider trading prevention procedures. It is unclear what being "subject to Section 204" is intended to mean as used there because portions of Section 204 apply to all advisers except those exempt from registration under Section 203(b). Prior to Dodd-Frank, this excepted all private fund advisers that fell within old Section 203(b)(3). Post Dodd-Frank, it will except only those that fall within the definition of "foreign private adviser" under the revised Section 203(b)(3). Other portions of Section 204 -- as amended by Dodd-Frank -- apply to any investment adviser registered under the Advisers Act. Still other portions apply to any adviser that is SEC-registered or regulated solely by a state.

[15] One exception is found in Advisers Act Section 205(b)(4), which permits advisers to charge performance fees to 3(c)(7) funds.

[16] Similarly, what happens if they have pre-existing contracts that do not contain the "no assignment" and "notice of partnership change" clauses contemplated by Sections 205(a)(2) and (3)? Must all those contracts be amended to include those clauses? If so, must this all occur before July 21, 2011?

[17] See also the August 10, 2006 no-action letter issued to the American Bar Association Subcommittee on Private Investment Entities for other provisions that were impacted by the holding in the *Goldstein* case.

[18] For example, existing venture capital funds that satisfy certain criteria are "grandfathered," as discussed in Section II.A.9. of the Exemptions Release, and certain "grandfathering" provisions are proposed for the books and records Rule 204-2, as discussed in Section II.D.2.b. of the Implementing Release.

It is unclear which of these categories of advisers Congress intended to be considered "subject to Section 204" and therefore required by Section 204A to have insider trading prevention procedures. Accordingly, I would urge you to consider this issue along with the Proposals, as you did with the pay-to-play rule, and determine whether the Commission can and should use its rulemaking powers to clarify the application of this requirement.

14) Address advisers to "mid-sized private funds."

Other than a reference in footnote 43 of the Implementing Release, I find no proposals or discussion in the Proposing Releases relating to advisers to "mid-sized private funds." As such, it is unclear whether or how the Commission has taken into account the factors in Section 203(n) of the Advisers Act added by Section 408 of the Dodd-Frank Act. I urge you to clarify in the Adopting Releases where advisers to "mid-sized private funds" fit into the Proposals and whether you intend to define the term "mid-sized private fund" or provide any registration or examination procedures specific to advisers to funds falling within that category.

* * *

Thank you for considering my comments. If you have any questions or would like any further clarification about these or related points, please contact me at the phone number referenced below.

Sincerely,

L. A. Schnase
Individual Investor and Attorney at Law
713-741-8821

Attachment: *The Investment Lawyer* article
"Practical Application of the Adviser Custody Rule and
How to Report Custody on Form ADV"

Copyrighted material redacted. Author cites:

Schnase, Lorna A. "Practical Application of the Adviser Custody Rule and How to Report Custody on Form ADV." *The Investment Lawyer* 17.12 (December 2010). Print. Also available at http://www.40actlawyer.com/Articles/Link2(11-10)%20Adviser%20Custody%20Rule%20(LSchnase%2011-29-10).pdf