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January 24, 2011

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

Re: ***File Number S7-36-10***

Dear Ms. Murphy:

We offer these comments on the rules which the Commission proposed in its Release IA-3110, published in the Federal Register on December 10, 2010 (the "Proposed Rules"). The Proposed Rules are part of the implementation of Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") as it relates to the Investment Advisers Act of 1940 (the "Advisers Act") and advisers to private funds (as defined in Section 402 of Dodd-Frank). Calfee, Halter & Griswold LLP appreciates the opportunity to comment on the Proposed Rules. Calfee counts among its clients a number of private funds that invest almost exclusively in small and mid-sized private companies. We believe that it is this type of adviser who will experience the greatest impact of the Proposed Rules.

Some of our comments are specific and technical. Other are broad, relating to the Commission's approach to private funds in general. We will present our specific comments first.

1. The Proposed Rules should "grandfather" existing 3(c)(1) funds under Rule 205-3, the "qualified client rule."

Dodd-Frank will require registration under the Advisers Act on the part of many investment advisers to private funds who previously had been exempt from registration under the Advisers Act by reason of Section 203(b) thereof. Many of such private funds are exempt from registration under the Investment Company Act of 1940 by reason of Section 3(c)(1) of that Act, and it is not known to their investment advisers, nor can it easily be ascertained, whether the equity owners of such 3(c)(1) funds include persons who are not "qualified clients" as defined in existing Rule 205-3. As soon as an investment adviser to a 3(c)(1) fund becomes so registered, the legality of any pre-existing performance-fee arrangements between the investment adviser and the 3(c)(1) fund (i.e., compensation of the kind described in Section 205(a)(1) of the Advisers Act) will be cast into doubt, unless existing Rule 205-3 is modified.

To avoid any such doubt, we urge the Commission to "grandfather" pre-existing performance-fee arrangements involving 3(c)(1) funds, in much the same way the Commission did when it adopted paragraphs (c)(2) and (c)(3) of Rule 205-3 in its Release No. IA-2333 in December 2004. One way to accomplish such a grandfathering might be simply to replace the date of February 10, 2005, in each place where it appears in such paragraphs (c)(2) and (c)(3), with the date of July 21, 2011, or another appropriate date.

2. The Proposed Rules should clarify whether unfunded capital commitments are to be counted as assets under management for purposes of the qualified client rule.

The Proposed Rules would require an investment adviser to a private fund to include in its calculation of regulatory assets under management the amount of any uncalled capital commitments made to the private fund, for purposes of determining whether the adviser is required to become registered under the Advisers Act.

Paragraph (d)(1)(i) of Rule 205-3, as currently in effect, provides that the term "qualified client" includes a natural person who or a company that immediately after entering into an investment advisory contract has at least $750,000 under the management of the investment adviser. However, it is not clear whether the amount of the uncalled capital commitment of an equity owner of a private fund should be counted as an asset "under management" for purposes of paragraph (d)(1)(i) of Rule 205-3, in the same way that it is proposed to be so counted for purposes of determining whether the investment adviser is required to become registered under the Advisers Act. We urge the Commission to treat uncalled capital commitments consistently for these purposes, and clarify that the term "qualified client" will include a natural person or a company making a capital commitment to a private fund in at least the amount now or hereafter specified in paragraph (d)(1)(i) of Rule 205-3.

3. The Proposed Rules should modify Rule 206(4)-2, the "Custody Rule," so that certificated securities issued by non-publicly traded companies need not be maintained with a qualified custodian.

Paragraph (b)(2) of Rule 206(4)-2 under the Advisers Act, the "Custody Rule," currently provides that in order for a registered investment adviser to avoid the requirement that it engage a qualified custodian to maintain possession of privately offered securities owned by a private fund which it advises, such privately offered securities must be uncertificated. This aspect of the Custody Rule will impose significant ongoing expenses and administrative burdens upon the many formerly exempt investment advisers whose venture capital funds and leveraged-buyout funds invest exclusively in securities for which no public market exists and which are usually represented by certificates the transfer of which is restricted, if not prohibited, by applicable securities laws or by contract. (The issuers of such securities, for their part, generally act as their own transfer agents, have no securities registered under the Securities Act of 1933, and have no reporting obligations under the Securities and Exchange Act of 1934.) Because of the illiquidity of these securities and the relatively low risk of fraud associated with the certificates that represent them, the extension of this aspect of the Custody Rule to these private funds is of dubious benefit to the investors in such funds or to the public, and any such theoretical benefit is quite possibly outweighed by the attendant costs to such private funds and their investment advisers. We therefore urge the Commission to modify the Proposed Rule so as to either (1) remove from paragraph (b)(2)(i)(B) of Rule 206(4)-2 the requirement that securities covered by that provision be uncertificated, or (2) delay the applicability of the Custody Rule to certificated privately offered securities held by private funds for a period long enough to ascertain whether the benefits of such a requirement would justify the attendant costs to private funds and their investment advisers.

4. General comments about the applicability of the Advisers Act to private advisers.

Our comments concerning the Proposed Rules reflect a reality we have observed in the market over the past several months as we have talked with sponsors and investors who traditionally have been active in the private equity (and hedge fund) areas, especially with venture capital, leveraged buyout, mezzanine debt and real estate funds. These discussions have resulted in the conclusion that there are several aspects of the Advisers Act which do not logically apply to investment advisers to private funds (other than, perhaps, those which can be classified as true hedge funds).

The main thrust of the Advisers Act over the years has been to regulate advisers who primarily manage separate client accounts which invest primarily in publicly traded securities, not (as here) advisers to pooled investment vehicles which invest primarily, if not exclusively, in highly illiquid securities. Substantial aspects of the Advisers Act relate to trading activity in publicly traded securities, and these are not at all relevant to the operations of private funds holding restricted securities. While the time and effort required for advisers who engage in these activities to comply with these regulations may well be justified for the protection of investors, the balance of the costs versus the benefits do not seem to be the same for private advisers to mid-sized private funds. Simply put, these funds are not themselves leveraged, and it is difficult to see how they could present "systemic risk" of the type which underpins much of the rationale for the regulatory scheme of Dodd-Frank. Also, our conversations have suggested that even those funds which are able to claim an exemption from registration under the Advisers Act will be required to adopt the compliance procedures (and incur the attendant costs and burdens) as prospective investors may not be willing to distinguish between registered funds and those exempt from registration but rather apply "registered fund" criteria across the board. We cite here three examples of instances where the Advisers Act appears to place a much greater burden on private advisers with no reciprocal benefit to investors.

First, as noted above and as others have aptly commented (Olympus Partners, Cortec Group, Sentinel Capital Partners), certain aspects of Rule 206(4)(2) regarding the custody of privately offered securities are not applicable to a private adviser managing private funds that only invest in private companies. Many private funds invest in certificated operating companies and would thus have to engage a qualified custodian to hold stock certificates that are not negotiable instruments and have no intrinsic value. This places additional burdens and expenses on private advisers and provides no corresponding benefit to investors.

Second, aspects of Rule 204-2 regarding record-keeping and compliance are much more tailored to investors who trade in publicly-traded companies. Mid-sized private advisers typically have just a few investment vehicles that themselves have just a handful of investments in private companies.

Third, private equity funds developed during a time when there were no restrictions on charging "carried interest" and as such, "carried interest" economics have become a bedrock principle of private funds. The qualified client rule will prohibit those otherwise eligible investors who are not qualified clients from investing in private equity funds that are advised by managers with more than $150 million in assets under management. It is not obvious or logical why such a limitation should exist. If non-qualified clients are to be prohibited from investing in this class of funds, such a decision should be arrived at on the merits, and not merely because certain private equity funds trip the bar for registration.

Advisers to mid-sized private equity funds will be able to comply with the provisions of the Advisers Act. However, we believe the costs of registration will be substantial, and just as important, we believe many provisions and restrictions in the Advisers Act will not provide any comfort or clarity to investors because such provisions and restrictions have no logical relationship to the manner in which advisers to private equity funds operate.

We support the proposed approach (made in other comment letters) of a one-year exemption from registration under the Advisers Act for those advisers that solely advise private funds that invest predominantly in private companies. During this year, the Commission could study developing an alternative regime of regulating such advisers under the Advisers Act. Perhaps private advisers could be exempt from those provisions of the Advisers Act that make little sense in the context of private funds (custody rule, certain record-keeping requirements, prohibition on performance fees) and other provisions (such as the modifications to Form ADV for private funds that are in the Proposed Rules) could be incorporated to specifically address private advisers. We believe these types of modifications would be cost efficient to advisers and beneficial to investors.

In closing, we urge the Commission to also consider broader consequences of imposing a major financial burden on private advisers that could easily result in their withdrawal from the business. Private equity funds have become an important element in the nation's economy.

They are an engine for investment in midsize enterprises that create jobs and contribute to economic strength and stability by building on success now an in the future.

Very truly yours,

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