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Business Law Section
Securities Regulation Committee

April 1, 2011

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

E-mail address: rule-comments@sec.gov

Attention: Elizabeth M. Murphy, Secretary

RE: File No. S7-37-10
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; and

File No. S7-36-10
Rules Implementing Amendments to the Investment Advisers Act of 1940
Release No. IA-3110

Ladies and Gentlemen:

The Securities Regulation Committee of the Business Law Section of the New York State Bar Association (the "Committee") appreciates the invitation from the Securities and Exchange Commission (the "Commission" or the "SEC") in Investment Advisers Act Release No. 3111[1] and Investment Advisers Act Release No. 3110[2] to

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1 Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers Act

comment on the Commission's proposed rules and rule amendments (collectively, the "Proposed Rules") under the Investment Advisers Act of 1940, as amended (the "Advisers Act")[3] to implement provisions of the Private Fund Investment Advisers Registration Act of 2010 (the "Registration Act").[4]

The Committee is composed of members of the New York State Bar Association, a principal part of whose practice is in securities regulation. The Committee includes lawyers in private practice and corporation law departments. A draft of this letter was reviewed by certain members of the Committee. The views expressed in this letter are generally consistent with those of the majority of members who reviewed and commented on the letter in draft form. The views set forth in this letter, however, do not necessarily reflect the views of the organizations with which its members are associated, the New York State Bar Association or its Business Law Section.

Background

As part of the transformative financial regulatory reforms established by the Dodd-Frank Act, the Registration Act rescinds the "private adviser exemption" contained in Section 203(b)(3) of the Advisers Act,[5] pursuant to which certain advisers,

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Release No. 3111 (Nov. 19, 2010) (hereinafter, the "Exemptions Release"), *available at* http://www.sec.gov/rules/proposed/2010/ia-3111.pdf.

2 Rules Implementing Amendments to the Investment Advisers Act of 1940, Investment Advisers Act Release No. 3110 (Nov. 19, 2010) (hereinafter, the "Implementing Release"), *available at* http://www.sec.gov/rules/proposed/2010/ia-3110.pdf.

3 15 U.S.C. §§ 80b-1 to 80b-21.

4 The Registration Act comprises Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (hereinafter, the "Dodd-Frank Act"). *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, tit. IV, 124 Stat. 1376, 1570-80 (2010) (amending or enacting various sections of the Advisers Act, 15 U.S.C. §§ 80b-1 to 80b-21).

5 *See* Dodd-Frank Act § 403, 124 Stat. at 1571 (amending Advisers Act § 203(b), 15 U.S.C. § 80b-3(b)) (effective July 21, 2011). Section 203(b)(3) of the Advisers Act, 15 U.S.C. § 80b-3(b)(3), currently exempts from registration any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company registered under the Investment Company Act of 1940, as amended (the "Investment Company Act"), 15 U.S.C. §§ 80a-1 to 80a-64, or a company which has elected to be a business development

including those to many private funds, have been largely exempt from registration, recordkeeping and reporting requirements under the Advisers Act. The Registration Act also introduces various new exemptions from registration and re-assigns responsibility to the states for oversight of investment advisers that have between $25 and $100 million in assets under management.[6] These amendments have the effect of both expanding and contracting the universe of advisers subject to registration with the Commission, thus triggering significant changes in regulatory status for many investment advisers. Further, if adopted, the Proposed Rules would significantly increase the information advisers are required to provide to regulators in order to register (or remain registered).[7] The Form ADV filings would be publicly available on the SEC's website, the Investment Adviser Public Disclosure System ("IAPD"), thus resulting in an unprecedented level of public disclosure about advisers who relied on the "private adviser exemption" and the private funds they manage.

We appreciate the thought and effort of the Commission in formulating implementing proposals that follow the Congressional mandate to protect investors and increase transparency, while also attempting to ease regulatory burdens and avoid duplicative requirements. In anticipation of the Proposed Rules, a great deal of uncertainty has surrounded the implementation of the Congressional registration mandate, as well as the transition process. Most of the provisions in the Registration Act become effective on July 21, 2011,[8] most notably the obligation to register, which compels many advisers to establish substantially new compliance systems in the brief period leading up to the July 21, 2011 registration deadline, with respect to reporting, disclosure, operations and recordkeeping. We anticipate that these changes will have a profound effect on the advisory community and the client-adviser relationship. We agree with the Commission that it is crucially important to individual investors, advisers and the markets as a whole to promote an orderly and effective transition process.

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company pursuant to Section 54 of the Investment Company Act, 15 U.S.C. § 80a-53. *See* 15 U.S.C. § 80b-3(b)(3).

6 *See* Dodd-Frank Act § 410, 124 Stat. at 1576-77 (amending Advisers Act § 203A(a), 15 U.S.C. § 80b-3a(a)) (effective July 21, 2011).

7 The Proposed Rules significantly revise Form ADV: Uniform Application for Investment Adviser Registration ("Form ADV"). *See* Implementing Release Apps. A-E, *available at* http://www.sec.gov/rules/proposed/proposedarchive/proposed2010.shtml.

8 *See* Dodd-Frank Act § 419, 124 Stat. at 1580.

According to the Commission's estimates, approximately 4,100 of the 11,850 SEC-registered advisers will be required to withdraw their registrations and re-register with one or more state securities authorities,[9] and an additional 750 previously-exempt advisers to private funds would also be required to register with the Commission.[10] Although some advisers are clearly required to register, many are uncertain if they will be regulated by the Commission or the applicable states or whether they will qualify for an exemption, as these determinations depend on the final rules adopted by the Commission.

The following discussion is divided into two parts. Part A sets out certain comments on the Exemptions Release and Part B relates to the Implementing Release. For ease of reference, comments on different aspects of the Proposed Rules are categorized by sub-heading. The discussion of the Committee's comments on the Proposed Rules, as well as responses to certain questions posed by the Commission in its request for comment, are intended to suggest additional refinements, clarify particular areas of ambiguity or further reduce costs and burdens on the client-adviser relationship. We believe that many of these modifications to the Proposed Rules would increase the likelihood of uniform application and minimize disparate impact, without jeopardizing Congress' stated goals of increasing investor protection and reducing systemic risk. We respectfully request that the Commission consider the issues and recommendations presented in this letter prior to adoption of the final rules.

A. Exemptions Release

1. Definition of Venture Capital Fund

One of the new exemptions proposed by Congress is for advisers solely to venture capital funds, without regard to the number of such funds advised by the adviser or the size of such funds. In directing the Commission to implement the "venture capital fund" exemption, Congress expressly noted that "venture capital funds do not present the same risks as the large private funds whose advisers are required to register with the SEC" under Title IV of the Dodd-Frank Act and, further, that "their activities are not interconnected with the global financial system . . . did not contribute

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9 Implementing Release at 9 & n.15.

10 *Id.* at 109.

to the implosion that occurred in the financial system in [2009], nor [do they] pose a future systemic risk to our world financial markets or retail investors."[11]

As stated by the Commission, the proposed definition of "venture capital fund" is intended to be consistent with Congress's understanding of what venture capital funds are.[12] We appreciate the Commission's efforts to propose uniform rules for purposes of the Congressional exemption. Building on our members' experience advising venture capital funds and their advisers, our comments and suggestions below highlight areas of the Proposed Rules that we believe warrant additional flexibility in order to render the exemption more accessible, in keeping with the Congressional mandate.

In adopting the proposed definition, the Commission seeks to distinguish advisers to "venture capital funds" from the larger category of advisers to "private equity funds" for which Congress considered, but ultimately did not provide, an exemption.[13] As discussed in more detail below, many of the six elements of the proposed definition of "venture capital fund" would be burdensome for venture capital fund advisers to satisfy and could result in defeating Congressional intent to provide an exemption for such advisers.

We recognize the value of the Commission's proposal for uniform rules pursuant to which an adviser to a venture capital fund would assess each of its qualifying investments in order to determine whether it may avail itself of the exemption. However, the adviser would likely incur significant costs and time in evaluating each potential investment to determine whether it would be a qualifying investment for purposes of the exemption. Further, the proposed definition does not permit any level of non-qualifying investment by venture capital funds. Because the consequence of having even one inadvertent, non-qualifying investment is likely full registration, and given the Congressional mandate, we believe that allowing some limited flexibility in this regard is appropriate. Therefore, we recommend that the definition be revised to allow for a certain level of non-qualifying investments by a venture capital fund, not to exceed 20% of its capital commitments.

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11 *See* Exemptions Release at 12, n.43 (quoting S. REP. NO. 111-176, at 74-5 (2010) (internal quotation marks omitted)).

12 *See* proposed rule 203(l)-1 (to be codified at 17 C.F.R. pt. 275); Exemptions Release at 10.

13 *See* Exemptions Release at 10.

a. Definition of "Qualifying Portfolio Company"

Private Companies. The definition provides that at the time of each investment by a venture capital fund in a portfolio company, such portfolio company must be a private company, although a venture capital fund may continue to hold securities of a portfolio company that subsequently becomes public.[14] We believe this element of the proposed definition should be clarified and expanded to allow for follow-on investments by venture capital funds in portfolio companies that have become public companies. In our experience, these types of follow-on investments are not unusual, and we do not see any evidence that these investments would create systemic risk.

Cash and Cash Equivalents and Short-Term U.S. Treasuries. We agree with the Commission's inclusion of cash, cash equivalents and short-term U.S. Treasuries as permissible investments for venture capital funds,[15] although we believe the types of permissible short-term investments should be expanded to allow venture capital fund advisers greater flexibility to select temporary investments pending investment or distribution, such as, for example, U.S. Treasury securities with maturities in excess of 60 days, money market mutual funds, and deposit accounts.

Equity Securities. The Commission acknowledges that while venture capital funds typically invest in common stock or common equivalent securities, some venture capital funds extend bridge financing to portfolio companies to allow such portfolio companies to satisfy their operational needs or for other legitimate reasons.[16] We recommend that the definition permit a venture capital fund to extend short-term loans with a maturity date of 365 days or less to a qualifying portfolio company, up to 15% of the venture capital fund's capital commitments, without requiring such loan to be convertible into equity.

In addition, we consider that the ability of the venture capital fund to purchase up to 20% of the portfolio company securities directly from existing investors in the portfolio company[17] should be extended to permit the venture capital fund to invest in the portfolio company, which could then redeem its investors' interests. We

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14 *See* proposed rule 203(l)-1(c); Exemptions Release at 14-15.

15 *See* proposed rule 203(l)-1(a)(2); Exemptions Release at 14.

16 *See* Exemptions Release at 22-23.

17 *See* Exemptions Release at 33.

believe this expansion would be consistent with the Commission's proposal as it is merely a different way to accomplish the same result. We also believe that an increase from 20% to 30% for this exception would allow venture capital funds additional flexibility without creating any systemic risk or undermining Congressional intent.

Portfolio Company Leverage. As proposed, a qualifying portfolio company would not borrow, issue debt obligations or otherwise incur leverage in connection with the venture capital fund's investments.[18] The Commission recognizes the vagueness of the term "in connection with" the fund's investment.[19] We note that it may be particularly difficult to determine because the portfolio company may well be borrowing at the time of the venture capital fund's investment. We suggest that additional guidance be provided to avoid uncertainty regarding compliance with the definition.

We also believe that the definition should specify that the only impermissible leverage would be a borrowing provided or arranged by the venture capital fund, subject to our recommendation above regarding bridge financing. If the Commission adopts our recommendation above regarding bridge financing, this requirement should also be modified to allow for bridge financing.

Capital Used for Operating and Business Purposes. Similar to the portfolio company borrowing limitation discussed above, the Commission's main concern with respect to this element of the definition focuses on the use of proceeds received by the portfolio company from the venture capital fund.[20] We recommend that the language be clarified as suggested above so that redemptions, exchanges, repurchases or distributions by a portfolio company involving existing portfolio company investors be permitted of up to 30% of the investment by the venture capital fund.

Operating Companies. While direct investments in operating companies are common for venture capital funds, venture capital funds that are not "funds of funds" also frequently invest through other investment vehicles for legal, tax or regulatory reasons that are unrelated to circumvention of the intended scope of the exemption. Therefore, we believe that venture capital funds should be permitted to

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18 Proposed rule 203(l)-1; Exemptions Release at 27.

19 *See* Exemptions Release at 28.

20 *See id.* at 32-34.

continue to use these structures to invest in portfolio companies without being required to register under the Advisers Act.

b. **Management Involvement**

We agree with the Commission's "offer-only" approach with respect to managerial assistance to portfolio companies in addition to the option to control the portfolio company. The Commission notes that this requirement is proposed to apply to each and every investment by a venture capital fund even though it acknowledges that venture capital funds sometimes invest as a group and only one adviser may in fact be expected to provide such assistance.[21] We recommend that the proposed definition be clarified so that only one adviser needs to satisfy this element of the definition if funds invest as a group because requiring all advisers of the group to offer such assistance would be duplicative and impractical.

In addition, we recommend that any venture capital fund that has "management rights" with respect to a portfolio company for purposes of the venture capital operating company rules under ERISA would also be deemed to have offered managerial assistance with respect to such portfolio company for purposes of this definition. This revision would facilitate compliance by venture capital funds with both ERISA and this rule.

c. **Limitation on Leverage**

We agree with the Commission that a venture capital fund's leverage be limited to a specified threshold of 15%, as this element of the definition is intended to respond to Congressional concern about the connection between leverage and systemic risk.[22] The Commission notes that to the extent venture capital funds use short-term leverage to cover fund expenses or to bridge capital contributions, a 90-day term has been typical and that it accordingly proposed to allow terms of up to 120 days.[23] In our experience, venture capital funds may arrange lines of credit for longer terms. We suggest that this element of the proposed definition be revised to allow for 180-day terms.

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[21] *See id.* at 39-40.

[22] *See id.* at 43-44.

[23] *See id.* at 44.

d. <u>No Redemption Rights</u>

We agree with the Commission's proposal that an exempt venture capital fund would not provide investors special redemption rights during the life of the fund except in "extraordinary circumstances," such as changes in regulatory, tax or other legal requirements.[24] Although we appreciate the difficulty in proposing an exhaustive list of what constitutes "extraordinary circumstances," we think that additional guidance from the Commission by providing examples of permissible and non-permissible redemption rights would be helpful. In addition, it would be helpful for the Commission to clarify that the allowance for "pro rata" distributions[25] is not intended to exclude certain ordinary course distributions that may not be pro rata, such as carried interest distributions or tax distributions.

e. <u>Representing Itself as a Venture Capital Fund</u>

We agree with the Commission's proposal that a fund must represent itself as being a venture capital fund to its investors and potential investors in order to avail itself of the exemption.

f. <u>Private Fund</u>

We agree with the Commission's proposal that a venture capital fund be a private fund as defined in section 202(a)(29) of the Advisers Act,[26] with the additional clarification as discussed in the section below with respect to its applicability to non-U.S. advisers.

2. Application to Non-U.S. Advisers

The Commission has solicited comments as to whether the venture capital exemption should be applied to non-U.S. advisers. We believe that non-U.S. advisers to venture capital funds should be permitted to qualify for this exemption if all of their U.S. clients are venture capital funds.[27] The Commission recognizes that in

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[24] *See id.* at 47-48.

[25] *See id.*

[26] 15 U.S.C. § 80b-2.

[27] *See* Exemptions Release at 53.

other contexts (such as the currently effective client-counting rule 203(b)(3)-1(b)(5)), the Advisers Act only looks to non-U.S. advisers' U.S. clients, and we believe the approach for non-U.S. venture capital fund advisers should be consistent.

In addition, the Commission notes that a non-U.S. venture capital fund would need to use U.S. jurisdictional means in offering its securities to qualify as a private fund and as a venture capital fund under the proposed definition.[28] Such a requirement could impose a significant burden on a non-U.S. venture capital fund that operated as a venture capital fund in a manner that would otherwise meet the criteria under the proposed definition and could unnecessarily compel a non-U.S. fund to make offerings in the United States in order for its adviser to avail itself of the exemption. For this reason as well, we recommend that non-U.S. funds advised by a non-U.S. adviser to venture capital funds be excluded in applying the definition.

3. Grandfathering Provision

We agree with the Commission's proposal to provide a broad grandfathering rule to existing venture capital funds in an effort to not burden these funds with revising their fund terms or liquidating non-qualifying investments to satisfy the proposed rule.[29]

In sum, we are concerned that, unless the proposed definition is revised in a manner consistent with our suggestions described above, many venture capital funds will be subject to registration requirements at significant cost because the availability of the exemption would be extremely limited. We believe this result was not intended by Congress when it adopted the exemption under new section 203(l) of the Advisers Act.[30]

4. U.S. Advisers and Non-U.S. Advisers

Proposed rule 203(m)-1 differentiates between United States advisers, who are advisers with a principal office and place of business in the United States

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28 *See id.* at 55.

29 *See id.* at 56-57.

30 *See supra* discussion at paragraphs 1-3 of Part A.1.

("U.S. Advisers"), and non-United States advisers, who are advisers with a principal office or place of business outside the United States ("Non-U.S. Advisers").[31]

a. Advice to Non-U.S. Persons That Are Not Qualifying Private Funds

We agree with the Commission that Non-U.S. Advisers should be able to rely on the private fund adviser exemption even though they have clients that are not qualifying private funds, as long as such clients are not United States persons.[32] Non-U.S. Advisers should not lose the benefit of the private fund adviser exemption as a result of their business activities outside the United States.

b. Assets Managed in the United States

Under proposed rule 203(m)-1, all of the private fund assets of a U.S. Adviser are deemed to be assets under management in the United States, even if the U.S. Adviser has offices outside the United States where the day-to-day management of certain assets effectively occurs.[33] In contrast, a Non-U.S. Adviser only needs to count private fund assets that it manages from a place of business in the United States toward the $150 million asset limit under the exemption.[34] The Commission states that it seeks to "avoid difficult attribution determinations that [are] required if assets are managed by teams located in multiple jurisdictions, or if portfolio managers located in one jurisdiction rely heavily on research or other advisory services performed by employees located in another jurisdiction."[35] We believe that the Commission should provide additional guidance on how it intends to make these determinations. For example, we request the Commission clarify that if a Non-U.S. Adviser engages a U.S.-based sub-adviser, the Non-U.S. Adviser will not be deemed to be managing its assets from a place of business in the United States. It would also be helpful for the Commission to clarify that a Non-U.S. Adviser will not be treated as having a place of business in the United States because it has U.S. affiliates who provide it or its clients research, due diligence or administrative services.

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31 *See* Exemptions Release at 59-60, 64-69.

32 *See id.* at 59.

33 *Id.* at 64-65.

34 *Id*. at 64.

35 *Id.* at 65.

5. Foreign Private Adviser Exemption

To be eligible for the foreign private adviser exemption, an adviser must: (1) have no place of business in the United States; (2) have, in total, fewer than 15 clients (e.g., managed accounts or pooled investment vehicles) and investors in the United States in private funds advised by the investment adviser; (3) have less than $25 million (or such higher amount as the Commission may deem appropriate) in aggregate assets under management that are attributable to clients in the United States and investors in the United States in private funds advised by the investment adviser; and (4) neither hold itself out generally to the public in the United States as an investment adviser nor act as an investment adviser to any registered investment company.[36]

a. <u>Raising the AUM Threshold of the Foreign Private Adviser Exemption</u>

We understand the Commission's willingness to limit the burden of the new regulations for advisers that have no place of business in the United States. We believe that raising the eligibility threshold for the foreign private adviser exemption from $25 million to $150 million would be more in line with Congress's objectives since the threshold of $25 million makes the exception almost unavailable because it is so low. Placing the threshold for the foreign private adviser exemption at $150 million is consistent with congressional intent and with the threshold for the private fund adviser exemption. This should also ensure that only foreign advisers with a significant amount of assets under management originating from the United States will need to bear the cost and regulatory burden of registering with the Commission.

b. <u>Counting Clients, Investors and Capital</u>

Under the current rule 203(b)(3)-1 safe harbor for counting clients, advisers are not required to count clients from which they receive no compensation. For purposes of counting clients toward the 15-clients-and-investors limit in the foreign private adviser exemption, proposed rule 202(a)(30)-1 would include those clients which do not compensate the adviser.[37] Generally, clients that do not compensate the adviser are not considered to require the same level of protection as clients who pay a fee for the advisory services they receive. This is because non-paying clients generally have a special relationship with the adviser. Therefore, we believe that this proposed

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[36] *Id.* at 6-7, 9, 72.

[37] *Id.* at 73.

change is unnecessary. Similarly, we also believe that advisers should continue to be entitled to exclude knowledgeable employees from being counted as investors consistent with current practices.[38]

Proposed rule 203(m)-1 requires each private fund adviser relying on this exemption to calculate but not report the amount of private fund assets it has for purposes of whether it meets the private fund adviser exemption.[39] We suggest that an annual rather than a quarterly valuation for testing assets under management would be more appropriate. Many advisers do not value their assets on a quarterly basis, and an annual test would also avoid registration requirements based on intra-year fluctuations in value.

In addition, we also believe that the proposed three-month grace period for advisers who meet the threshold of $150 million in assets under management should be extended to six months, in order to allow these advisers sufficient time to prepare for registration.

6. Subadvisers and Non-U.S. Advisory Affiliates of Registered Investment Advisers

The Commission stated that it expects advisers with advisory affiliates to have interpretative questions as to whether they are allowed to disregard the activities of their affiliates for purposes of determining if they can rely on any of the new exemptions.[40] On this topic, the Commission referenced its longstanding position that the determination of whether the advisory businesses of an adviser and its affiliate may be required to be integrated depends on the degree of separateness between them and is a question of facts and circumstances.[41] However, the Commission did not state that this approach would be dispositive in the future. Additionally, the Commission appears not to have squarely addressed the continued viability of certain staff positions set forth

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38 Proposed rule 202(a)(3)-1(c)(1)(i); Exemptions Release at 80-81.

39 Proposed rule 203(m)-1(c); *see also* Exemptions Release at 60-64.

40 Exemptions Release at 87.

41 *Id.* at 87 n.70; *see also* Richard Ellis, Inc., SEC No-Action Letter, 1981 WL 25241, at *1 (Sept. 17, 1981) ("*Ellis*").

in *Unibanco*[42] and similar staff no-action letters that have led to the development of certain operating structures for registered investment advisers with foreign advisory affiliates. We believe that the Commission should take this opportunity to affirm or codify the relief it provided in *Ellis*, *Unibanco* and their progeny and thereby eliminate any doubts about its continued availability.

B. Implementing Release

1. Transition to State Registration

In order to facilitate the withdrawal of the estimated 4,100 SEC-registered investment advisers who will now be required to register with one or more state securities authorities, the Commission proposes that each investment adviser that is registered with the Commission on July 21, 2011:

(1) file an amendment to its Form ADV by August 20, 2011 specifying whether it meets the new eligibility criteria for SEC registration and reporting the market value of its assets under management as determined within 30 days of the filing (the "August 20 Filing"); and

(2) file a Form ADV-W by October 19, 2011 (if no longer eligible for SEC registration).[43]

Additionally, the Commission would require an exempt reporting adviser to file its initial report on Form ADV no later than August 20, 2011.[44] The Commission indicated

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[42] Uniao de Bancos de Brasileiros S.A., SEC No-Action Letter, 1992 WL 183054 (July 28, 1992) ("*Unibanco*").

[43] Implementing Release at 172 (proposed rule 203A-5(a), (b), to be codified at 17 C.F.R. § 275.203A-5(a), (b)).

[44] Implementing Release at 46; *see id.* at 175 (proposed rule 204-4, to be codified at 17 C.F.R. § 275.204-4); Implementing Release App. B, at 5; proposed Form ADV: Instructions for Part 1A, instr. 2.k (Item 2.C: Reporting by Exempt Reporting Advisers); Implementing Release App. D, at 6 (From ADV Part 1A, Item 2.C (SEC Reporting by *Exempt Reporting Advisers*)).

that it expects to cancel the registration of any adviser who fails to file an amendment or withdraw its registration in accordance with the proposed rule.[45]

We recognize the efforts of the Commission to craft Proposed Rules that balance efficiency and prompt implementation of the Registration Act with the heightened compliance costs and regulatory burdens. However, the proposals for transition to state registration for advisers who no longer meet the SEC thresholds contemplate an extra filing on August 20, 2011 for *all* registered advisers and an abbreviated timeline thereafter for those transitioning to state registration.

Although the proposed August 20 Filing would certainly facilitate Commission review, it is needlessly burdensome and costly for (i) advisers who just registered (an estimated 750 new registrants who would have recently filed, most likely between April and June in order to meet the July 21 compliance deadline) and (ii) the majority of registered advisers who by the Commission's own estimates will continue to meet the Registration Act's assets under management threshold. It is only the estimated 4,100 advisers who will not meet the Registration Act's greater threshold that should be required to proceed with the additional August 20 Filing. We therefore suggest that a more narrowly tailored rule addressed directly to such advisers be adopted in lieu of proposed rule 203A-5(a).

Additionally, proposed rule 203A-5(b) provides a transition period of only 90 days for investment advisers switching from SEC to state registration due to the implementation of the Registration Act. We understand that the Commission has proposed this shortened transition period, in lieu of the 180 days traditionally afforded such investment advisers,[46] in order to more promptly implement the Congressional Dodd-Frank Act mandates.[47] While we agree with the Commission that the registration mandate should be implemented with all due speed, we believe that a conventional, 180-day transition period would not undermine this goal. In view of the proposed rule requiring that "regulatory assets under management" be determined 30 days prior to the

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45 Implementing Release at 10. The Commission noted that its ability to effect the timely transition to state regulation is dependent on reprogramming the IARD system and recognizes the possibility of the programming not being complete within the proposed time, in which case the Commission would further delay implementation of the new thresholds. *Id.* at 12.

46 *See* Implementing Release at 11.

47 *See id.*

August 20 Filing, the transition timeline is compressed for advisers who are on the peripheries of the registration threshold, thus requiring a more rapid transition.[48]

We note also that the compressed compliance timeframe will be difficult for all advisers, and especially for the approximately 620 advisers registered with the Commission who are small advisers.[49] The brevity of the proposed 90-day period may not suffice to timely comply with the new regulatory requirements. For example, some advisers may not have personnel who are qualified, ready or willing to take the examinations required for many state-registered advisers by the compliance date. Others may have difficulty determining which state(s) they are required to register with, and whether they would be subject to examination as investment advisers by the applicable state securities commissioner.[50] By allowing the traditional 180 days, and by offering the additional possibility of an extension for good cause shown, the Commission would increase the likelihood of an orderly transition, for the benefit of all market participants.[51]

2. Exception during Transition Period for Current Registrants

We agree with the Commission's proposal to decrease the regulatory burden on advisers who reach the $25 million asset threshold prior to the effective date of the Registration Act or during the transition period. The Commission has indicated that it would not object if an investment adviser that reaches the $25 million asset threshold prior to the effective date of the Registration Act and during the subsequent transition period does not register with the Commission during the period beginning January 1, 2011 until the end of the transition period on October 19, 2011, provided that

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48 *See* Implementing Release at 172 (proposed rule 203A-5(a)). The intra-30-day valuation requirement will also be problematic, inasmuch as it will require a valuation in addition to the quarter-end valuations typically required by most advisers' advisory contracts. Flexibility to rely on a valuation as of an adviser's last fiscal quarter-end should not materially affect the calculation and would reduce the burden of complying with the additional filing.

49 *See* Implementing Release at 147-48.

50 As the Commission recognizes, there is a great deal of uncertainty in this area. *See id.* at 34-35.

51 The SEC acknowledges that IARD may not be ready to accept amended Form ADV by August 20, 2011, in which case the reporting deadline may be delayed. *Id.* at 46. We encourage the Commission to continue to delay implementation until the IARD system is ready to accept the new filings, as the IARD and IAPD systems are the most efficient mechanism for advisers and exempt reporting advisers to meet their filing obligations and make such filings available to the public.

the investment adviser: (1) reports on its Form ADV that it has between $30 million and $100 million of assets under management; (2) is registered as an investment adviser in the state in which it maintains its principal office and place of business; and (3) reasonably believes that it is required to be registered with, and is subject to examination as an investment adviser by, that state.[52] This policy would alleviate the regulatory burden on such investment advisers, and we commend the Commission for issuing this guidance so promptly.

3. Regulatory Assets Under Management

The Implementing Release also sets out the Commission's proposal for a uniform methodology for calculating "regulatory assets under management" or "RAUM" for the following purposes: (1) determining eligibility for SEC registration; (2) reporting assets under management on Form ADV; and (3) applying the new exemptions from registration under the Advisers Act for (a) advisers to private funds with less than $150 million in assets under management in the U.S. and (b) foreign private advisers.[53] The Commission also proposes related amendments to the Form ADV instructions to guide investment advisers in their calculation of assets under management for these purposes.[54]

These proposed amendments are a reversal of the policy currently reflected in Item 5.F. of Form ADV Part 1A, which permits an investment adviser certain discretion in choosing which assets to include in this calculation. This type of flexibility was provided in connection with the Investment Advisers Supervision Coordination Act,[55] and allowed certain advisers to opt into SEC or state registration.

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[52] Implementing Release at 13.

[53] *See* Implementing Release at 15-22. Similarly, the SEC is proposing to amend Advisers Act Rule 203A-3, 17 C.F.R. § 275.203A-3 (2010), to add a definition that would continue to require that "assets under management" for purposes of Advisers Act § 203A, 15 U.S.C. § 80b-3a, be the assets under management reported in the investment adviser's Form ADV. *Id.* at 16 & n.40; *see also id.* at 172 (proposed rule 203A-3(d)).

[54] *See* Implementing Release App. B, at 7-10 (proposed Form ADV: Instructions for Part 1A, instr. 5.b (Item 5.F: Calculating Your Regulatory Assets Under Management)).

[55] *See* National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, tit. III, 110 Stat. 3416, 3436-40 (amending sections of the Advisers Act, Title 15 U.S.C., and ERISA, Title 29, U.S.C.).

However, such discretion is contrary to the current Congressional registration mandate, and we agree in principle with the Commission's policy of establishing a standardized methodology for calculating RAUM.

The Proposed Rules specify that advisers must include in their RAUM assets in a securities portfolio for which an investment adviser provides continuous and regular supervisory or management services, as well as proprietary assets, assets managed without receiving compensation and assets of non-United States clients (all of which may (but are not required to) be included on the current Form ADV).[56] Although we are in agreement with that policy and the general formula, we understand that the Commission's proposed instructions prohibiting an adviser from subtracting outstanding indebtedness and other accrued fees and expenses or the amount of any borrowing from RAUM[57] could artificially and in certain cases grossly inflate an adviser's RAUM. Accordingly we request that indebtedness and accrued fees and expenses be excluded from the calculation as the result will more accurately reflect RAUM.

We also note that if an adviser managed only proprietary assets or assets without compensation it would not meet the definition of "investment adviser," which contemplates advice to others, for compensation.[58] Permitting an adviser to exclude these amounts would yield an RAUM figure that more closely approximates the actual value of "other people's money" managed by the adviser, which should continue to be the principal determinant of an adviser's regulatory status under the Advisers Act. We accordingly suggest that these amounts should be omitted from the RAUM calculation.

The Commission should also permit advisers calculating RAUM to value capital commitments and assets denominated in other currencies to use an average exchange rate over a period of 6 months to a year in order to reduce the impact of exchange rate volatility.

We also wish to provide comment on the Commission's proposed instructions regarding how an investment adviser to private funds must calculate

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[56] We also agree with the Commission's proposal to distinguish "regulatory assets under management" in Part 1A of Form ADV from the "assets under management" client disclosure in Part 2, which will likely be different. *See* Implementing Release at 17.

[57] *Id.* at 17 & n.48.

[58] Advisers Act § 202(a)(11), 15 U.S.C. § 80b-2(a)(11).

RAUM.[59] The Commission would now require an investment adviser to include the value of any private fund over which it exercises continuous and regular supervisory or management services, regardless of the nature of the assets held by the private fund. In other words, there is no requirement that the private fund assets consist of "securities."[60] Sub-advisers to a private fund would only include the portion of the portfolio over which they provide advisory services.[61] Uncalled capital commitments to private funds would be required to be included in assets under management under the proposed rule.[62] We generally concur with these proposals, which we understand are intended to result in a more coherent application of regulatory requirements and more consistent reporting across the industry.

However, the proposed instructions also require that an investment adviser determine for the RAUM calculation the "fair value" of the private fund assets.[63] There are numerous difficulties with "fair value" methodologies, which have previously been extensively studied by the Commission, particularly in the context of illiquid or inactive markets.[64] The Commission notes in the Implementing Release that such illiquid assets include "distressed debt" and certain types of emerging market securities that are not readily marketable.[65] Going further, private fund investments cover the full spectrum of illiquid assets; to cite only a few examples, such investments

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59 *See* Implementing Release at 18-21.

60 Implementing Release App. B, at 7 (proposed Form ADV: Instructions for Form ADV, Part 1A, instr. 5.b.(1) (Item 5.F: Calculating Your Regulatory Assets Under Management)).

61 *See* proposed Form ADV, Part 1A, Note to Item 7.B., *available at* http://www.sec.gov/divisions/investment/iard/iardfaq.shtml#item7B; proposed Section 7.B.2. of Schedule D, *available at* http://www.sec.gov/divisions/investment/iard/iardfaq.shtml#item7B; *see also* Implementing Release at 49-51 & n.153.

62 Implementing Release at 19; *id.* App. B, at 7 (proposed Form ADV: Instructions for Part 1A, instr. 5.b.(1) (Item 5.F: Calculating Your Regulatory Assets Under Management)).

63 Implementing Release App. B, at 9 (proposed Form ADV: Instructions for Part 1A, instr. 5.b.(4) (Item 5.F: Calculating Your Regulatory Assets Under Management)).

64 SEC, Office of the Chief Accountant, Division of Corporation Finance, Report and Recommendations Pursuant to Section 133 of the Emergency Economic Stabilization Act of 2008: Study on Mark-To-Market Accounting 8 (Dec. 30, 2008), *available at* http://www.sec.gov/news/studies/2008/marktomarket123008.pdf.

65 Implementing Release at 20 & n.57.

encompass the typical controlling or minority stake in a non-public company to investments in books, jewels, art, motion pictures, video games and new technologies. As oft-noted by the pundits during the height of the financial crisis, it is a challenge to insist on a "fair market value" for assets in which there is no market.

Although the "fair value" requirement as proposed does not require a particular determination in accordance with GAAP or other international accounting standards, it nevertheless would require advisers to apply a fair valuation method to highly illiquid assets and liabilities, which may over- or understate actual value. In these circumstances, the Commission should require advisers to value such assets in accordance with the method set out in the applicable advisory contract agreed between client and adviser and used by the adviser to calculate the dollar amount on which its fees are based.[66] In many cases, advisers are required to value illiquid assets at historical cost until a disposition thereof, an approach that has the virtue of being less likely to overstate value, as many advisers are contractually required to mark down assets that in the good faith judgment of the adviser have become permanently impaired. To the extent that a private fund is contractually required to use different valuation methods for different purposes, the Commission should also require that the adviser's RAUM be calculated accordingly. While these requirements may result in different advisers utilizing different methodologies and deriving different valuations for the same illiquid asset, we understand that the discrepancies should ultimately be proportional to the good faith differences in "fair valuation" that would otherwise inevitably result. Absent a showing of fraud or other attendant illegality, any margin in these cases should be left to conclusive resolution in accordance with the advisory contract negotiated between client and adviser. Only on a speculative basis might we conclude that one of these approaches is superior for purposes of reducing the incidence of fraud or otherwise improving valuations. In the absence of any such evidence, the approach we suggest has the comparative virtue of not imposing any additional costs or burdens on advisers, other than those their clients already require.

The Commission also solicited comment with respect to whether it should require an adviser to update its RAUM quarterly or any time the adviser files an other-than-annual amendment. The premise underlying the once-annual reporting with respect to assets under management has been that an adviser should not be required to undergo the costs and regulatory burden of changing its registration status back and forth due to fluctuations that occur during the course of the year.[67] We believe that the

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[66] *See id.* at 22-23.

[67] *Id.* at 23.

Commission's current rules in this regard reflect sound policy and appropriately balance the regulatory costs and burdens with the need for continuing oversight. Accordingly, we support the Commission's status quo with respect to annual reporting of RAUM.

4. Switching Between State and Commission Registration

The Implementing Release also sets out the Commission's proposed rule to amend rule 203A-1 under the Advisers Act to eliminate the $5 million buffer permitting investment advisers having between $25 and $30 million in assets under management to remain registered with state securities authorities rather than requiring such advisers to register with the Commission.[68] The Commission states that permitting an investment adviser to rely on its assets under management as reported annually on Form ADV (as opposed to more frequently) should be sufficient protection against such adviser's need to change registration status as a result of intra-year fluctuations in the value of its assets under management. As proposed, investment advisers no longer eligible for registration with the SEC would continue to have the benefit of the current 180-day grace period to switch to state registration.[69]

We recognize Congress' general determination to require advisers having between $30 million and $100 million to be registered with the states, and we agree with the Commission's suggestion that the utility of a buffer becomes more attenuated given the greater spread between the regulatory thresholds. However, given the difficulties in valuing RAUM and the regulatory costs and burdens associated with requiring variable registrations even from one year to the next, it seems that providing a small buffer for advisers whose RAUM are close to the registration thresholds remains the most appropriate, cost-effective balance. We note that Congress granted the Commission discretion in the Registration Act to adjust the assets under management thresholds under Advisers Act Rule 203A-1(a) as it may by rule deem appropriate in accordance with the purposes of Title IV.[70] A comparable buffer of $5 million would contribute to increased stability in the adviser's registration status by providing for continuous oversight by one regulator in circumstances where the adviser's RAUM fluctuate within a small, defined range. However, it would be more appropriate and

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68 *Id.* at 23-24.

69 *Id.*

70 *See* Advisers Act § 410, 15 U.S.C. § 80b-3a; rules 203A-1, 0-7, 17 C.F.R. §§ 275.203A-1, 275.0-7 (2010).

consistent to extend an equivalent buffer based on the previous formula. The previous $5 million buffer provided a 20% cushion, and for consistency, we submit that a similar 20% cushion based on the new threshold would be a superior alternative. In light of the new threshold, as equalized under the existing formula, the new buffer would be $20 million.

5. Elimination of Safe Harbor

The Implementing Release proposes the repeal of the safe harbor in rule 203A-4 that protects investment advisers who are not registered with the SEC, but who are instead registered with the state securities authorities in the state in which they have their principal office and place of business. This safe harbor applies so long as such investment advisers reasonably believe that they are prohibited from registering with the SEC because they do not have at least $30 million of assets under management. The Commission states that investment advisers have not relied on this defense, which only protects against enforcement actions, not private actions.[71]

While the original basis for the safe harbor related to the inclusion of non-discretionary assets in the adviser's assets under management and that would now be required for purposes of calculating RAUM, the general challenges in calculating RAUM are still similar to what they were at the time the safe harbor was adopted. Given the potential challenges in accurately calculating assets under management, we believe maintaining the safe harbor provided by Rule 203A-4 and extending its availability to the increased registration threshold is the better regulatory result.

6. Repeal of Certain Exemptions from Prohibition on Registration

In light of recent developments since the adoption of certain exemptions from registration, the Commission proposes to: (1) eliminate the exemption that permits nationally recognized statistical rating organizations ("NRSROs") to register with the

[71] The SEC views the safe harbor as no longer applicable since it was adopted for smaller investment advisers with less than $30 million in assets under management who may not have been able to calculate their assets. The SEC believes that investment advisers with more than $100 million in assets under management would be aware of their assets under management. Implementing Release at 30-31.

SEC;[72] (2) narrow the exemption pertaining to pension consultants by increasing the minimum value of relevant plan assets from $50 million to $200 million (which corresponds to the increase from $25 million to $100 million as the threshold for registration with the SEC under section 410 of the Dodd-Frank Act);[73] and (3) amend the multi-state adviser exemption for small investment advisers to align it with the Registration Act's multi-state adviser exemption for mid-sized investment advisers by permitting SEC registration by all investment advisers otherwise required to register with 15 or more states (rather than the current 30-or-more-states requirement under the multi-state adviser exemption and the current 25-state requirement for SEC-registered investment advisers).[74]

We agree with the Commission's Proposed Rules in this area. We also share the opinion that section 410 of the Dodd-Frank Act reflects a Congressional view on the number of states (15) with which an adviser must be required to register before the regulatory burdens associated therewith warrant registration solely with the Commission and application of the federal preemption provisions of the Advisers Act.[75] Further to our comments with respect to promoting greater continuity and uniformity, as well as equalizing buffers, we also support application of the 15-state threshold to all advisers (and not only mid-sized advisers) and the establishment of a new 5-state buffer that permits such advisers to remain registered with the Commission even if they are no longer registered in 5 of the states in which they were initially registered.

7. Reporting by Exempt Reporting Advisers

Although the Registration Act excuses exempt reporting advisers from having to register with the SEC, it is silent with respect to overlapping state oversight and such advisers may still be required to register with one or more states.[76] Although

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72 *See* Rule 203A-2(a) under the Advisers Act, 17 C.F.R. § 275.203A-2(a) (2010). Since the SEC adopted this exemption, Congress amended the Advisers Act to exclude NRSROs and provided for a separate regulatory regime for them under the Exchange Act. Implementing Release at 26.

73 *See* Rule 203A-2(b) under the Advisers Act, 17 C.F.R. § 275.203A-2(b) (2010); *see also* Implementing Release at 27, 170 (proposed rule 203A-2(a)).

74 Implementing Release at 28-30, 170-71 (proposed rule 203A-2(d)).

75 *See* Advisers Act § 410.

76 Implementing Release at 38.

such advisers are excused from SEC registration, the Registration Act specifically directs the Commission to require exempt reporting advisers to (i) maintain certain records as determined by the Commission, which it shall have the authority to examine, and (ii) submit such reports as the Commission determines necessary or appropriate in the public interest.[77]

In exercising this authority, the Commission proposes new rule 204-4, which would require exempt reporting advisers to e-file reports on IARD responding to a limited subset of items on the revised Form ADV, which is proposed to become both a registration form and an exempt reporting adviser form.[78] As currently proposed, these items include: (1) identifying details, such as the exempt reporting adviser's name, address, contact information, form of organization and ownership;[79] (2) the exemption it is relying on to report, rather than register, with the SEC;[80] (3) its, and certain of its affiliates', disciplinary histories, other business activities and financial industry affiliations;[81] and (4) information about any private funds that it advises.[82]

The Implementing Release indicates that the Commission considers that the information so reported would permit it to determine whether these investment advisers or their activities present sufficient concerns as to warrant further attention from the SEC to protect their clients, investors or other market participants.[83] We

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77 Dodd-Frank Act §§ 407, 408, 124 Stat. at 1575 (amending Advisers Act § 203, 15 U.S.C. 80b-3).

78 The Commission also indicates that exempt reporting advisers that are required to register with a state can also use Form ADV to satisfy their state and SEC filing requirements. Implementing Release at 38.

79 Implementing Release App. D, at 1-4, 6, 16 (proposed Form ADV Part 1A, Items 1 (Identifying Information), 3 (Form of Organization) and 10 (Control Persons).

80 *Id.* at 6 (proposed Form ADV Part 1A, Item 2.C (SEC Reporting by *Exempt Reporting Advisers*)).

81 *Id.* at 11, 12, 16 (proposed Form ADV Part 1A, Items 6 (Other Business Activities), 7A (Financial Industry Affiliations and *Private Fund* Reporting) and 11 (Disclosure Information).

82 *Id.* at 12 (proposed Form ADV Part 1A, Item 7.B. (Financial Industry Affiliations and *Private Fund* Reporting)). Exempt reporting advisers are not proposed to be required to complete or file Items 4, 5, 8, 9, or 12 in Part 1 of Form ADV or a client brochure (Part 2 of Form ADV). The SEC should not require exempt reporting advisers to complete these Items or provide a brochure. This additional disclosure would impose additional reporting, and in the case of Part 2, it would duplicate much of the disclosure in the private placement memoranda investors typically receive.

83 Implementing Release at 41.

respectfully disagree. Although the Commission in the Implementing Release frequently refers to the benefits of these proposals,[84] the cost-benefit analysis is sparse, and the Commission has relied on the premise that the additional data collection would permit it to identify risks to these advisers' investors.[85] This would represent a misallocation of the Commission's regulatory resources, as these advisers manage private funds for sophisticated investors who are capable of "fending for themselves" and who do not need the protection of the securities laws.[86]

Although we concur with the Commission that Congress endowed it with expansive authority to regulate exempt reporting advisers,[87] it does not follow that such authority should be exercised by imposing onerous reporting and updating requirements that do not serve the interests of investors or the markets. Congress created a category of "exempt" reporting advisers and the Proposed Rules currently do not distinguish sufficiently between registered and exempt reporting advisers. In fact, the Commission inquires whether the reporting obligations for the two classes of advisers should be identical.[88] We would respond in the negative, noting that the cumulative effect of the Proposed Rules is to require excessively burdensome reporting, recordkeeping and related compliance obligations for exempt reporting advisers, where Congress instead determined that a lower level of regulatory oversight was appropriate.

In general, we propose that the Commission consider limiting the disclosure obligations for an exempt reporting adviser to (i) its identifying details, (ii) recitation of the exemption it is relying on to report, rather than register, with the SEC, and (iii) disciplinary disclosure. The Commission should require updates upon the occurrence of any material changes rather than annual filings, and should permit these advisers to facilitate disclosure to their clients as they deem necessary and appropriate in accordance with their fiduciary obligations, but without imposing any brochure delivery requirements. Information about any private funds under the exempt reporting adviser's management should not be required to be disclosed (for the same reasons we

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[84] *Id.*

[85] *Id.* at 42.

[86] *See, e.g.*, Defining the Term "Qualified Purchaser" under the Securities Act of 1933, Securities Act Release No. 8041 (Dec. 19, 2001), *available at* http://www.sec.gov/rules/proposed/33-8041.htm.

[87] Implementing Release at 41.

[88] *Id.* at 43.

discuss in the following section), although the Commission should impose recordkeeping requirements and retain authority to conduct examinations and request additional information as it deems appropriate.

We also take advantage of this opportunity to underscore the anomalous result that "exempt" reporting advisers who have less than $100 million in assets under management are potentially subject to greater regulation at the state level than certain of their colleagues who have between $100 million and $150 million in assets under management and may be largely exempt therefrom. There is no indication in the Registration Act's legislative history that Congress intended such an awkward outcome, and we suggest the Commission and the state regulators work together to equalize this unfortunate result. We commend the efforts of the North American Securities Administrators Association, Inc. ("NASAA") in this regard,[89] although we favor a federal solution that produces a neutral result for federally exempt reporting advisers, i.e., preemption of state-imposed requirements to the same extent enjoyed by SEC-registered advisers.

8. Private Fund Reporting

The Commission's proposed amendments to Form ADV would now require not only registered investment advisers, but also exempt reporting advisers, to complete newly expanded Item 7.B. of Part 1A. The new requirements are intended to provide information regarding the basic organizational, operational and investment characteristics of the private fund, its gross and net asset values, the types of investors in the private fund and its service providers.[90] The Commission would require reporting on all private funds, regardless of their form of organization, but would no longer require investment advisers to report on private funds advised by affiliates to avoid duplicative reporting since both registered investment advisers and exempt reporting advisers would be required to complete proposed Section 7.B. of Schedule D.[91]

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[89] NASAA has proposed model rules in this regard. *See* NASAA, Proposed NASAA Model Rule on Private Fund Adviser Registration and Exemption, *available at* http://www.nasaa.org/content/Files/Exempt_Report_Adviser_Model%20Rule.pdf.

[90] Implementing Release at 51.

[91] We separately note that question 19 in Section 7.B.1. (Private Fund Reporting) of Schedule D to Form ADV Part 1A is ambiguous and seems misplaced. *See* Implementing Release at 31.

The Commission states that the new disclosure would assist it in assessing private fund advisers for purposes of targeting examinations.[92] That may be the case, however, certain Form ADV disclosure requirements are needlessly burdensome for advisers, as well as duplicative. For example, the questions relating to whether a private fund relies on an exemption from registration of its securities under Regulation D of the Securities Act of 1933 and, if so, to provide the file number, requires disclosure of information that is already public and easily accessible via EDGAR.[93]

The Commission also indicated in its request for comments that it sought to avoid disclosure of proprietary information about private funds but seeks comment as to whether it succeeded.[94] We note the Commission's proposal to allow investment advisers to use a code rather than a legal name to identify a private fund, so as to preserve that client's anonymity.[95] However, for many advisers, their fund products are readily identifiable by competitors based solely on the investment strategy, and a code would not suffice to protect this unprecedented disclosure of sensitive proprietary information, such as whether a private fund is part of a master-feeder structure or a fund of funds. All of this information is and should remain proprietary, strategic information, not subject to scrutiny by other market participants. Similarly, given that Item 5.F. requires disclosure of the adviser's RAUM, what additional regulatory purpose is served by the public disclosure of the gross and net asset values of each of the adviser's private funds?[96] Again, this is proprietary, strategic information that advisers should not be required to make public.

When the Commission recently considered public disclosure of net asset values of private funds in connection with its 2008 amendment of Form D, it provided ranges rather than requiring a particular dollar amount of disclosure and also allowed a "Decline to Disclose" option, recognizing that it would reduce the amount of

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[92] *Id.* at 48.

[93] *See id.* at 31 (questions 23-24 in Section 7.B.1. (Private Fund Reporting) of Schedule D to Form ADV Part 1A).

[94] Implementing Release at 56.

[95] *Id.* at 52.

[96] *Id.* at 30 (proposed Form ADV question 11 in Section 7.B.1. (Private Fund Reporting) of Schedule D).

information it received.[97] The Commission also acknowledged that market participants regard this type of information as confidential, and after weighing these countervailing considerations in light of the importance of the information, it determined, on balance, that it is best to provide filers the option to decline to disclose.[98]

While we recognize the crucial regulatory imperatives that are involved, we believe that the balance continues to be the same and that it extends to all of the information proposed for disclosure. The public disclosure of this information would not protect the sophisticated investors that participate in the private funds managed by such advisers and neither would it contribute to the stability of the financial markets. Rather than requiring all private fund advisers to publicly disclose proprietary information, it would enhance and better direct regulatory oversight if the Commission separately and privately solicited this and any other information it deemed appropriate from those advisers whose RAUM disclosures in Item 5.F so merit, such as is proposed to be required on proposed Form PF.[99] This type of narrowly tailored solicitation would better focus scarce oversight and examination resources, while protecting the sensitive, confidential information about an adviser's services to its private fund clients. For these reasons, other than requiring disclosure of (1) whether the adviser provides advisory services to a private fund and (2) whether the adviser provides sub-advisory services to a private fund, we believe the remainder of the Schedule D Section 7B disclosure with respect to private funds should be omitted.

9. Service Providers to Private Funds – Section 7.B.1.B.

This section would require investment advisers to report information concerning certain service providers or "gatekeepers" of each private fund advised by the investment adviser, i.e., its auditors, prime brokers, custodians, administrators and marketers. As proposed by the Commission, the investment adviser would need to indicate with respect to each such service provider: (i) whether it is a related person and (ii) identifying information, such as its registration or regulatory status.

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97 *See* Electronic Filing and Revision of Form D, Securities Act Release No. 8891, Exchange Act Release No. 57,280, Investment Company Act Release No. 28,145, at 23-25 (Feb. 6, 2008), *available at* http://www.sec.gov/rules/final/2008/33-8891.pdf.

98 *Id.*

99 *See* Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, Release No. IA-3145 (Jan. 26, 2011) (to be codified at 17 C.F.R. pts. 275, 279), *available at* http://sec.gov/rules/proposed/2011/ia-3145.pdf.

For the reasons set out in the preceding section, this proposed disclosure would result in an unwarranted ventilation of competitively sensitive information. Many advisers prefer to maintain a low profile, and do not and may not make public announcements of their offerings, financings or other activities, particularly if they relate to private fund investments in an area where competition to develop new products or services is intense. The electronic posting of Form ADV may create a business problem for these advisers and their private funds, by making information publicly available about their private activities that they had not otherwise wanted or been required to disclose.

In our judgment, the Commission has not provided any explanation as to how this disclosure would contribute to the effective oversight of the markets and the protection of investors. Investors or other interested parties are already apprised of the identities or roles of the service providers (or capable of obtaining the information). Investors in private funds have ample opportunities to conduct due diligence with respect to the funds and fund management prior to submitting their subscription agreements. Moreover, the Commission may readily obtain this information upon request or in connection with an examination of the adviser. We accordingly request that the Commission reconsider this proposal.

10. Disclosure of Adviser's Legal Counsel

The Commission also requested comment with regard to whether it should require advisers to report identifying information about their legal counsel on Form ADV.[100] For the same reasons we presented above regarding the proposed disclosure about the other service providers to private funds, requiring disclosure of the adviser's legal counsel (whether in-house or independent) would also be detrimental and unnecessary for purposes of regulating the adviser. Moreover, it may also be misleading, as in many instances, counsel may not be retained to assist with the preparation of Form ADV and the inclusion of counsel's name may imply that the filing received a greater level of review in cases where it has not had such benefit. Further, requiring investment advisers to include such information may suggest or imply that the Commission considers counsel's review to be necessary, required or otherwise recommended (as opposed to well advised), thus contributing to the escalating costs of preparing and updating Form ADV and intervening in the filer's determination of whether to self-represent. We deem the cumulative effect of such a requirement and its

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[100] Implementing Release at 56.

potential ramifications to be highly problematic, and we accordingly recommend that the Commission omit any such disclosure requirement.

11. Proposed Amendments to "Pay-to-Play" Rule

The Implementing Release also proposes various amendments to Advisers Act rule 206(4)-5.[101] We agree with the Commission that the rule should apply to exempt reporting advisers and foreign private advisers.[102] However, the proposed rule limits permissible third-party placement agents to a "regulated municipal advisor," defined as a municipal advisor registered with the Commission under section 15B of the Securities Exchange Act of 1934 that is subject to the Municipal Securities Rulemaking Board's pay-to-play rules on political contributions.[103]

As the Commission recognizes, rule 206(4)-5's solicitation limits could be read to apply to solicitors affiliated with the investment adviser.[104] In short, an adviser's affiliates would be banned from soliciting for the adviser — a sub-optimal regulatory result. Why should an adviser have to pay a third party for services that could be performed by an affiliate that is registered as a municipal advisor and subject to the same regulation as the third-party? This result would require the registered adviser to provide confidential information about its proposed services or securities offering to a third party under circumstances where that information could be kept "in house" without compromising the authority of any regulator. An employee of an investment adviser's affiliate should accordingly be permitted to solicit municipal entity business on behalf of the adviser as long as he or she is treated as the adviser's "covered associate."[105] We agree with the proposed solution set out in the Commission's request for comment, which would be to amend rule 206(4)-5 to provide that any person that

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[101] *Id.* at 68 (proposed rule 206(4)-5).

[102] *Id.* at 69.

[103] *Id.* at 69 n.215 (proposed rule 206(4)-5(a)(2)(i)).

[104] *Id.* at 72 & n.224.

[105] *See id.* at 73 n.225 (rule 206(4)-5(f)(2) (defining a "covered associate" of an investment adviser as: "(i) Any general partner, managing member or executive officer, or other individual with a similar status or function; (ii) Any employee who solicits a government entity for the investment adviser and any person who supervises, directly or indirectly, such employee; and (iii) Any political action committee controlled by the investment adviser or by [any other covered associate]")).

controls, is controlled by, or is under common control with an investment adviser (and, if that person is an entity, its personnel) would be deemed to be a "covered associate" of the investment adviser if the investment adviser pays or agrees to pay such person (or such personnel) to solicit a government entity on its behalf.[106] We also agree with the Commission's proposed technical amendment of rule 206(4)-5 to clarify that the term "covered associate" includes legal entities as well as natural persons.[107]

12. Annual Amendments

The Commission also requested comment with respect to a possible reduction from 90 to 60 days for an adviser to file its annual amendment following its fiscal-year-end.[108] The Commission stated that this change would provide more timely information to the public. We note, however, that many registered advisers have difficulty complying with the existing 90-day timeframe, because in order to provide complete information, they must await reports with respect to their portfolio companies or other illiquid assets, as well as their portfolio fund investments in the case of a fund of funds and any assets managed by a third-party. For many private advisers, this constitutes the majority of their portfolio. In light of the proposed broadening of the disclosure requirements, such a reduction would require advisers to disclose more, and with less time. We believe this proposed change would further increase advisers' regulatory burden and expense without a corresponding enhancement to the quality or timing of the disclosure.

13. Reporting $1 Billion in Assets

Pursuant to Section 956 of the Dodd-Frank Act, the Commission has also proposed additional disclosure to identify advisers with $1 billion or more in assets.[109] We agree with the Commission's proposal to define "assets" for these purposes to mean the total assets of the advisory firm rather than its total "assets under management."[110]

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[106] *Id.* at 72-73.

[107] *See id.* at 73 & n.225 (proposed rule 206(4)-5(f)(2)).

[108] Implementing Release at 67.

[109] *Id.* at 63-64.

[110] *Id.* at 64 & n.196.

However, the Commission should clarify the proposal that the amount of reportable assets should be the adviser's total assets determined in the same manner as the amount of "total assets" is determined on the adviser's balance sheet for its most recent fiscal year end. In particular, we note that consolidation rules under generally accepted accounting principles ("GAAP") may require an adviser to include in its balance sheet the assets of some or all of the private funds it manages on behalf of outside investors, unless the adviser has taken steps to deconsolidate these fund assets. Absent clarification, a balance sheet measure could lead to arbitrary differences in result for similarly-situated advisers, where the only distinction is whether the adviser consolidates or does not consolidate third party fund assets. We accordingly recommend that the Commission confirm that an adviser may exclude third-party assets for these purposes, notwithstanding the application of GAAP.

14. Request for Additional Comment Period

Given the tremendous impact of these proposals on advisers, their investors, and the markets, if timing and regulatory resources should so permit, we respectfully request that the Commission consider re-proposing the rules and amendments contemplated in both the Exemptions Release and Implementing Release, and provide an extraordinary additional comment period prior to its planned adoption of final rules in the second quarter.[111]

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[111] SEC, Implementing Dodd-Frank Wall Street Reform and Consumer Protection Act — Upcoming Activity (modified Mar. 3, 2011), *available at* http://www.sec.gov/spotlight/dodd-frank/dfactivity-upcoming.shtml#04-07-11 (last visited Mar. 9, 2011).

We are grateful for the opportunity to provide these comments on the Proposed Rules and for the Commission's attention and consideration. We hope that our comments, observations, and recommendations contribute to the important work of the Commission in carrying out the regulative initiatives under the Dodd-Frank Act. We would be happy to discuss these comments further with the Staff.

Respectfully submitted,

SECURITIES REGULATION COMMITTEE

By: /s/ Howard Dicker
Howard Dicker
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