GOODWIN | PROCTER

Elizabeth Shea Fries
617.570.1559
efries@
goodwinprocter.com

Goodwin Procter LLP
Counselors at Law
Exchange Place
Boston, MA 02109
T: 617.570.1000
F: 617.523.1231

February 2, 2011

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20001

Re: Proposed Rule Regarding 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 Release No. 3111, File No. S7-37-10 (Nov. 19, 2010)

Dear Ms. Murphy:

Goodwin Procter LLP ("Goodwin" or "we"), on behalf of certain of our clients, appreciates the opportunity to provide comments to the Securities and Exchange Commission (the "Commission") on proposed rules under the Investment Advisers Act of 1940 (the "Advisers Act") that would clarify key aspects of new statutory exemptions from registration under the Advisers Act for venture capital fund advisers, private fund advisers with less than $150 million in assets under management and foreign private advisers (the "Proposed Rules") under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

Although not specifically raised by the Commission's proposing release setting forth the Proposed Rules, this comment letter focuses on the applicability of the Proposed Rules to persons that advise their own employees' securities companies[1] and/or other funds that solely

---

1 "Employees' securities company" is defined in Section (2)(a)(13) of the Investment Company Act of 1940 (the "1940 Act") as:

> any investment company or similar issuer all of the outstanding securities of which (other than short-term paper) are beneficially owned (A) by the employees or persons on retainer of a single employer or two or more employers each of which is an affiliated company of the other, (B) by former employees of such employer or employers, (C) by members of the immediate family of such employees, persons on retainer,

benefit the person, the person's employees or affiliated employees, persons on retainer, former employees or members of the immediate family of such employees, persons on retainer and/or former employees ("Employee Funds"). We agree with the statement by the Commission staff (the "Staff") and the Staff's historical position that "the employer-employee relationship is unlike the commercial relationship between an investment adviser and its client that the Advisers Act was intended to regulate."[2] We believe that employers that provide investment advisory services to, or on behalf of, their employees through Employee Funds do so not for profit but as a service to attract and retain those employees. Accordingly, we respectfully recommend that, as part of the Proposed Rules, the Commission also consider creating a voluntary exemption, as further described below, for employers (including their subsidiaries) that provide investment advice solely to their own Employee Funds.[3]

Prior to the enactment of the Dodd-Frank Act, several employers relied on the "private adviser" exemption in Section 203(b)(3) of the Advisers Act to provide investment advice to their Employee Funds without registration under the Advisers Act so long as the aggregate number of such Employee Funds totaled less than fifteen.[4] While the Dodd-Frank Act will intentionally eliminate the "private adviser" exemption later this year, it will unintentionally remove the key mechanism for those employers to avoid the unnecessary and costly requirements of registration under, and compliance with, the Advisers Act.

As noted above, the Staff has recognized that the Advisers Act was intended to govern commercial, and not employer-employee, relationships. In a 1995 no-action letter, the Staff considered whether employer-sponsors of defined contribution plans that provide certain types of investment-related information to their employees who participate in those plans were

---

or former employees, (D) by any two or more of the foregoing classes of persons, or (E) by such employer or employers together with any one or more of the foregoing classes of persons.

2 *See* Olena Berg (pub. avail. Dec. 5, 1995) (the "1995 Berg Letter").

3 To avoid any benefits that certain employers may obtain by registering under the Advisers Act, we believe that the exemption should be one that is voluntary to avoid requiring employers already registered with the Commission as investment advisers from having to de-register.

4 Section 203(b)(3) of the Advisers Act, in relevant part, currently provides relief from the registration requirements of the Advisers Act to any investment adviser who during the course of the preceding twelve months 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 an investment company registered under the 1940 Act. We note that, while "employees' securities companies" may be deemed to be investment companies under the 1940 Act, the employees' securities companies that we represent and that we believe should be included as "Employee Funds" for purposes of this comment letter would only be those that have received exemptive relief from the Commission from the registration requirements under the 1940 Act.

investment advisers.[5] In concluding that such employers were not investment advisers, the Staff noted the unique nature of the employer-employee relationship and that the employers were providing such investment-related information to their employees without a profit motive but in an attempt to educate those employees. Similarly, employers generally do not establish Employee Funds in order to seek a profit but to compensate and reward their own employees for their services.

In this regard, we believe that employers that only provide investment advisory services to Employee Funds and only receive reimbursements do not seek or receive profits for such services and should not be treated as, or required to register as, investment advisers.[6] In 2006, the Staff, consistent with this position, provided relief from the Advisers Act registration requirements to an entity that furnished investment advisory services solely to its own employee benefit plans and certain of its own trusts.[7] The Staff noted that such relief was based on, among other things, the fact that the only amounts received by the employer were reimbursements subject to the restrictions imposed by the Employee Retirement Income Security Act of 1974 ("ERISA").[8] Although the employer subsidiary in the Lockheed Letter advised not only employee benefit plans subject to ERISA, the representation that the reimbursements were consistent with those permitted under ERISA applied to each of the entities to which it provided investment advisory services, including its own trusts and other employee benefit plans that were not subject to ERISA. We believe that a similar standard could be used in exempting employers advising solely Employee Funds.

Employees' securities companies, which typically seek and receive exemptive relief from the Commission from several provisions of the 1940 Act, may be limited to paying fees that are

---

5 *See* 1995 Berg Letter, supra note 2 *See also* Olena Berg (pub. avail. Feb. 22, 1996).

6 We understand that the Staff has viewed the receipt of expense reimbursements as a form of compensation and an indication that a person is an investment adviser. *See, e.g.*, Daughters of National Charity Health System, Inc. (pub. avail. Apr. 3, 1998) and Northeastern Pennsylvania Synod of the Evangelical Lutheran Church in America (pub. avail. May 25, 1988). *See also* Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons who Provide Investment Advisory Services as a Component of Other Financial Services, Investment Advisers Act Release No. 1092 (Oct. 8, 1987). However, we do not believe that an employer's receipt of such reimbursements should require that employer to register under the Advisers Act when such employer only provides investment advisory services to Employee Funds. Any such investment advisory services would only serve to benefit a narrow universe of persons of which the employer is intending to compensate and retain and not make a direct profit from.

7 *See* Lockheed Martin Investment Management Company (pub. avail. June 5, 2006) ("Lockheed Letter").

8 ERISA permits plan fiduciaries to receive reimbursements for their "direct expenses," which do not include any profit element or allocable portion of overhead costs. *See* 29 CFR 2550.408c-2 (2011).

designed to reimburse such employers for any expenses incurred in establishing such funds.[9] Likewise, other funds that benefit employees, such as employee benefit plans that are subject to ERISA are limited to paying employer fiduciaries reimbursements of the direct expenses properly and actually incurred by them.[10] If these payments would cause an employer to be deemed an investment adviser and to register as such, employers would be forced to bear these expenses themselves. By limiting the costs received by the employers of such Employee Funds relying on such exemption to expense reimbursements, the Commission could ensure that the proper employees are subsidizing such services and that such employers are not engaged in any profit-making activities that are inconsistent with the Staff's view.

Further, we note that Employee Funds are often covered by other regulatory regimes that impose substantive regulations on the funds to protect investors in those funds. Employees' securities companies are generally regulated by the 1940 Act and employee benefit plans are generally governed by ERISA. Each of these regulatory frameworks ensures that investors in those funds are protected from those that provide investment advisory services to those funds. For example, ERISA imposes fiduciary obligations on employer fiduciaries providing investment advisory services to such funds. By exempting employers that provide investment advisory services from the registration requirements of the Advisers Act, the Commission would be saving employers who should not be regulated as investment advisers from the additional costs and burdens of registration and this potentially overlapping regulatory regime.[11]

The Commission has previously considered and adopted rules consistent with this view. In 1976, the Commission adopted a rule that excluded in-house asset managers from the definition of "investment adviser" under the Advisers Act if they provided investment advice to an employee benefit plan sponsored by an employer of such person, if such person did not engage in the business of providing investment advice or management to others and did not hold

---

9 *See, e.g.*, TWB Investment Partnership, L.P., Investment Company Act Release Nos. 28528 (Dec. 9, 2008) (notice) and 28576 (Jan. 6, 2009) (order) (employees' securities companies permitted to reimburse employer for reasonable out-of-pocket expenses specifically attributable to the organization and operation of the companies, excluding the allocation of any of the employers' operating expenses to the companies) and GDC Partners Fund, LLC, Investment Company Act Release Nos. 25768 (Oct. 15, 2002) (notice) and 25801 (Nov. 12, 2002) (order) (employees' securities companies permitted to reimburse the employer for direct costs of disbursements and expenses incurred by GDC on behalf of the fund).

10 *See supra* note 8.

11 In addition, the requested rulemaking would permit the Commission or the Staff to continue to deem certain of those employers, who may not be registered, investment advisers under the Advisers Act. Specifically, although employers that solely advise Employee Funds would be exempt from Advisers Act registration requirements, such employers may still meet the definition of "investment adviser" and be subject to liability for fraudulent activities under Section 206 of the Advisers Act.

himself out generally to the public as an investment adviser. The rule was enacted to prevent trustees of employee benefit plans from registering as investment advisers to escape liability under ERISA. Such rule was rescinded in 1983, not because the Commission did not feel that such entities should not be regulated, but because many of the in-house managers that had voluntarily registered with the Commission as investment advisers had already withdrawn their registration as a result of the rule. In rescinding the rule, the Commission also noted that employers would typically be exempt from registration under Section 203(b)(3) of the Advisers Act.

With the impending repeal of Section 203(b)(3) of the Advisers Act by the Dodd-Frank Act, we encourage the Commission to consider the creation of an exemption for employers that provide investment advisory services solely to Employee Funds in connection with the adoption of the Proposed Rules. Such an exemption would permit employers that provide investment advisory services to attract and retain their employees to avoid the unintended consequences and costs that would result through the implementation of the Dodd-Frank Act.

****

We appreciate the opportunity to comment on the Proposed Rules and respectfully request the Commission consider the comments and recommendations set forth above. We are available to discuss these comments or recommendations should the Commission or the Staff have any questions. Thank you once again for the opportunity to provide comments on the Proposed Rules.

Sincerely,

Elizabeth Shea Fries

cc: Mary L. Schapiro, Chairman
Kathleen L. Casey, Commissioner
Elisse B. Walter, Commissioner
Luis A. Aguilar, Commissioner
Troy A. Paredes, Commissioner
Jennifer B. McHugh, Acting Director, Division of Investment Management
David A. Vaughn, Attorney Fellow, Division of Investment Management
Danielle Marchesani, Attorney, Division of Investment Management
Tram N. Nguyen, Attorney, Division of Investment Management