Alternative Investment Management Association

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549
USA

Submitted via the SEC website **S7-37-10** and **S7-36-10**

24 January 2011

Dear Sir / Madam,

The Alternative Investment Management Association ('AIMA'[1]) appreciates the Securities and Exchange Commission's (the 'Commission') invitation to comment on its proposed rule-making in relation to certain rules and exemptions to the investment adviser registration requirement introduced by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the 'Dodd-Frank Act') as proposed in the Releases on 'Rules Implementing Amendments to the Investment Advisers Act of 1940' (the 'Implementing Release') and on 'Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers' (the 'Exemptions Release').

The registration requirement introduced by the Dodd-Frank Act will require certain of AIMA's manager members – as 'advisers' - to become registered with the SEC. AIMA has been consistent in its support for ensuring that investment advisers are subject to appropriate levels of supervision by competent regulatory authorities, so that, in principle, the registration requirement presents no concern for AIMA and its members. We expect that many of our managers who are not based in the United States will, however, be able to avail themselves of the private fund adviser exemption.

We are grateful to the Commission for the helpful clarification provided in the Releases of various particulars of the proposed rule-making, especially as regards interpretation of the private fund adviser exemption and, for example, the proposed addition to section 202(a)(30) of the Investment Advisers Act of 1940 (the 'Advisers Act'), to allow a foreign private adviser to treat as a single US investor any person who is an investor in two or more private funds advised by such adviser and thus avoid double-counting of private funds and their investors, for the purposes of the 'client', 'investor' and 'AUM' thresholds stipulated in the exemptions.

We are, however, concerned as to the impact for non-US advisers of the reporting and examination regime to which they will become subject under the exemption for private fund advisers and we seek clarification in respect of other specific provisions and definitions, especially as they affect non-US advisers. Our comments are in respect of both Releases, as we believe that they cover the same broad policy areas and that neither set of proposals should be considered in isolation.

[1] AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector – including hedge fund managers, fund of hedge funds managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,200 corporate bodies in 45 countries, with 11% based in the US and over 30% of AIMA members' total assets under management (AUM) managed by US investment advisers.

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A. Foreign private adviser exemption

Although the conditions for a non-US fund adviser to qualify for this exemption are quite prescriptive, non-US fund advisers who advise solely "private funds" and have no place of business in the US should be able to rely on this exemption.

We anticipate, however, that many of AIMA's members, even if they have no place of business in the US and do not hold themselves out to the public in the US as investment advisers, will not be able to bring themselves within the prescribed limits of fewer than 15 clients in the US and investors in the US in private funds advised by the adviser and less than $25 million assets under management attributable to such clients and investors.

As a preliminary point, such a threshold for assets under management is exceedingly low. Section 202(a)(30)(C) of the Advisers Act provides the Commission with authority to increase the $25 million threshold and we submit that a reasonable, fair and proportionate threshold would be at least $100 million, being the minimum 'trigger' for registration with the Commission instead of a state regulator.

For AIMA's members who may be able to avail themselves of this exemption as proposed, the counting rules and definitions present fewer issues than arise in respect of the private fund advisers exemption (see B below). However, we seek clarification of some points, as set out below.

1. Counting rules – investors in a private fund

a. Sub-advisers / affiliates

As expressly stated in the Exemptions Release, sub-advisers should be able to rely on each of the new exemptions available - to private fund advisers, foreign private advisers and venture capital fund advisers. Consistent with past interpretation by the Commission's staff (the 'Staff'), the activities of an advisory affiliate should not be attributed to an adviser that seeks to rely upon the new exemptions, except if the affiliate is not separately formed or, if separately formed, it does not operate independently of such affiliate. In any such case, US persons who are provided advisory services (including research) by personnel of an affiliate which is deemed to be an "associated person" of the adviser should be counted as clients of the adviser under the *Unibanco* line of no-action letters (*Uniao de Bancos de Brasilerios S.A.*, Pub. avail. July 28, 1992). However, other clients of such an affiliate should not be counted as clients of the adviser.

The activities described above should be distinguished from a situation in which a US adviser establishes a discretionary account solely for the benefit of a US client with a non-US advisory affiliate that, in turn, delegates complete management of the account to the US adviser. In such circumstances, the Rule would depart from the definition of "U.S. person" under Regulation S and deem the non-US discretionary account to be a "U.S. Person" in order to prevent abuse of the exemption. AIMA recognises the legitimacy of the Staff's concern but believes that this special provision should be narrowly drawn in order that legitimate sub-advisory relationships between a US adviser and its non-US affiliates are not frustrated.

b. Third party holders of instruments that effectively transfer invesment risk

The Exemptions Release provides that "an adviser would need to count as an investor any holder of an instrument, such as a total return swap, that effectively transfers the risk of investing in the private fund from the record owner of the private fund's securities."

The Dodd-Frank Act defines a "swap" to include "any agreement, contract or transaction commonly known as . . . a total return swap." However, it does not define the term "total return swap" and that term is not defined in the Securities Exchange Act of 1934 (the 'Securities Exchange Act'), the Investment Companies Act of 1940 or the Advisers Act. We also note that Section 766 of the Dodd-Frank Act amends Section 13(d)(1) and Section

13(g)(1) of the Securities Exchange Act to subject to the reporting requirements thereunder any person who "becomes or is deemed to become a beneficial owner of [any class of specified equity securities] upon the purchase or sale of a security-based swap that the Commission may define by rule". However, the Commission has not yet addressed these issues by rule-making. Because of the lack of clarity in the definition of "total return swap" and the importance of the treatment of such instruments under various provisions of the securities laws, AIMA recommends that this matter be the subject of further analysis and guidance to the industry.

2. *Place of business*

We consider the definition of "place of business" by reference to Rule 222-1 of the Advisers Act both logical and appropriate.

However, in connection with the foreign private adviser exemption, which requires the investment adviser to count investors in the US as well as US clients, we are concerned that the term "client" in proposed Rule 202(a)(30)-1 may be interpreted to include US investors in private funds advised by the investment manager. We believe that such an interpretation would be overly broad and we request that the Commission confirm, in a footnote, that the term "client" in Rule 202(a)(30)-1 will be interpreted narrowly, to apply only to US clients.

We would also request clarification of the position where an adviser avails itself of activities permitted by US broker/dealer legislation and regulation (for example, attendance at a capital introduction or raising event in the US arranged and organised by a broker/dealer) to solicit clients. We would expect that, in those circumstances, an adviser would not be regarded as having a "place of business" in the US.

We also believe that the definition of "place of business" in proposed Rule 202(a)(30)-1 should be clarified to provide that a "place of business" does not include an office where solely administrative services are performed. That would provide assurance that communications to and from an office in the US with clients that are not "U.S. persons" and back-office books and recordkeeping activities, among others, would not void the ability of an adviser that otherwise satisfies the requirements of the Rule to rely upon it. This change would be consistent with the standards that such office and its personnel would not be holding out as providing advisory services, clients should have no expectation that they would have the protections of the Advisers Act, and the principles of the "conducts and effects test" in which the Staff recognised that in order to subject a non-US adviser to the requirements of the Advisers Act a "sizable amount of advisory services take place in the United States." (*See generally*, Division of Investment Management, SEC, *Protecting Investors: A Half Century of Investment Company Regulation*, May 1992, at 222).

B. Private fund adviser exemption and application for non-US advisers

This exemption will be available if the adviser's principal office and place of business is outside the US and all its clients which are US persons are "qualifying private funds".

We are pleased that the application of the exemption to non-US advisers has been addressed and clarified, so that such advisers can rely on this exemption if all their "US clients" are qualifying private funds and their AUM managed from a place of business in the US are less than $150 million.

We also understand that an adviser with no place of business in the US can rely on the exemption (as such an adviser's "assets under management in the US" would be zero), so that, even if such adviser had US persons as private fund investors, this exemption would be available to the adviser. We consider this reasonable and appropriate, since any potential impact from the activities of such a non-US adviser must be minimal and certainly would not justify full registration and regulation by the Commission. Similarly, we believe that it is a correct interpretation of the rule-making provisions that only an adviser's activities in the US, as indicated by the term "assets under management in the United States", and not activities in other jurisdictions must be considered.

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We do, however, have these comments and requests to make on the proposed rules and the terms of the exemption.

1. Qualifying private fund

We believe that the proposed rule should provide guidance as to whether an entity (for example, a Delaware Limited Partnership fund with a single Limited Partner) formed for one investor would be considered a "qualifying private fund". Often, the General Partner will also invest a substantial amount in such a structure. If such a structure is not regarded as a "qualifying private fund", the adviser will not be able to rely on this exemption. Such structures are very common and are popular with some of the largest US investors.

2. Managed accounts

We note that a non-US adviser will not count the AUM of its non-US managed accounts managed outside the US. We request that the Commission confirms whether managed accounts which are structured as private funds (pursuant to either section 3(c)(1) or 3(c)(7) of the Investment Company Act) would come within the exemption. In practice, most (if not all) managed accounts operated by European hedge fund managers will be Cayman, Jersey, Delaware (or equivalent) entities structured as fund entities.

3. Place of business

We request that the Commission confirms that, when a non-US investment adviser to private funds engages a US-based registered investment adviser as a sub-adviser to a private fund, the non-US investment adviser would not have to treat the sub-advised assets as assets managed from a place of business in the US, even if the sub-adviser appointed is an affiliate of the non-US investment adviser.

4. Private fund assets

We note that "regulatory assets under management" includes all securities portfolios for which an adviser provides continuous and regular supervisory or management services, regardless of whether such assets are proprietary, managed for no compensation or managed for non-US clients.

We agree that a clear and unified approach for calculation of AUM is necessary and we believe that using as a standard the assets for which an adviser has "responsibility" is appropriate.

We consider that including total assets both on a private fund's balance sheet and uncalled capital commitments is acceptable, provided that the private fund adviser has full contractual rights to call that capital within a reasonable time period and would be given responsibility for management of those assets.

5. Calculating the value of assets

We believe that seed capital from an adviser and/or its affiliates for the first twelve months should be excluded from the calculation of assets. The Volcker Rule allows a financial institution to seed hedge funds sponsored by itself or an affiliate for such a period. Such exclusion would recognize the importance of seed capital in the hedge fund industry (as 'skin in the game') and would benefit US investors, giving them a wider choice and variety of investment vehicles.

We believe that it must be sensible for investment advisers to rely on a body of accounting principles with which they will already be familiar (and will be using for their financial statements). Most non-US advisers do not value their assets by reference to US GAAP, IFRS or other accounting principles except for financial statement

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purposes, as AIMA's Guide[2] to Sound Practices for Hedge Fund Valuation makes clear, but rather, they value their assets as set out in a fund's offering documents.

If value must be calculated more frequently than annually, to accord with such accounting principles, that will place an unnecessary burden on advisers. Asset valuation is a substantial administrative task and is currently undertaken annually for other purposes (for example, Form ADV), so that a requirement for annual valuation would appear to strike a fair balance between ensuring that firms whose AUM is at or above the applicable threshold are 'captured' and avoiding both complications with short-term market value fluctuations and over-burdening investment advisers.

We would add that financial statements are often not finalised until more than three months after year end, which may create a timing issue.

6. Assets managed in the United States

Assets managed in the US are determined to be those managed from a principal office in the US or from a place of business in the US so that, for a non-US investment adviser, the Commission would only consider assets managed from a US place of business. The test as to "directs, controls and coordinates" is helpful and should make it clear that where a non-US firm has, for example, a small US research office which provides information to the investment adviser, the adviser would not be managing assets in the US. We agree with the Commission's approach that it should be presumed that a non-US adviser does not manage assets in the US but we believe that further clarity as to what it means to "direct", "control" or "coordinate" investment advice is required. We would also suggest that a *de minimis* requirement may be appropriate in respect of certain parts of a business which may, for example, coordinate on advice. Also, it is important that in the case of a sub-adviser managing assets in the US for a non-U.S. adviser, only the sub-adviser would be deemed to be managing assets from the US, so that only it will be required to register.

The Commission has requested comment on whether it should interpret "assets under management in the United States" under the private fund adviser exemption by reference to the source of the assets (i.e., US private fund investors). Under such approach, a non-US adviser would count the assets of private funds attributable to US investors toward the $150 million threshold, regardless of whether those assets were managed in the US or outside the US. In the interests of our non-US manager members, we do not support such an interpretation and prefer the proposal as currently put forward. We would add that the current proposal generally would be more consistent with existing practices and, conceptually, would not break new ground.

We request that the Commission confirm that, when a non-US investment adviser to private funds engages a US based registered investment adviser as a sub-adviser to a private fund, the non-US investment adviser would not have to treat the sub-advised assets as assets managed from a place of business in the US, even if the sub-adviser appointed is an affiliate of the non-US investment adviser.

7. United States Person

In defining a US person, we believe the Commission should incorporate the well-established definition in Regulation S for determining who is a client (other than a private fund) of an investment adviser, where the fiduciary or beneficiary of the client is a US investor.

[2] http://www.aima.org/en/document-summary/index.cfm/docid/FC269E93-4A10-49D3-AC37B7892762EC23. AIMA's Guide points out that hedge funds' valuation policies, whilst often very similar, are enshrined in each individual Fund's Offering Document and constitution and are not subject to a standardised rules-based approach. The fund's Offering Document will set out the guiding principles for the valuation of the assets and liabilities of the Fund and usually included is the disclosure that the ultimate responsibility for the pricing of the Fund's assets and liabilities rests with the Governing Body of the Fund.

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We understand the rationale for the special rule proposed by the Commission for discretionary accounts maintained outside the US for the benefit of US persons and we believe that that is an appropriate safeguard against avoidance of the registration requirement.

8. Transition Rule

The Commission proposes that an investment adviser would have up to three months to register after it became ineligible for the exemption because of an increase in AUM (to or exceeding $150m). Our main concern with that provision is that, although three months may be sufficient to complete the registration process and procedures, it should be made clear that the requirement would arise from the time of the last annual valuation of assets and not when the investment adviser could, were a valuation to be effected, be said to be over the threshold.

9. Application of marketing and other rules

We request that the Commission clarify whether all its 'marketing' rules will apply to advisers availing themselves of the private fund adviser exemption or whether it will be the case that only the anti-fraud rule (Rule 10b-5 promulgated under section 10(b) of the Securities Exchange Act) applies (and which applies to all market participants in any event).

10. Requirements for exempt reporting advisers

Investment advisers who come within the private fund adviser exemption will be exempt from registering with the Commission in the normal way but will be required to keep records, which may be subject to inspection, and to report (and keep updated periodically) information referred to as a limited, subset of information required by the Commission's Form ADV (used by registered advisers). Such information would include identifying information for the adviser, its owners and affiliates and information about the private funds which the adviser manages and other business activities in which it and its affiliates are engaged which, as the Commission's press release when the Releases were issued describes them, "present conflicts of interest that may suggest significant risk to clients".

We consider that such reporting and filing requirements of exempt advisers, along with wide powers to examine exempt reporting advisers, are disproportionate and in many cases excessive and, in effect, they negate much of the benefit that would be accorded to those advisers. We understand that Congress understood the burden being imposed on investment advisers in the Dodd-Frank Act and sought to create a substantive exemption for firms with only limited AUM in the US. The private adviser exemption as proposed could be seen as equally burdensome and costly for firms relying on the exemption, but without the 'seal of approval' of being a fully registered adviser.

The Commission has requested alternative approaches to reporting by exempt reporting advisers which it should consider and we suggest that, instead, the Commission should place reliance on its cooperation agreements with other regulators for the purposes of 'auditing' non-US advisers; that would also put less strain on the Commission's resources.

If the Commission is, however, still inclined to apply such record requirements to exempt advisers, we add that, as we understand the rationale for not providing a full exemption from such requirements, appears to be that, although the potential impact is not sufficient, US investors will be materially disadvantaged in terms of lack of oversight by the Commission, so that the Commission wishes to retain powers of oversight to identify market and systemic risks that may arise. In such circumstances, we see no reason why the information reported needs to be made public. While disclosure of basic information (for the purposes of monitoring potential systemic risk) poses no difficulty for AIMA's members, it is very important that more proprietorial data concerning, for example, trading strategies should not be made public.

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We note that the revised Form ADV, at 7 B 1, item 12 will require current value to be calculated in accordance with US GAAP; as mentioned above under B 5, we believe that valuation should be permitted to accord with whichever accounting standards a fund uses.

As proposed, the Commission will have the authority to examine an exempt adviser's records and, as the Release makes clear, to use the information provided in a Form ADV to create risk profiles of advisers and permit examiners to better prepare for and more efficiently conduct on-site examinations. Again, such broad-sweeping powers could equate to those for fully registered investment advisers and would negate many of the advantages of being an exempt reporting adviser.

Conclusion

We are most appreciative of the availability of the private fund exemption accorded to non-US advisers but we do ask that the Commission exercises the authority delegated to it to raise the AUM threshold for the foreign private adviser exemption, from $25 million to at least $100 million, to provide consistency with the new registration threshold for US advisers required to register.

Although the private fund adviser exemption may be available to many AIMA members who are non-US advisers, the proposals as currently put forward would, nevertheless, result in a significant burden and cost for such exempt reporting advisers by the requirements to comply with an extensive record-keeping, reporting and examination regime. It does, therefore, appear that advisers who come within the scope of the exemption would not receive key advantages, over those who are subject to full registration with the Commission, and we do not believe that that is a desirable or proportionate result.

We also ask the Commission to provide clarification and certainty as to the other points we have raised in this letter.

We are, of course, very happy to provide any further information that may assist the Commission in its consideration of the proposed rule-making.

Yours faithfully,

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