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January 24, 2011

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

Re: Comments on Behalf of Certain Global Advisory Firms
<u>SEC File Nos. S7-36-10 and S7-37-10</u>

Ladies and Gentlemen:

On behalf of certain clients that are global investment advisory firms with their principal office and place of business outside of the United States ("Non-U.S. Advisers"), we respectfully submit the following comments on the proposal by the Securities and Exchange Commission (the "SEC" or "Commission") of certain rules (the "Implementing Rules") intended to implement a number of proposed exemptions (the "Exemptive Rules") under the Investment Advisers Act of 1940, as amended (the "Advisers Act") and other provisions of Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd- Frank"), enacted on July 21, 2010.[1]

We would like to thank the Commission for this opportunity to comment on the proposals for the Implementing Rules and the Exemptive Rules on behalf of these clients. We believe that these comments will aid in formulating a regulatory regime that addresses Congress's concern in enacting Dodd-Frank to strengthen protection of investors in the United States and obtain better information to manage systemic risk without undue burdens on international commerce and comity.

The clients for whom we are writing are generally affiliated with large financial or banking institutions, are regulated in their home jurisdictions and by the European Union, have affiliates in a number of jurisdictions, including the United States, among others, and in many cases, have registered such affiliates or submitted such affiliates operations to the regulation of the relevant jurisdiction. These clients also have already registered one or more affiliated advisory entities with the SEC to conduct any advisory business for U.S. clients in reliance on existing staff guidance. The advisory business of both the Non-U.S. Adviser and the SEC-registered affiliate generally includes providing investment advice to one or more private funds.

Our comments address, specifically:

1 The Proposed Exemptive Rules were published in Release No. IA-3111 (Nov. 19, 2010). The Proposed Implementing Rules were published in Release No. IA-3110 (Nov. 19, 2010).

- the "private fund adviser exemption"
- the "foreign private adviser exemption"
- safe harbors for unregistered Non-U.S. Advisers with SEC- registered affiliates
- clarification and safe harbors for application of the regulatory and reporting provisions to foreign advisers with no clients in the United States.
- The proposed reporting obligations for advisers to private funds and exempt reporting private fund advisers
- Transition periods

1) Implementation of the "Private Fund Adviser Exemption" of Section 203(m) in Respect of Non-U.S. Advisers

We agree with the territorial approach pursued by the Commission in the proposed rules to implement Section 203(m) of the Advisers Act added by Dodd-Frank. Interpreting the phrase "assets under management in the United States" as assets managed from a place of business in the United States, we believe, properly focuses U.S. regulatory efforts and recognizes the conflicts of competing regulation of multi-national advisory firms. However, the proposed rules leave a number of ambiguities that have sparked debate as to the proper application of the rules. These should be further clarified and refined to avoid confusion and unnecessary expense.

(a) Availability of Private Fund Adviser Exemption to Non-U.S. Advisers.
(i) Advises Solely Private Funds

The Commission has proposed to make the private fund adviser exemption available to Non-U.S. Advisers if:

a) the investment adviser has no client that is a United States person except for one or more qualifying private funds; and

b) All assets managed by the investment adviser from a place of business in the United States are solely attributable to private fund assets, the total value of which is less that $150 million.[2]

We agree this approach, but suggest the following clarifications:

➢ ***The Commission should make it clear that the private fund adviser exemption would be available to an adviser even if none of the private funds it advises are "United States persons."***

[2] Proposed Rule 203(m)-1(b)

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Because the explanation of this proposal in the release formulates the first requirement slightly differently, stating that the exemption may be available to Non-U.S. Advisers if "all of the adviser's clients that are United States persons are qualifying private funds," some believe the SEC intended to make the exemption available only to Non-U.S. Advisers who have at least one private fund client that is a United States person. We do not believe that the proposed rule requires this. We believe that it is intended that the exemption would be available to an adviser even if it has no clients who are United States persons[3] (assuming for these purposes only that the Advisers Act would apply to such investment advisers). We believe that the SEC's explanation was intended to assure Non-U.S. Advisers that the application of the rule would not differ if a private fund vehicle advised by that Non-U.S. Adviser that admits United States persons were formed in a state of the U.S. or in an offshore jurisdiction and thereby allow advisers to structure fund vehicles based on concerns other than regulatory arbitrage. The clarification we are requesting would not require a change in the wording of the proposed rule itself as set forth under (a) above. We suggest that the explanation of the application of this rule in the adopting release should be clarified.

➢ ***In response to the SEC's request for comment on the specific question, we agree that the exemption should be available to a Non-U.S. Adviser who meets the criteria even if not all of the non-U.S. funds it manages are offered to U.S. persons.***

(ii) Private Fund Assets

➢ ***"Assets under management" should not include proprietary assets or assets managed without compensation for purposes of Section 203(m), regardless of whether they are managed from a place of business in the United States.***

This is in response to the Commissions request for comment on this specific question. Including proprietary assets and assets managed without compensation appears to add nothing to the goal of protecting U.S. investors while potentially inflating the "assets under management" of a firm. Advisers tend only to manage assets without compensation for their principals or similar related parties or for themselves. As a result assets managed without compensation is often synonymous with "proprietary assets." The related

[3] We believe that the jurisdiction of the Advisers Act would not extend to foreign advisers operating outside the United States who have no U.S. clients as discussed below in connection with the foreign private advisers exemption. Our comment here, however, discusses the application of the proposed rules assuming that such jurisdiction exists.

party investor or the adviser itself, in such instance, is not relying on or expecting SEC regulation to protect it and therefore applying full SEC oversight of an adviser who is pushed over the asset limit from being an "exempt reporting" adviser because proprietary and assets managed without compensation are included in the computation is an unnecessary diversion of scarce resources from the SEC's main task. In cases of Non-U.S. Advisers who may manage large sums of proprietary assets, including such assets would be a deterrent to the adviser establishing U.S. operations and employing U.S. residents. Advisers, particularly those affiliated with financial institutions, often use proprietary assets to seed new funds and test investment strategies. The investment of these proprietary assets allows such advisers to establish a performance history for these funds and to implement a strategy even before attracting significant outside investors. This is protective of the early investors in a fund and allows more investor choice. Further, investors often take comfort from the presence of the adviser's proprietary assets in a fund as it aligns investor and adviser interests and represents "skin in the game" for the adviser. We also note that excluding these assets does not absolve the adviser from its reporting obligations as an "exempt reporting" adviser and therefore seems the most efficient means of achieving the policy goal.

- ***Exempt Reporting Advisers should only have to calculate and report assets under management annually.***

As noted in the proposing release, any method that the SEC mandates for determining AUM may well differ from the method used by the adviser for other purposes. Because the SEC is requiring reporting of this information annually, the calculation should also be required annually.

- ***Availability of the exemption under Section 203(m) should be determined based on the annually-reported assets under management.***

Many advisers only determine their aggregate assets under management on an annual basis. The level of AUM generally fluctuates and the consequence of AUM fluctuating above the $150 million threshold is full registration and compliance with the Advisers Act and the rules thereunder. For Non-U.S. Advisers, the burden of educating themselves on all the requirements of the Advisers Act, formulation of policies and procedures that comply with U.S. rules and coordination of such requirements with those of its local regulator are great and time-consuming. It would be extremely burdensome and detrimental to investors if Non-U.S. Advisers had to operate to manage the AUM levels within the short time span of a single calendar quarter.

(iii) Assets Managed in the United States

We also agree with the approach taken in the second prong of the rule – that assets under management in the United States be interpreted as those managed from a place of business in the United States. The explanation in the proposing release of this requirement, however, also contains ambiguities and implies that there has been a significant change in policy with respect to determining when a Non-U.S. Adviser has a place of business in the United States that we hope was not intended.

- ***The Commission should make it clear that the private fund adviser exemption would be available to a Non-U.S. Adviser even if it has no place of business in the United States.***

The SEC's reference in the proposing release in contrasting its approach to non-U.S. private fund advisers to the foreign private adviser exemption (which, the SEC states, sets forth circumstances under which a Non-U.S. Adviser may be exempt if it has no place of business in the U.S.) has led some to believe that an adviser with no place of business in the U.S. can only be exempt under the foreign private adviser exemption of Section 203(b)(3) as defined in proposed Rule 202(a)(30)-1, and may not take advantage of the private fund adviser exemption of Section 203(m). We would request that the explanation in any adopting release make it clear that a Non-U.S. Adviser need not have a U.S. place of business to avail itself of Section 203(m) and where it has no such place of business, its "assets under management in the United States" would be $0.

Alternatively, in order to avoid the difficulties inherent in determining the location from which management of any particular assets of a private fund is performed in the case of multi-jurisdictional advisers, we urge the Commission to adopt the same territorial approach for Non-U.S. Advisers as it proposes to apply to U.S.-based advisers – that the assets be deemed to be managed from the location of the adviser's principal office and place of business. Although the Commission suggested that this approach would be at odds with the foreign private adviser exemption in new Section 203(b)(3) of the Advisers Act, as it would allow Non-U.S. Advisers with substantial activities in the United States to avoid U.S. regulatory oversight,[4] we note that such advisers would be subject to the reporting obligations imposed by the SEC on exempt reporting advisers, would be required to keep certain records (still to be specified by the SEC) and would be subject to examination by the

[4] Exemptive Release, text accompanying fn 205.

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SEC. If a Non-U.S. Adviser to private funds has no clients in the U.S. or only U.S. clients that are private funds and controls the investment process from its principal place of business outside the U.S., there is a strong rationale for not expending the U.S.'s scarce resources on full regulation of such advisers.

- ***Separately incorporated affiliates in the United States of Non-U.S. Advisers that provide support services to the Non-U.S. Adviser in connection with the Non-U.S. Adviser's investment advice to its clients, including private funds, should not be deemed a "place of business" of that Non-U.S. Adviser and the activities of affiliates should not be attributed to each other in most circumstances.***

Non-U.S. Advisers may establish a separate entity in the United States to provide certain services to it to aid in its offshore advisory business that are not in themselves investment advice. The SEC has long taken the position that Non-U.S. Advisers to non-U.S. clients may use U.S. jurisdictional means to acquire information about the securities of U.S. issuers and effect transactions in securities of U.S. issuers through U.S. broker dealers without registering as an investment adviser.[5] A Non-U.S. Adviser that uses the resources of a U.S. based affiliate to conduct research or implement trades that have been mandated by the Non-U.S. Adviser should not be deemed to have a place of business in the United States or to be "managing assets" from a U.S. place of business.

- ***A Non-U.S. Adviser should be able to take advantage of all applicable exemptions even if it has an affiliate that is registered with the SEC, or the appropriate state regulator, as required because of such affiliate's advisory activities. Further, such Non-U.S. Adviser should be protected from the direct application of the substantive regulation of the Advisers Act if it has an SEC-registered affiliate and provides all advice to persons in the United States through such registered affiliate under guidance provided by the SEC through various no-action letters.***

We note with concern the reference in footnote 270 of the Exemptive Release to the position taken by the staff in *Richard Ellis, Inc.*, SEC Staff No-Action Letter (Sept. 17, 1981) and the implication that separately organized affiliated advisers would have to meet the standards of separateness set forth in the letter to avoid integration of their advisory activities.

Historically, the SEC had concerns under Section 208(d) of the Advisers Act that unless the activities of commonly controlled affiliates were integrated, an

[5] *Paul Vogele,* SEC No-Action Letter, pub. Avail. April 9, 1990.

adviser could engage in activities indirectly through a separate entity under its control that it could not do directly. The SEC recognized the arguments made in no-action requests that in the case of Non-U.S. Advisers, the establishment of separate entities to provide advice to U.S. persons was not necessarily intended to violate Section 208(d), but necessary to conduct business across multiple jurisdictions.[6] The SEC granted relief to advisers who complied with strict guidelines for maintaining separateness of related entities under *Richard Ellis* in 1981. The staff refined its approach first in a special report issued in 1992[7] and subsequently in a series of no-action letters culminating with *Royal Bank of Canada* in 1998.

In *Richard Ellis*, the staff took the position that an unregistered investment adviser affiliated with a registered investment adviser could remain unregistered and operate on that basis only if it was "separate and independent" from its registered affiliate. It agreed that a subsidiary of a Non-U.S. Adviser would be considered to have a separate and independent existence if it:

(1) was adequately capitalized;

(2) had a majority of directors independent of the parent;

(3) had employees, officers and directors who were not in the parent's advisory business;

(4) made its own decisions on investment advice; and

(5) kept such advice confidential until communicated to clients.

The SEC subsequently concluded that these criteria posed "great difficulty in practice" resulting in "harsh effects" and "deleterious consequences" [8]for the quality of advice available to U.S. clients. In the report of the staff study of 50 years of regulation of investment management published in 1992, the SEC acknowledged that the *Richard Ellis* principles, while still effective, may have led to the "unfortunate effect of limited United States investors' access to foreign advisory expertise,"[9] and were not necessary to protect American

[6] SEC Staff Report, *Protecting Investors: A Half Century of Investment Company Regulation*, May 29, 1992, at 221 (hereinafter, "SEC Staff Report")

[7] *Ibid.* at 221-236

[8] *Ibid.* at 225-226.

[9] *Ibid.* at 229.

regulatory concerns. The report also noted that some of the *Richard Ellis* requirements actually worked to the detriment of U.S. investors by denying them access to the most talented portfolio managers and research capabilities of a Non-U.S. Adviser affiliate and hampering the flow of information and exchange of ideas between portfolio managers of the parent and the subsidiary. The staff set forth a different standard for determining separateness that it was planning to apply and would further refine through no-action letters. The staff enumerated the following criteria for limiting U.S. regulatory oversight of the non-U.S. affiliates of an SEC- registered adviser:

- The affiliated U.S. and non-U.S. companies are separately organized (i.e., two distinct entities);

- The U.S. entity is registered as an investment adviser and is staffed with personnel (whether physically located in the U.S. or abroad) capable of providing investment advice;

- All persons involved in U.S. advisory activities (including those employed by non-U.S. affiliates) are deemed "associated persons" of the U.S. registered adviser and are thereby subject to SEC jurisdiction; and

- The SEC is given access to trading, personnel and other records of each affiliated entity to the extent necessary to monitor and police conduct that may harm U.S. investors.

The staff indicated that it would adopt requirements generally analogous to those in Rule 15a-6 under the Securities Exchange Act of 1934.[10]

Between 1992 and 1998, the staff issued a series of no-action letters[11] that elaborated and refined how the foregoing principals would be implemented. Multi-national advisory firms such as our clients structured their businesses to comply with these guidelines. Very few of the Non-U.S. Advisers who currently have an SEC-registered affiliate would meet the *Richard Ellis* criteria. Unless they restructure their businesses prior to July 21, 2011 to impose the separateness requirements (and thereby reimposing all the detriment to U.S. investors the SEC noted as problematic in the 1992 report),

[10] *Ibid.* at 234.

[11] E.g., *Royal Bank of Canada*, SEC No-Action Letter (June 3, 1998); *ABN AMRO Bank*, SEC No-Action Letter (July 1, 1997); *Murray Johnstone Holdings Ltd.*, SEC No-Action Letter (Oct. 7, 1994); *Mercury Asset Management plc.*, SEC No-Action Letter (Apr. 16, 1993); *The National Mutual Group,* SEC No-Action Letter (Mar. 8, 1993); and *Uniao de Bancos de Brasileiros S.A.*, SEC No-Action Letter (July 28, 1992) ("*Unibanco*").

a substantial number of Non-U.S. Advisers would become required to register with the SEC.

Such registration would impose SEC oversight and U.S. regulation on Non-U.S. Advisers and their businesses, including that with no connection to the United States or U.S. investors. These Non-U.S. Advisers already submitted their activities in or related to U.S. clients to SEC regulation and in many cases submitted various aspects of their foreign operations that were used in providing advice to U.S. clients to SEC examination and compliance through procedures described in the staff no-action letters. We urge the Commission to confirm that these no-action letters, often referred to as the *Unibanco* line of no-action letters, continue to represent the position of the Commission and may still be relied upon by Non-U.S. Advisers and their SEC-registered affiliates. Further, Non-U.S. Advisers with SEC-registered affiliates should not be deemed to have a "place of business" in the United States as a result of the existence of the SEC-registered affiliate in the United States. For a Non-U.S. Adviser whose only dealings with U.S. persons is as an adviser to private funds or through services provided by a registered affiliate, this approach would give the SEC the oversight it needs to fulfill its mandate; the activities of the Non-U.S. Adviser and its affiliates that are conducted from the United States or to U.S. clients other than private funds would be subject to full Adviser Act regulation and compliance through the registered affiliate and information as to private funds advised by the Non-U.S. Adviser directly would be provided under the provisions of Section 203(m) and the rules thereunder.

In addition, Non-U.S. Advisers may also want to tap the expertise of personnel of the SEC-registered affiliate in connection with the Non-U.S. Adviser's business and clients outside the United States. To the extent such U.S. affiliate is registered with the SEC, investment advice provided by the employees based in the United States to the Non-U.S. Adviser for use in connection with its clients who are not U.S. persons should not cause the Non-U.S. Adviser to have a place of business in the United States so long as the employee providing the advice is a "supervised person" of the SEC-registered adviser, even if such employee is "dual-hatted" – employed by both the SEC registered adviser and the Non-U.S. Adviser -- and even if the Non-U.S. adviser and the SEC-registered adviser share a brand name. Further, because the SEC registered adviser would not be a "place of business" of the Non-U.S. Adviser, these advisory activities would not cause the Non-U.S. Adviser to lose the ability to rely on the private fund adviser exemption. The SEC however, would have full regulatory oversight over the U.S adviser and the activities of its supervised persons, including any "dual-hatted" employees.

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The SEC also has means other than forcing registration of Non-U.S. Advisers of policing compliance with U.S. securities laws. Many large Non-U.S. Advisers have entered into "participating affiliate" agreements between its. SEC-registered affiliate and a non-U.S. based (and usually much larger) affiliate so that personnel of various affiliates may provide services as deemed appropriate to U.S. clients under the umbrella of the SEC-registered entity. Ignoring the structures currently in place and reverting to the standards of *Richard Ellis* would cause many non-U.S. Advisers to become subject to registration under the Advisers Act. This would be an inefficient use of SEC resources serving no regulatory purpose as there are already safeguards to give the SEC access to records and personnel of Non-U.S. Advisers through such adviser's local regulator. The United States is a party to the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information dated May 2002, which has 72 current signatories and 37 jurisdictions pursuing legislative changes to be in a position to adhere. The SEC also has bilateral agreements with all of the major developed nations. Therefore, the SEC should rely on such arrangements and seek cooperation from local agencies in cases where it feels that additional information and/or further investigation is required about an affiliated Non-U.S. Adviser with whom the SEC-registered entity has entered into employee or resource sharing arrangements in accordance with SEC guidance.

- ***A Non-U.S. Adviser should not be deemed to be managing private fund assets from the United States if a separately incorporated affiliate in the United States that is registered with the SEC or appropriate state regulator, if required, advises such affiliate's U.S. clients about investing in, or manages private funds that invest in, private funds advised by the Non-U.S. Adviser.***

Many Non-U.S. Advisers have a substantial business outside of the United States, may manage hundreds of investment funds, and have expertise in non-U.S. markets that is very attractive to high net worth and institutional U.S. investors. The U.S. affiliate of any such Non-U.S. Adviser often has greater knowledge and understanding of the fund offerings of its group member than an unrelated adviser and may use this expertise to form private feeder funds or fund of funds to invest or may advise U.S. clients directly, on a discretionary or non-discretionary basis, as to investment in such private funds of the Non-US. Advisor. The advisory service provided by the U.S. affiliate consists mainly of asset allocation and risk monitoring and is unrelated to the advisory services provided by the Non-U.S. Adviser to the private fund vehicles. In such circumstances, the assets managed by the SEC registered affiliate should not be deemed to be assets managed from a place of business in the United

States by the Non U.S Adviser and the Non-U.S. Adviser should not lose its ability to rely on the private fund adviser exemption as a result of the formation of any such private fund by its U.S. affiliate.

(iv)Definition of United States Person.

- ***United States Person should be defined as provided in Regulation S without modification with respect to accounts of related fiduciaries.***

We note that the SEC requested comments on its proposed adoption of the definition of U.S. person contained in Regulation S with certain modifications for purposes of the Advisers Act. We commend the SEC's adoption of this standard, with which Non-U.S. Advisers to private funds are already familiar and agree that avoiding the proliferation of similar terms with different meanings is a highly desirable result in regulation. We believe, however, that the proposed modification of the definition solely for purposes of the Advisers Act that would treat an account as a United States person if that account were managed by a non-U.S. fiduciary for the benefit of a United States person if the fiduciary were related to the investment adviser adds unnecessary complexity. The potential behavior the staff cited that this modification is designed to prevent is already prohibited by Section 208(d) of the Advisers Act and the rule does not recognize that in large financial institutions, many legally related entities operate as independently from their affiliates as they do from unrelated parties. Non-U.S. Advisers who are not soliciting U.S. clients or U.S. investors for private funds they offer may have no reason to inquire of an independently operated client or investor, related or unrelated, if it is acting as a fiduciary for a U.S. person.

(v) Transition Rule

- ***Exempt Reporting Advisers should only have to determine eligibility under Section 203(m) once a year at the time of filing the annual updating amendment and should have at least 180 days from the date it files an annual update indicating it is no longer eligible for the exemption to register.***

The proposed rule that exempt reporting advisers be required to register with the SEC within 90 days of date as of which it is no longer eligible for the exemption is onerous, particularly for Non-U.S. Advisers. The level of assets under management of an adviser generally fluctuates during any given time period and the consequence of such assets fluctuating above the $150 million threshold is full registration and compliance with the Advisers Act and the rules thereunder. For previously unregistered advisers, and particularly for

Non-U.S. Advisers, the burden of educating themselves on all the requirements of the Advisers Act, formulation of policies and procedures that comply with U.S. rules and coordination of such requirements with those of its local regulator, if applicable, are great and time-consuming. It would be unduly burdensome and detrimental to investors if Non-U.S. Advisers had to operate to manage the AUM levels within the short time span of a single calendar quarter.

It is not clear why the SEC is proposing to grant exempt reporting advisers less time to register than it is allowing state registered advisers to switch to SEC registration (application must be filed with SEC no later than 90 days after the date of the annual updating amendment to Form ADV showing $100 million or more in assets under management). The deadline for filing the Form ADV update is 90 days after fiscal year end, which gives the adviser 180 days to become ready to register. For advisers switching from SEC to state regulation, the rules provide 180 days from fiscal year end to withdraw from SEC registration. Exempt reporting advisers should have 180 days from the date they file the annual updating amendment to register given the amount of work necessary for compliance. At the very least, they should have at least as much time as state or SEC registered advisers have to switch between regulators.

- ***If the current transition rule proposal remains, then it should be accompanied by a buffer similar to the current $5 million buffer that may be used by advisers to avoid having to switch frequently between SEC and state regulation. We would urge that such buffer be set at $50 million in assets under management in the United States (i.e. under $150 million an adviser would be exempt reporting, over $200 million and it would have to register with the SEC and between $150 million and $200 million, it could choose whether to stay exempt reporting or to register with the SEC.***

2) Foreign Private Advisers

- ***The Advisers Act does not grant jurisdiction to the SEC to regulate Non-U.S. Advisers with no place of business in the United States and no U.S. clients.***

Before determining if an exemption to registration as an investment adviser is available, an adviser must first conclude that it would be subject to the Advisers Act absent such an exemption. Section 203(a) of the Advisers Act provides that "it shall be unlawful for any investment adviser, unless registered under this section, to make use of the mails or any means or instrumentality of interstate commerce in connection with his or its business as an investment adviser." The Advisers Act defines an "investment adviser" as someone who advises others for compensation as to the value of or advisability of investing in securities.[12] This indicates that an adviser must have at least one person other than itself who pays the adviser for investment advice to be subject to the Advisers Act. Principles of international conflicts of laws and comity and American principles of statutory construction[13] would dictate that, absent clear indications to the contrary in the relevant legislation, a Non-U.S. Adviser with no place of business in the United States would not be subject to the Advisers Act unless it had at least one client in the United States so that it would be using U.S. jurisdictional means in connection with its advisory business.[14] Without at least one client that is a U.S. person, application of the statute to Non-U.S. Advisers would be imposing U.S. regulation on a foreign person with respect to its dealings with other foreign persons outside the United States without any indication that Congress intended such a result.

Some may argue that congressional intent to apply the Advisers Act extraterritorially to private fund advisers is made clear by the inclusion of a "look-through" in the foreign private adviser definition in Section 202(a)(30) that requires an adviser to count clients and investors in private funds in the United States as well as assets attributable to such clients or investors. However, as stated above, a Non-U.S. Adviser need not rely on the foreign private adviser exemption in Section 203(b)(3) if its activities would not cause it to be subject to the registration requirement of Section 203(a) in the first instance. Congress did not change section 203(a) to make extraterritorial application obvious and there is almost no discussion of the look-through of private funds and no indication that Congress appreciated the full consequences of this provision. The legislative history also provides no guidance as to how

[12] Advisers Act Section 202(a)(11).

[13] *Morrison et. al. v. National Australia Bank Ltd. et. al.*, 561 U.S. ____ (2010) (quoting the Court's decisions in *EEOC v. Arabian American Oil Co.*, 499 U.S. 244, 256 (1991) ("*Aramco*"), "the probability of incompatibility with the applicable laws of other countries is so obvious that if Congress intended foreign application "it would have addressed the subject of conflicts with foreign laws and procedures."" and "unless there is the affirmative intention of the Congress clearly expressed to give a statue extraterritorial effect, we must presume it is primarily concerned with domestic conditions" *Aramco*, supra at 248 and *Smith v. United States,* 507 U.S. 197, 204, n.5 (1993) "Congress ordinarily legislates with respect to domestic not foreign matters."

[14] Offering securities issued by an investment fund advised by the Non-U.S. Adviser to U.S. persons in a private placement alone is not an investment advisory business. See e.g. proposed rule 202(a)(30)-1(b)(2), stating that "an adviser is not required to count an owner as a client solely because the adviser, on behalf of the legal organization, offers, promotes, or sells interests in the legal organization to the owner, or reports periodically to owners as a group solely with respect to the performance of or plans for the legal organization's assets or similar matters." The offering of securities in the United States is governed by the Securities Act of 1933 and should not also be subject to the Advisers Act.

Congress expected the SEC to handle the conflicts of laws and regulation or the potential drain on resources of trying to regulate foreign activities of foreign advisers.

- ***Non-U.S. Advisers who become subject to SEC registration should not be regulated by the SEC in respect of their services to non-U.S. clients outside the United States.***

A Non-U.S. Adviser who has at least one U.S. client and does not meet the criteria for the foreign private adviser exemption in Section 203(b)(3) or another exemption will have to register with the SEC as an investment adviser. Once registered, such Non-U.S. Adviser would be required to apply U.S. regulation to all of its advisory business unless the SEC clarifies that the Advisers Act and its rules do not apply to the Non-U.S. Adviser's activities outside the United States or in respect of non-U.S. clients. This approach is consistent with the SEC's approach to securities regulation in other contexts (such as Regulation S) and its "territorial" approach to application of the Advisers Act as described in the Exemptive Release and in the 1992 SEC staff report, *Protecting Investors: A Half Century of Investment Company Regulation, supra.*

a) Counting Clients and Investors – the "look-through"

- ***Knowledgeable employees, persons who pay no compensation and persons who have already been counted in another capacity should not be included in calculating the number of clients and investors in private funds managed by an adviser.***

We agree generally with the proposed methods of determining the number of "clients" and investors in private funds" managed by an adviser proposed in rule 202(a)(30)-1 and urge that double counting of any person as a client and an investor or as an investor in more than one private fund be eliminated completely. Further, an adviser should not have to count any investor or client who pays no compensation for advisory services. Such persons are likely to be in a special relationship with the adviser that allows them to benefit from the advisers' investment advice without having to pay. Such persons are likely to be principals of the adviser or other related person, and since such person is not paying any compensation should not be considered a "client."

- ***Total Return Swaps should not be disregarded in all instances.***

It has never been clear in what circumstances the SEC would deem a transaction such as a total return swap ("TRS") to be an indirect holding of the underlying security and the SEC staff argued in an *amicus* letter to the judge in *CSX vs. The Children's Fund*[15] that TRS in general are not the same as beneficial ownership absent the presence of other

[15] Letter from Brian Breheny, Deputy Director of the Division of Corporation Finance, to Judge Kaplan (June 4, 2008).

factors or their use as a device to avoid application of the securities laws. We would urge the SEC to clarify that TRS should not in all cases disregarded and follow the standard it has espoused in other contexts, that investors in a TRS should not be deemed to own the security directly absent the presence other facts and circumstances.

i) Clients who pay no Compensation

As previously discussed, compensation is a requirement for a person to be deemed an "investment adviser" as defined in the Advisers Act. A foreign private adviser should not have to count as a client or investor any person for whom it manages assets without compensation since, by definition, the adviser is not providing investment advise that is subject to the Advisers Act if it is not compensated for such advice.

ii) Knowledgeable Employees

Further, we believe it is not in the best interests of the U.S. to require foreign advisers with no place of business in the U.S. to count knowledgeable employees as clients or investors. Such employees do not invest with the adviser because of any marketing or solicitation by the adviser and often such investment serves as additional compensation or incentive to the employee. Requiring the adviser to count such employees as clients or investors will discourage such advisers from allowing employees to have "skin in the game" and to invest in the funds that they are involved in managing. Further, it will penalize U.S. persons who work for non-U.S. based advisers in incentive compensation.

iii) Place of Business

- ***Our comments above in connection with determining when a Non-U.S. Adviser has a place of business in the United States as a result of the existence of an affiliated entity apply equally in the foreign private adviser context and we again urge the Commission to reaffirm its position as stated in* Unibanco *and subsequent letters.***

iv) Assets Under Management

- ***Proprietary assets, assets managed without compensation or assets of knowledgeable employees should not be considered assets under management for purposes of determining the availability of the foreign private adviser exemption.***

The $25 million dollar threshold under 203(b)(3) is very low. Given this low bar, including assets that do not raise significant U.S. regulatory concern would result in regulation of foreign entities that present little risk to U.S. investors or markets. Further, the instructions for calculating "regulatory assets under management" do not address how a foreign private adviser should apportion the AUM between its US and non-US investors. Finally, because a foreign private adviser, by definition, may have no place of business in the United States and the assets under management that it has to monitor are limited to those attributable to U.S clients and investors, it is extremely unlikely that proprietary assets or assets of knowledgeable employees could be attributable to U.S. persons. Further, if an adviser

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manages certain assets without compensation, it implies that those assets are not attributable to any "client".

3) Implementing Release

- ***The reporting required with respect to private funds for registered advisers and exempt reporting advisers is onerous and should be reformulated in the case of exempt reporting advisers to provide aggregate information to the SEC only and not to the public.***

The information proposed to be supplied by exempt reporting advisers on a fund by fund basis could quickly become an onerous task. Our clients include major global advisory firms that manage hundreds of private funds. The SEC has proposed to require, in Section 7.B. of Schedule D to Form ADV, advisers to answer 29 separate questions, most with multiple parts, with respect to each private fund. Virtually all of the requested information would already have been provided to investors in the fund through an offering document or follow up status reports. One of the items asks for information on assets and liabilities of each private fund broken down by asset or liability class and further divided into Level 1, Level 2 and Level 3 as provided under U.S. GAAP. For Non-U.S. Advisers who manage private funds outside the U.S. compliance with these requirements could be difficult if the same concepts to not exist under the accounting rules used by the private funds. Further Congress did not mandate that this information be made public, only that it be provided to the SEC for purposes of its oversight of U.S. securities markets. The information about each private fund required to be disclosed on proposed new Form ADV, may also provide competitors insight into these private investment vehicles to the detriment of investors and the investment vehicle.

- ***Investors in private funds managed by an exempt reporting adviser do not need and will derive little benefit from forcing the adviser to file information publicly through IARD or to prepare and distribute Part 2 of the Form ADV. U.S. investors in private funds would already have received an offering document that should have covered the items that would be made available publicly.***

- ***The Commission's request for comment on whether it should require advisers to calculate assets under management in accordance with U.S. GAA. We submit that the SEC is correct in not requiring the use of U.S. GAAP. Particularly for Non-U.S. Advisers, who are often required by regulatory or market imperatives in their home jurisdictions to apply valuation and accounting standards other than U.S. GAAP, such a requirement would be unduly burdensome.***

- ***When a private fund is managed by more than one adviser, whether in an adviser/sub-adviser situation or as co managers or other arrangement, the related advisers should***

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be able to decide which of the advisers will report the information and the others may simply refer to the reporting adviser's reports.

The adviser and sub-adviser should be able to decide whether required information will be reported by the adviser or sub-adviser (with other incorporating by reference) and not have it be set that the sub-adviser does not have to report if adviser does. Where there are multiple advisers, the SEC should allow more flexibility as to who makes the required reports. This approach would be similar to that taken with reports filed under Section 13(f) of the Exchange Act. Institutional Money Managers required to report on Schedule 13F may file a "holdings" report, a "notice" report or a "combined" report. Where institutional money managers share beneficial ownership of securities they will decide amongst themselves who will file a "holdings" report and who may file a simple "notice" referring in whole or in part to another person's "holdings" report. This works well because it allows the reporting entity with the most information to make the report. In some cases that may be the main adviser and in some cases it may be a sub-adviser.

* * * *

Please contact either Marilyn Selby Okoshi (marilyn.okoshi@kattenlaw.com) or Marybeth Sorady (marybeth.sorady@kattenlaw.com), if you wish to discuss our comments further.

Sincerely,

Katten Muchin Rosenman LLP

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