

AMERICAN BAR ASSOCIATION

Section of Business Law

750 North Lake Shore Drive

Chicago, IL 60611

(312) 988-5588

FAX: (312) 988-5578

email: businesslaw@abanet.org

website: www.abanet.org/buslaw

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VIA E-MAIL

rule-comments@sec.gov

Securities and Exchange Commission

450 Fifth Street, N.W.

Washington, DC 20549-0609

Attention: Jonathan G. Katz, Secretary

**Re: File Number S7-30-04: Registration Under the Advisers Act of
Certain Hedge Fund Advisers (the "Proposing Release")**

Ladies and Gentlemen:

This letter is submitted on behalf of the Committee on Federal Regulation of Securities of the American Bar Association's Section of Business Law (the "Committee") in response to the Commission's request for comments on the Proposing Release. It was prepared by the Committee's Task Force on Hedge Fund Regulation.

The comments expressed in this letter represent the views of the Committee only and have not been approved by the American Bar Association's House of Delegates or Board of Governors and therefore do not represent the official position of

the ABA Section of Business Law, nor do they necessarily reflect the views of all members of the Committee.

Introduction

The proposal to require the registration under the Investment Advisers Act of 1940 (the “Advisers Act”) of certain hedge fund advisers has generated substantial controversy.¹ The controversy began in the Proposing Release itself, which was published with three Commissioners in favor and two Commissioners dissenting. At least one prominent member of the President’s Working Group on Financial Markets,² Federal Reserve Chairman Alan Greenspan, has stated that he does not favor registration.³ There are clear and articulated differences as to the rationale for registration of hedge fund advisers.

While there may be disagreement on the need for, and effectiveness of, registration, we are mindful of the concerns expressed by the Commissioners as to the lack of information on hedge funds and their proliferation.⁴ Accordingly, we recommend an alternative that responds to what seems to be a consensus in favor of gathering more information on hedge funds than is available today. As an alternative to requiring registration under the Advisers Act, we respectfully suggest the Commission develop a private fund registry with relevant information as described below. At a minimum, the Commission and the investing community would be aware of “private funds” and basic, but not confidential or proprietary, information concerning such funds. Utilizing this alternative would allow any further consideration of registration of hedge fund advisers to be deferred until more complete and compelling empirical information establishes that registration is both necessary and likely to be effective.

Analysis

In the Proposing Release, the Commission advances five principal reasons for the view that hedge fund adviser registration is necessary and in the public interest.⁵ These are:

- collection of necessary data to fill informational gaps;
- deterrence and early detection of fraud;
- ability to prevent unfit persons from managing hedge funds;
- adoption of compliance controls for the protection of investors;
and
- limitation on retailization, particularly by imposing certain minimum standards on investors as a condition to charging performance fees.

We assume that the Commission's majority view is that these five principal reasons in the aggregate justify hedge fund adviser registration.

With respect to data collection, we believe that a private fund registry would fill informational gaps on hedge funds and their activities while protecting the confidential and proprietary information of advisers and the privacy of their clients. We believe alternatives to registration may be developed to deal with other concerns of the majority of the Commissioners.

The Proposing Release cites a substantial growth in hedge fund fraud enforcement cases and states that registration would give the Commission authority to examine advisers' activities. We do not believe that registration of hedge fund advisers would necessarily or significantly reduce the incidence of fraud.⁶ In fact, under the current rules, unregistered hedge fund advisers are subject to the antifraud provisions of the Advisers Act and Commission enforcement action. The Commission's examination program would provide access to more information about a registered hedge fund adviser and the private funds it advises but only on a selective basis. Certain of this information may be obtained, if necessary, from other market participants, such as prime brokers, bank lenders and auditors. Moreover, the dissenting Commissioners state that the "inspection of . . . advisers will require the Commission to invest substantial resources and expertise that it does not have."⁷

With respect to the Commission's ability to prevent unfit persons from managing hedge fund advisers, registration will neither assist investors in determining who is a qualified adviser nor will it be of any substantial assistance to the Commission. The Commission currently has and frequently uses the authority, in an adjudication or consent situation, to bar or suspend someone it has found to have violated federal securities laws from acting as an, or being affiliated with any, investment adviser, whether or not registered.

As to the adoption of compliance controls, we believe there are other means available to protect investors. For example, in 2003, the Managed Funds Association developed a series of sound practices for hedge fund managers, including recommendations on valuation and compliance issues.⁸ The last reason for registration is the increased "retailization" of hedge funds. In its 2003 Hedge Fund Report, however, the Staff of the Commission found little evidence of "retailization." The Report noted that the Staff had "not uncovered evidence of significant numbers of retail investors investing directly in hedge funds."⁹ This conclusion is consistent with the views expressed by panelists at the Hedge Fund Roundtable in May 2003.¹⁰

Several commenters have questioned the Commission's authority, without additional legislation, to require hedge fund advisers to register under the Advisers Act, as provided in the Proposing Release.¹¹ We do not address that issue in this letter.

We believe that the Commission has demonstrated that it should have a mechanism for the collection of information on hedge funds. Therefore, we are proposing that private fund advisers that take advantage of the safe harbor of current Rule 203(b)(3)-1 be required to file a form with the Commission that will provide information for a private fund registry. The form would be required to be filed within 45 days after the end of each calendar year by each private fund adviser that claims an exemption under current Section 203(b)(3), and would provide the Commission with relevant information about the names of the advisers and the funds they advise, the exemption from registration relied upon by the private fund under the Investment Company Act, the investment strategies they pursue and the assets under management.¹² Accordingly, the registry would provide information on all unregistered investment advisers to private funds that meet the jurisdictional asset size test, while the Forms ADV would provide information concerning those advisers to private funds that register voluntarily under the Advisers Act. The form would be updated annually in the same manner as Schedule 13G filings.¹³ If any fund that is described in a form filed by an adviser liquidates or changes advisers, such event would be reported in an amended form filed within 10 days after its occurrence. We also believe that the adviser could be relieved of the filing obligation in any year in which the fund voluntarily files the form as to itself.¹⁴

It would be necessary to identify the “advisers” that have the filing obligation and the “private funds” that are the subject of the form. It is critical that these definitions be clear so as to minimize interpretative issues.

For many years, Rule 203(b)(3)-1 established the industry-wide practice that the fund, as distinguished from each investor in the fund, was the client of the adviser.¹⁵ This practice has been based on the premise that advisers provide investment advice to the collective vehicle and not individually to the investors. The needs and objectives of individual investors are not considered in advising a fund. We are particularly concerned that the Commission is proposing to overturn the policy judgment and factual reality that underlay Rule 203(b)(3)-1 in its current form, which is the basis on which advisers and investors have operated for decades. We believe the basis for the current rule continues to be valid.

If the look through provision is adopted, we urge the Commission to make clear that the provision should be used only for purposes of counting to 15 clients and not used to expand the fiduciary and other duties and responsibilities that a hedge fund adviser owes to its direct clients and the corresponding potential liabilities. We are concerned that expanding the concept of who is a client of a hedge fund adviser may have significant consequences, some of which are identified elsewhere in this letter. It is likely that neither we nor other commenters have identified all the consequences of this rule change, and we remain concerned by the prospect of consequences the Commission did not intend and we have not been able to foresee. We urge the Commission to consider the consequences of changing an established rule and practice when the underlying reasons for the rule are fundamentally unchanged.

We do not propose the private fund registry as a first step toward registration or further regulation. The purpose of the registry would solely be informational. We also do not believe that the registry filing obligation would economically burden or adversely affect the operations of hedge funds or their advisers. While we recognize that such filings would not provide the Commission with powers of inspection, we believe that sufficient questions have been raised as to the use of the Commission's resources for such purposes and the need for and effectiveness of inspections of advisers that such action is not warranted. No persuasive evidence suggests registration is warranted because of the potential usefulness of inspections for enforcement purposes. We do not preclude further consideration of these issues, but conclude that something as far-reaching as adviser registration should not be required unless clear and substantial evidence compels the conclusion that it is both necessary and has realistic prospects of being meaningfully effective in accomplishing its intended purposes.

The balance of this letter comments on various aspects of the Proposing Release, the content of our recommended filing, interpretative issues we have identified and answers to questions asked in the Proposing Release. References herein to the "Proposed Rule" means the new rule and the rule amendments proposed in the Proposing Release.

Specific Comments

I. Definition of "Owner" (Proposed Rule 203(b)(3)-2) and Definition of "Client" (Amendments to Rule 203(b)(3)-1)

Proposed Rule 203(b)(3)-2(a) would require hedge fund advisers to count each owner of a "private fund" as a client, and impose a "look through" requirement for purposes of Section 203(b)(3) of the Advisers Act with respect to those investors in a fund that meets the "private fund" definition.

The Proposed Rule presents a number of ambiguities that the Commission should address:

- The use of the "plain English" word "you" is confusing in this context. If "you" is to refer to the hedge fund adviser, the use of that term instead of "you" would help the reader.
- Footnote 125 of the Proposing Release states that in a multi-tier structure, the Proposed Rule would "compel looking through the top-tier fund." While we understand that the Commission intends to protect against an adviser doing indirectly what it cannot do directly, such a look through should be required only if, at the time the fund of funds acquires any securities of the underlying fund, such fund of funds owns at least 10% of the capital of the

underlying fund. This is analogous to the look through required for entities that own at least 10% of the outstanding voting securities of an underlying fund for purposes of counting beneficial owners under Section 3(c)(1)(A) of the Investment Company Act of 1940 (the "Investment Company Act").¹⁶

- In a multi-tier, or fund of hedge funds situation, does the adviser owe the investors in the investment entities that are investors in the private fund (when the adviser is not rendering investment advice directly to such investors) a brochure and other documentation given to clients? We do not believe that these requirements should apply. The hedge fund adviser is not providing investment advice to those investors, and ordinarily will not know their identities or their investment needs. If the hedge fund adviser is affiliated with a broker-dealer, this should not require that the broker-dealer refrain from engaging in agency cross or principal transactions with those remote investors. If the Commission adopts the Proposed Rule, the Commission should clarify that its rule changes are not intended to affect contractual arrangements involving a U.S. or non-U.S. private fund, and would not, for example, create rights on the part of remote investors that only direct investors today would have under the fund's constituent documents and agreements. Further, the look through should not apply to the counted clients for the purpose of approving the assignment of an advisory contract. These are some of the unintended consequences to which we referred in the Introduction. This can be remedied by limiting the look through solely to the counting of the number of clients.
- If the adviser to a hedge fund that has 15 or more investors engages a sub-adviser, the sub-adviser should not be required to register under the Advisers Act unless it has 14 or more other U.S. clients. The sub-adviser ordinarily would have no information about the investors in the hedge fund. Consistent with the manner of counting owners, the general partner or managing member of the hedge fund should not be counted as an investor for that purpose.

The following are our responses to some of the questions posed in Part II.C of the Proposing Release:

- A. *We request comment on the applicability of the minimum asset thresholds to hedge fund advisers.*

We believe it is appropriate in terms of recognizing the limitation on the Staff's resources to maintain consistency with the standards of The National Securities Markets Improvement Act of 1996, so that hedge fund advisers with assets under management of less than \$25 million would continue generally not to be eligible for Commission registration and hedge fund advisers with assets under management between \$25 and \$30 million would be eligible, but not required, to register with the Commission.¹⁷

The state in which a hedge fund adviser's principal place of business is located has the right to regulate that adviser. The state may revise its rules, if it desires, to look through hedge funds in applying its registration requirements. If an adviser is regulated or required to be regulated in the state where it maintains its principal place of business, the Commission is prohibited by Section 203A(a)(1)(A) to regulate that adviser unless it has at least \$25 million under management. Separately, pursuant to Rule 203A-1, the Commission established a threshold of \$30 million for the requirement to register. We see no reason to change in this context the principle established by Rule 203A-1 that federal registration is not required of an adviser with less than \$30 million under management even if that adviser is not required to register under the law of its home state.

As noted in footnote 126 of the Proposing Release, an offshore adviser that provides direct account management services is currently required to register if it is within the Advisers Act's basic jurisdictional provisions (*i.e.*, either because it holds itself out publicly as an investment adviser in the United States or because it had at least 15 U.S. clients during the preceding twelve months) without regard to the amount of its assets under management derived from U.S. clients.¹⁸ In the case of an offshore adviser that would be required to register solely because of investment by U.S. investors in offshore funds managed by that adviser, however, we suggest the Commission impose a threshold of \$30 million in initial investments by U.S. investors where capital contributed by U.S. investors represents 25% or more of the capital of the fund. Offshore hedge fund advisers in most cases are subject to regulation in their jurisdictions of organization and primary operation. U.S. investors who participate in offshore hedge fund offerings in general are tax-exempt entities and are sophisticated investors. Such investors customarily receive substantial offering documentation and engage in significant due diligence with respect to the funds in which they invest. Therefore, the United States has little interest in regulating such offshore advisers if their fund assets under management for U.S. investors do not meet the \$30 million and 25% thresholds. This percentage asset threshold would be consistent with the ERISA threshold which is relied on generally for benefit plans in the private fund industry. In addition, because the U.S. investors in

offshore funds typically are U.S. tax-exempt entities, including benefit plans, that symmetry would be logical and useful. Alternatively, the thresholds might not be applied in the unlikely event that an offshore adviser was not subject to regulation in the jurisdiction of its organization or primary operation. We do not propose that the thresholds apply, however, if an offshore adviser also provides direct account management services.

B. Have we provided detailed enough guidance on how advisers should count clients?

We note the following issues in connection with counting clients under the Proposed Rule:

- The use of the term “securityholders” in Proposed Rule 203(b)(3)-2(a) is broader, and captures a greater universe, than the commonly understood use of the term “investor.” For example, are persons or institutions that loan money to the fund – such as through preferred securities or investment notes – required to be counted as clients because they may fall within the definition of “securityholder”? While it is arguable, under the Commission’s approach, that a noteholder who receives a return indexed to the performance of the fund could be considered a client, a noteholder who receives a market rate debt return should not be considered a client. Holders of preferred instruments who receive a fixed or floating rate return, which is not indexed to the fund’s performance, also should not be considered clients. Hedge funds should be permitted to raise funds to leverage capital for the equity owners without counting non-equity securityholders as clients.
- Proposed Rule 203(b)(3)-1(a) provides (as does the current rule) that any relative, spouse or relative of the spouse of a natural person who has the same principal residence counts as a single client. Many wealthy families set up family partnerships or trusts for investment purposes. In most cases, the grantor or trustee with investment discretion should be deemed the client, rather than looking through the entity to count direct or contingent beneficiaries as owners. The Commission has recognized this by permitting members of a family living together to be counted as a single client, but private funds as defined in Proposed Rule 203(b)(3)-1(b)(6) would not be allowed to rely on that principle. This principle should be extended to private funds and to children, spouses of children, and their offspring (and spouses), whether or not they share a residence or are no longer minors. This would recognize the reality of family tax and estate planning. We recommend that the family-owned company part of the definition

of “qualified purchaser” contained in Section 2(a)(51)(A)(ii) of the Investment Company Act be incorporated into Proposed Rule 203(b)(3)-1(a). Moreover, we recommend that the Commission clarify that beneficiaries (direct or contingent) of other institutional accounts such as charitable organizations (for example, foundations, endowments or trusts) and non-self-directed employee benefit plans not be counted as clients.

- In the Proposed Rule, the Commission does not deal with employees of the investment manager as investors in the fund. Such employees should not be counted as clients for purposes of Proposed Rule 203(b)(3)-2(a), consistent with the “knowledgeable employee” provision of Rule 3c-5 under the Investment Company Act. Moreover, a provision allowing only knowledgeable employees to redeem their interests in a fund within two years after their purchase, including because their employment terminates for any reason, should not cause the fund to be deemed a private fund.
- Rule 222-2 under the Advisers Act provides that Rule 203(b)(3)-1 governs how advisees should be counted for purposes of determining the application of Section 222(d) of the Advisers Act. Section 222(d) provides that a state may not regulate an adviser if the adviser has no place of business in that state and had fewer than six clients there during the preceding twelve months. If states count investors in a private fund as clients for this purpose, hedge fund advisers may become regulated in numerous states. This is another example of the potential unintended consequences of the Proposed Rule. The Proposed Rule should not have any effect on how advisees are counted for this purpose.
- The Commission should make clear that, in a situation where a fund of hedge funds invests in a downstream hedge fund, the adviser of the fund of hedge funds should determine the suitability for its investors of the investment in the downstream fund. The adviser to the downstream fund should not be obliged to determine whether that investment was suitable for the investors in the fund of hedge funds or to assess whether the individual investors in the fund of hedge funds would have met the downstream fund’s suitability criteria if they had sought to invest directly.
- We commend the Commission’s approach with respect to offshore advisers in terms of exempting offshore advisers from most of the substantive provisions applicable to registered advisers. As described above, however, we recommend that the thresholds of \$30 million and 25% of the capital of the fund also apply to

offshore funds. In addition, our comments regarding the “look through” provisions and the definition of client also apply to offshore advisers and funds.

- In many cases, offshore advisers use a master-feeder structure whereby offshore investors (and tax-exempt U.S. investors) invest in an offshore feeder, and U.S. taxable investors invest in either a domestic or foreign feeder that is taxed as a partnership. The Proposed Rule should make clear that the offshore adviser remains exempt from such substantive provisions, even if the domestic feeder (or master fund) is set up as a U.S. entity, so long as the offshore adviser’s principal office and place of business are outside the United States.

C. Should offshore advisers be required to look through their offshore funds only if assets attributable to U.S. residents comprise more than a threshold percentage? If we impose a threshold, what should it be? Should the threshold apply to the cumulative assets of all offshore funds advised by the offshore adviser?

As explained above, a threshold of \$30 million in fund investments by U.S. investors would be appropriate before requiring registration. In addition, registration should not be required unless U.S. investors contribute 25% or more of the capital to an offshore fund. An adviser that advises multiple funds should not be required to register unless the 25% threshold is reached on an aggregate basis, regardless of the amount of investment by U.S. investors. If the Commission adopts an individual-fund percentage approach, provision should be made to look through feeder funds in master-feeder structures to the master fund in determining the relevant percentage, because feeder funds taxed as partnerships are frequently established exclusively for investment by U.S. investors (in order to confer the advantages of U.S. partnership taxation) while the master fund receives investments from non-U.S. investors through a corporate feeder fund (which may also accept investments from U.S. tax-exempt investors seeking to avoid the incurrence of unrelated business taxable income).

D. Would registration present difficulties for offshore advisers because of conflicts with the laws of their home jurisdictions?

We are not aware of conflicts of this sort. Nevertheless, a registration requirement will provide a disincentive to offshore advisers to advise U.S. investors, limiting the investment universe available to U.S. investors and reducing competition among advisers.

- E. Do offshore hedge fund advisers present different concerns or face different burdens? If so, what are they and how should we address them?*

In general, we are not aware of differing concerns or burdens, other than the issues already addressed in Part II.C.3.c. of the Proposing Release and the preceding response.

- F. Is the scope of the exception [from the definition of private fund for a company that has its principal office and place of business outside the U.S., makes a public offering of its securities outside the U.S. and is regulated as a public investment company under the laws of a country other than the U.S.] too broad or too narrow?*

The Proposed Rule takes a reasonable approach in treating an offshore fund as a single client if it is publicly offered and regulated as a public investment company under the laws of another country. The nature and scope of regulation, however, varies. See our discussion of Offshore Publicly Offered Funds in Part II below.

We recommend that the approach the Proposed Rule takes with offshore regulated investment companies be applicable to U.S. regulated investment companies. We do not believe the “look through” makes sense for this purpose. If the investors in a registered fund are not clients of the adviser to the registered fund, it is illogical to make such investors clients of the adviser to the hedge fund.

In addition, an offshore adviser that does not offer interests to U.S. residents should not be subject to regulation. Moreover, non-U.S. residents should be excluded from the count even if they subsequently move into the United States (subject to the Regulation S exception for offerings specifically targeted to U.S. citizens living abroad). We recognize that the U.S. status of a client under the Advisers Act in the case of direct account management depends on the residence of the client and not the location at the inception of the adviser’s relationship with the advisee. Despite the overall look through thrust of the rules proposed in the Proposing Release, however, there remains, at least for these purposes, a significant difference between the relationship established with an adviser by direct account management and the relationship established by investment in a fund that is managed for the benefit of all the fund’s investors through the fund.

We agree that when a non-U.S. resident moves to the United States, U.S. law appropriately applies to the direct account advisory relationship between a preexisting offshore adviser and that person, but we believe that a non-U.S. resident who invests in an offshore private fund cannot reasonably believe that U.S. regulation will attach to his or her relationship with the fund’s adviser simply because he or she moves to the United States. Indeed, this is the principle that was the basis of the Staff positions taken in the Investment Funds Institute of Canada¹⁹ and Goodwin Procter & Hoar²⁰ no-action letters, which provide that non-U.S. residents who acquire shares in an offshore fund abroad and subsequently move to the United States are not counted as U.S. investors

for purposes of the private investment company exemptions set forth in Sections 3(c)(1) and 3(c)(7) of the Investment Company Act. Similarly, and based on the principles set forth in the same no-action letters, U.S. residents who acquire securities in secondary market transactions abroad in an offshore fund that has never been offered in the United States should not be counted against the fewer-than-15 advisees limitation. Any other approach would unfairly subject offshore advisers to offshore funds to U.S. regulation for reasons beyond their control (their investors moving to the United States or transferring fund interests when the fund has never used U.S. jurisdictional means to offer its interests).

- G. *Is the exception [that would make most of the substantive provisions of the Advisers Act not apply to an offshore adviser to an offshore fund] a reasonable limitation on the extraterritorial application of the Advisers Act?*

The Proposed Rule is unclear whether, in exempting offshore hedge fund advisers from most of the substantive rules under the Advisers Act, such advisers will still be subject to Commission examination. It may be argued that because such advisers are registered, they are automatically subject to examination in the exercise of the Commission's jurisdiction under the Advisers Act, but advisers that are not subject to the substantive requirements of the Advisers Act (such as the requirement to make and keep books and records) should not be subject to examination.

II. Definition of "Private Fund" (Proposed Rule 203(b)(3)-2(d))

The Proposed Rule includes a new definition of "private fund" which would require advisers to look through a fund for purposes of counting clients and determining the availability of the private adviser exception in Section 203(b)(3) of the Advisers Act. We believe the definition has some ambiguities the Commission should address:

- *Transitional Issues.* If a fund has a two-year lock-up in place before the Proposed Rule becomes effective, we believe an investor should be able to redeem its interest two years after the investor purchased the interest, rather than having to wait two years after the effective date of the Proposed Rule. We assume that is what the Commission intended and request that the Commission make this clear in any final rule.
- *Reinvested Dividends.* Proposed Rule 203(b)(3)-2(d)(2)(ii) provides that a company is not a private fund if it permits redemptions within a two-year period in the case of "reinvested dividends."²¹ In light of the fact that many investment entities are organized as partnerships or limited liability companies that do not issue "dividends," we believe the language should be revised to

read “dividends, allocated profits or other returns on invested capital, whether or not distributed.” This should include any distributions or allocations of profit to investors from the capital invested in the fund, as well as distributions made to allow investors to satisfy their tax obligations (many fund agreements allow or require general partners to make annual tax distributions to their investors).

- *Additional Investments.* Footnote 140 of the Proposing Release states that the two-year redemption test would apply to each investment in the fund, not only the initial investment.²² If the Commission determines that any additional investments are subject to a new two-year lock-up period, the final rule should provide that the additional investment will not extend the lock-up period of the initial or any other investment. Additionally, the final rule should provide a protocol for partial redemptions by an investor that has made multiple capital contributions. For example, the final rule could provide that partial redemptions are funded on a first in, first out basis (that is, if an investor who has made contributions in installments partially redeems, the redemption is deemed to be funded first from profits earned on all capital, then from the initial capital contribution and then sequentially from each subsequent capital contribution).²³
- *Location of Fund.* Proposed Rule 203(b)(3)-2(d)(3) refers to a fund that, among other things, has “its principal office and place of business outside the United States.”²⁴ Hedge funds are passive vehicles and do not typically have offices. There was a time when for federal income tax purposes the issue of situs arose and the Internal Revenue Service developed a set of 10 mechanical tests (known as the “Ten Commandments”) for determining whether a fund was or was not “foreign.” The Service no longer applies the Ten Commandments and such an approach should not be resurrected here. Whether a fund is “foreign” should instead turn on the amount and percentage of investor capital it accepts from U.S. persons, as defined in Rule 902(k) under the Securities Act of 1933 (the “Securities Act”). This would provide a more objective method of identifying offshore funds than a principal office and place of business test. As described above, we recommend that an offshore adviser be subject to registration only if it meets the \$30 million and 25% of capital thresholds. For this purpose, it would be appropriate to exclude capital invested by the manager and its employees.

- *Offshore Publicly Offered Funds.* The reference in Proposed Rule 203(b)(3)-2(d)(3) to a fund that “makes a public offering of its securities outside the United States and is regulated as a public investment company under the laws of the country other than the United States” may be confusing and uncertain when applied.²⁵ A number of countries in which offshore funds are organized do not distinguish sharply between public and private offerings and do not impose on investment companies a scheme of regulation such as the Investment Company Act. As a result, it may be difficult to interpret and apply the proposed test. Many offshore funds are offered to investors in more than one country. Would it suffice, for example, under this test if the fund offered some but not all of its shares in a country outside the United States that did differentiate between public and private offerings and regulated public investment pools and private investment pools? Would a fund be deemed to have had a public offering for this purpose if it conducted media advertising or other sales efforts outside the United States that, had they been conducted in the United States, would constitute a “general solicitation” for purposes of Regulation D under the Securities Act? On balance, these criteria are largely irrelevant, and whether an offshore publicly offered fund is a “private fund” should depend on the source of the invested capital rather than the nature of the offering or of the regulatory scheme to which the fund is subject. In its Rule 2790 on New Issues, the NASD refers to entities that offer their securities to the public outside the United States or are listed on a securities exchange outside the United States.²⁶ If the Commission determines to impose tests based on factors other than the source of the invested capital, it might consider a similar approach.

The following are our responses to certain questions posed in Part II.D of the Proposing Release:

A. *Should we narrow the rule? If so, how?*

See discussion above. In addition, an entity that comprises family members should not be considered a private fund because it does not meet the third prong of the test set forth in Proposed Rule 203(b)(3)-2(d), that “interests . . . (in the family-owned entity) are or have been offered based on the investment advisory skills, ability or expertise of the investment adviser.”²⁷ If the investment adviser to a family-owned entity is a family member (whether or not a professional adviser), the nature of the adviser’s expertise should not dictate whether the adviser is subject to registration. The Proposing Release contains little discussion of the intent or purpose of this element of the test. We recommend that if the Commission intends, as we believe would be sensible, to exclude family entities from the definition of private fund (regardless of who is the investment

adviser), it should make that clear. See our discussion in Part I.B of this letter about incorporating the family-owned company part of the definition of “qualified purchaser” contained in Section 2(a)(51)(A)(ii) of the Investment Company Act.

B. Should “private fund” include private equity, venture capital, and other investment pools that are not hedge funds?

The record developed by the Commission to date has focused exclusively on traditional hedge funds. We agree with the Commission that this record does not provide any support, empirical or otherwise, for extending the registration requirement to managers of private equity, venture capital or other investment pools that are not traditional hedge funds. As the Commission notes, there have not been significant enforcement problems with advisers to these types of funds and there is no evidence of retailization in these funds.

C. Do the three characteristics used in the rule effectively distinguish hedge funds from these other types of funds? If not, what specific tests should apply?

The two-year redemption test should be sufficient to distinguish hedge funds from other types of private equity funds. In private equity funds, investors commit to contribute capital over a specified time period and, absent legal or other regulatory issues, do not generally have any right to withdraw capital or terminate their commitment. Furthermore, those who manage such other investment pools have different market skills, abilities and expertise from those who manage hedge funds.

There is a risk, however, that the definition is broad enough to capture certain structured finance entities and their advisers that would meet the literal definition notwithstanding the Commission’s intention to exclude them. In particular, although most collateralized debt obligations (“CDOs”) do not offer redemption rights to investors within two years after a purchase of interests in the CDO, some may. We note also that the Proposing Release appends the word “ongoing” to the “investment advisory skills, ability or expertise” standard, but the Proposed Rule does not. Even if that word were added to the Proposed Rule, however, we think some of the vehicles used in structured finance permit and indeed contemplate that the manager will have some authority to vary the portfolio, which could cause them to satisfy the definition of “private fund.” We do not believe that this is warranted. The incidents of fraud and retailization have not been experienced in the CDO area and we request that the Commission clarify its definition of “private funds” by specifically excluding structured finance entities, such as CDOs, and their advisers.

As the Proposing Release focuses on the attributes of a hedge fund in defining a “private fund,” we assume that actions taken by an investor to “hedge” its investment in a private fund (such as being a party to a derivative transaction with a third party) will not affect the definition of “private fund.” There is no discussion of such

transactions in the Proposing Release. Such transactions should not affect and should be irrelevant to the two-year lock-up in the definition of a private fund. The Commission should clarify that point.

D. Is two years an appropriate time period for redemptions? If not, should it be longer or shorter, and why?

Two years is a significant period of time to restrict the redemption of an interest in a hedge fund that typically invests in more liquid securities, and we believe it is an appropriate measure. We believe it would be useful for the Commission to make clear that this lock-up relates solely to the period after an investor contributes capital to a fund and, after such period, the fund may offer more frequent liquidity to such investor. Otherwise, the lock-up may discourage investments which should not be a consequence of the adoption of the Proposed Rule. See our comments on Additional Investments above.

E. Are there any other circumstances prompting redemptions that need to be excepted from the two-year test?

Proposed Rule 203(b)(3)-2(d)(2)(i) provides that a company is not a private fund if it permits redemption within a two-year period in the case of “extraordinary and unforeseeable” events. “Unforeseeable” is too broad and should be deleted. If the Commission nevertheless wishes to retain that concept, the word “unforeseeable” should be replaced by “not reasonably anticipated to occur.” Provisions in some investment vehicle documentation that would protect investors in cases of unexpected but possible events would be captured inappropriately by the “unforeseeable” test.

In addition, we recommend clarifying that redemptions would be permitted if prompted by events beyond the control of the investor that materially alter the investment expectation or the risk/reward ratio of an investment in the fund. We agree with the Commission that redemptions should be permitted if the investor dies or is disabled, or circumstances occur that make it illegal or impractical for the investor to continue to own its interest in the fund. We believe that other extraordinary situations that affect the investor, such as the investor’s bankruptcy and dissolution (if the investor is an entity), should be permitted as well. Investors often bargain for protective provisions that give them a right to redeem their interests in the case of extraordinary events such as (a) the death or disability of the founding or key manager, which might not cause a dissolution of the fund but could materially alter the investment and prompt some investors to want to leave or (b) a change in investment strategy that would likely make the investment riskier or reduce the likelihood of reward and thus change the investment characteristics of interests in the fund. In the case of preferred interests, additional provisions are not uncommon, such as a right of redemption upon, *e.g.*, a 30% draw-down in value of junior equity, a material change in the business plan or investment strategy of the fund, ERISA withdrawal for regulatory reasons or other events materially

changing risk characteristics of fund. We believe the two-year exception should permit such redemptions.

The Commission should clarify that (a) a redemption or exclusion from the fund by the manager and not the investor (such as is typically permitted in hedge funds) would not run afoul of the two-year lock up and (b) the two-year lock-up would not apply to debt interests issued by a fund because they are not "ownership" interests in the sense contemplated by the Proposed Rule. To provide clarity to hedge fund advisers, the Commission should recognize that the general partner or manager of the fund is entitled to determine what constitutes extraordinary circumstances, and that such bona fide determinations will not affect the status of the fund or the adviser. Otherwise, the consequences of the decision will inadvertently affect the adviser and all investors.

III. Amendments to Rule 204-2

Pursuant to Rule 204-2, registered investment advisers are required to maintain books and records supporting any claims made by the adviser regarding its performance track record. The Commission has proposed amendments to this Rule in order to exempt hedge fund advisers from these recordkeeping requirements during periods prior to the adviser's registration under the Proposed Rule.

In addition, the amendment would clarify that the books and records of a registered hedge fund adviser include records of private funds for which the adviser serves as general partner, managing member or in a similar capacity.

The following are our responses to the questions posed in Part II.F of the Proposing Release:

- A. *Is this exemption [which would exempt hedge fund advisers from record keeping requirements for periods prior to registration under the Advisers Act] necessary?*

Yes; the proposed amendments are necessary and appropriate to avoid unjust treatment of existing funds. Without such an amendment, the recordkeeping rules would apply retroactively to newly registered hedge fund advisers, thereby placing them at a competitive disadvantage and in violation of the law for lawful conduct when the conduct occurred.

In addition, any document retention requirements should apply to registered hedge fund advisers only to the extent that such books and records relate to investment advisory services. To apply this requirement to an adviser's non-advisory services that are unrelated to the management of private funds would be overbroad.

- B. *Is the scope of this provision [which would clarify that the books and records of a registered hedge fund adviser include records of private*

funds for which the adviser serves as general partner, managing members or in a similar capacity] too narrow or too broad?

This amendment would clarify that the records of a fund managed by a registered adviser are subject to Commission review. This provision creates problems when applied to registered advisers to offshore funds. The adviser and the fund are usually separate legal entities and the requirement should apply only to books and records within the adviser's possession or control.

Moreover, records of an affiliated general partner that do not relate to a private fund or other investment advisory activities should be excluded from the application of any amended rule. The issue here is whether the amendment should be clarified by excluding records of affiliates that relate to the administration of hedge funds but do not relate to investment advisory activities. If the activities were performed at an adviser level, we believe the Commission should have access to records related to those activities, but records of an affiliated general partner or managing member unrelated to a private fund or other investment advisory activities should not be subject to Commission review.

IV. Amendments to Rule 205-3

The Commission has proposed amendments to Rule 205-3 to avoid requiring certain investors in hedge funds that pay performance fees to divest their current interests in those funds.²⁸ Current Rule 205-3 permits registered investment advisers to charge performance fees to qualified clients that meet certain minimum net worth or assets under management criteria. As some hedge funds permit a small number of non-qualified client investors, upon registration of an adviser under the Advisers Act there may be a small number of investors that do not meet the standards of Rule 205-3. Accordingly, to maintain some stability with individuals who have already invested in hedge funds, the proposed amendment would allow a hedge fund's current investors who are not qualified clients to retain their existing investment in that fund and even add to that account.

- A. *Is it appropriate to create this exemption for current investors? If not, should we require that investors who are not qualified clients exit the hedge funds, or should we require that they be carved out of paying the performance fee?*

This amendment is necessary and appropriate to avoid unfair treatment or undue burdens on hedge fund advisers. It would be unjust to require advisers to sever existing investor relationships because of a change in the law. Moreover, precedent supports this type of grandfathering. For example, private funds relying on Section 3(c)(7) were not required to eliminate investors who were not "qualified purchasers" and acquired securities of the issuer prior to September 1, 1996.²⁹

- B. *Is the scope of the exemption appropriate? If it is too narrow, should we permit current investors to open new accounts or invest in other hedge funds managed by the same adviser? Alternatively, if it is too broad, should we prohibit current investors from adding to their investments?*

The amendment to Rule 205-3 should clearly specify that existing investors will not be prohibited from making additional investments in the same fund. The Proposed Rule would permit a current investor to add to an account, but not to open a new investment account in the same hedge fund or other hedge funds managed by the same adviser. Non-qualified investors should be able to continue to invest in the hedge fund or other hedge funds managed by the same adviser, because the investor has already determined that it has sufficient information about such adviser. Any attempt by the Commission to establish a distinction between investing in an existing account and establishing a new account in the same private fund or a different fund managed by the same adviser would create interpretive complexity and serve little purpose.

V. Amendments to Rule 206(4)-2

The Proposing Release recommends amending Rule 206(4)-2 to relieve an adviser to a “fund of funds” from the requirement that it distribute audited financial statements of the fund within 120 days after the fund’s fiscal year end. The Proposed Rule would extend this deadline to 180 days.

- A. *Is the 180-day period too long?*

We believe this amendment is necessary and appropriate because it recognizes the practical difficulty in obtaining audited financial statements of underlying funds on a timely basis. The adviser of a “fund of funds” should not be deemed to violate the custody rule solely because of an event outside of its control, including the failure of an underlying fund to forward its financial reports in a timely manner. We suggest that the Proposed Rule provide for this extension.

- B. *Would a 150-day period achieve the same goal?*

The proposed 180-day period is more appropriate than a 150-day period to avoid the consequences of a failure to receive the audited financial statements.

VI. Amendments to Form ADV

We agree that Item 7 B. of Part 1A and Section 7 B. of Schedule D of Form ADV should be amended as described in the Proposing Release. Advisers to hedge funds typically identify “private funds” that they manage in response to these Items when those funds are organized as limited partnerships or limited liability companies, of which the advisers or related persons are the general partners or managing members. The primary effect of the amendment will be to require the identification of “private funds”

organized in non-U.S. jurisdictions, most commonly as corporations or trusts, to which the advisers provide investment advice.

Whether or not the Proposed Rule is adopted, the Commission should take this opportunity to clarify the use of the term “client” throughout Form ADV as it relates to investment advisers to hedge funds. The current Form ADV is unclear and inconsistent, sometimes seeming to regard the hedge fund and sometimes seeming to regard its investors as the adviser’s clients. If the Proposed Rule is adopted, an abundantly cautious adviser would likely use its definition of “client” for all responses in the Form ADV. This could impair the accuracy of the data that the Proposed Rule seeks about hedge fund advisers and the hedge funds they manage.

To ensure that the Commission and the public receives accurate information, we believe that the term “client” in the following items in the Form ADV should refer to a “private fund,” as opposed to the fund’s investors, for the reasons stated below:

- Part 1A, Item 5.C – a hedge fund adviser provides its investment advisory services to the fund and not the fund’s investors.
- Part 1A, Item 5.D – one of the types of clients listed is “pooled investment vehicles,” so the question is intended to be answered with respect to the fund and not its investors. In addition, if the Proposed Rule is adopted, the term “private funds” should replace “hedge funds” in the parenthetical in Item 5.D.(6).
- Part 1A, Items 8.A. through 8.E – the questions in these sections relate to an adviser’s interest in client transactions and an adviser’s authority over client accounts, and only elicit the intended information if “client” is defined as the private fund.
- Part II, Item 2 – this Item and Part 1A, Item 5.D. elicit similar information. “Client” should have the same definition in both Items.
- Part II, Item 9 – this Item refers to transactions between the investment adviser and its clients. If an adviser to a hedge fund were to enter into such a transaction, the transaction would be between the adviser and the fund, not investors in the fund. “Client” should refer to the fund and not its investors.
- Part II, Item 12.B – an adviser to a hedge fund selects brokers for transactions by the fund, not for transactions by investors in the fund.

- Part II, Item 13.A – an adviser to a hedge fund may receive soft dollar credits from brokers with respect to trades that the adviser effects on behalf of the fund, not trades for the fund’s investors.

The Commission should consider adding the following sentence to the definition of “client” in the Glossary of Terms of the Form ADV: “If your firm advises a “private fund” as defined in Rule 203(b)(3)-2, you should respond to the following Items with respect to the private fund and not any investors in the private fund: Part 1A, Items 5.C. and 5.D., Items 8.A. through 8.E., and Part II, Items 2, 9, 12.B. and 13.A.”

The Commission should also reexamine the usefulness of the questions in Schedule D, Section 7.B. regarding whether and to what extent “clients” are solicited to invest in the entities described. If “clients” refers to investors in those entities, the question whether clients are solicited to invest in those entities will always be answered “yes” and the question regarding the percentage of clients invested will always be “100%.” If, instead, the question refers to clients for whom the adviser manages a separate account distinct from the fund, the answer to the second question would be whether advisers to hedge funds who also manage separate accounts ask those clients to invest in their hedge funds. In either case, the questions do not elicit useful information with respect to investment advisers to hedge funds and should be deleted. We believe Item 8.D. of Part II of Form ADV should be deleted for similar reasons, and also because the requested information regarding the partnerships or other entities will be available in the amended Schedule D, Section 7.B.

We also suggest the Commission confirm that a “private fund” will not lose the exemption from registration provided by Section 4(2) of the Securities Act, or Rule 506 thereunder, as a result of reporting that fund on Section 7.B. of Schedule D of Part 1 of the Form ADV. For example, an individual searching the IARD system might learn of a “private fund” that has been listed on an adviser’s Schedule D, request offering materials regarding the fund, and subscribe for interests in that fund as a result of the Schedule D listing.

VII. Compliance Period

In response to the Commission’s request for comments on the compliance period, we note that hedge fund advisers required to register with the Commission under the Proposing Release may need significant time to develop, adopt and implement compliance systems that meet the requirements of the Advisers Act. As the Commission noted in the Proposing Release, many unregistered hedge fund managers currently maintain informal compliance procedures.³⁰ To comply in a meaningful way with the Advisers Act, these managers will need to engage compliance experts to educate them about specific Advisers Act requirements, develop and adopt written compliance procedures tailored to their businesses, and train their personnel to implement the new procedures. Even advisers who already have formal compliance procedures will need to

re-evaluate them in light of the Advisers Act requirements, and will likely need to adopt and implement some additional written policies and recordkeeping systems. These steps will require significant investments of advisers' time and attention if undertaken thoughtfully and thoroughly. We see no public interest in setting a timetable for implementing the Proposing Release that may result in managers taking shortcuts or adopting generic or boilerplate policies and procedures. In adopting Rule 206(4)-7 under the Advisers Act, the Commission gave existing registrants approximately eleven months to adopt expanded written compliance procedures.³¹ Advisers that are not accustomed to operating under the full requirements of the Advisers Act will need more time to develop and implement appropriate compliance procedures.

Moreover, the Commission's recent major expansion of formalized compliance rules under the Advisers Act and other rules affecting investment advisers (such as the new rules relating to proxy voting policies and codes of ethics) has vastly increased the demand for compliance professionals in this industry. Because of the scope of the compliance policies and procedures now required of registered advisers, many advisers who previously found periodic consultations with outside attorneys or consultants sufficient to meet their need for compliance expertise are now either seeking to hire in-house compliance experts or making historically unprecedented demands on outside compliance professionals. As a result, the market for experienced compliance personnel has become much more competitive. Many law firms and compliance consulting firms are losing experienced personnel to in-house employment with investment advisers, and many advisers are having trouble finding capable compliance officers. The Proposing Release will only intensify the already stiff competition. The compliance period should take into account that the infrastructure has not developed in the industry to meet the demands.

A six-month implementation period is unrealistic. It would promote a scramble to reach the minimum compliance level, but may not promote the level of compliance that the Commission is seeking. We also believe that specifying a calendar year-end compliance deadline may be helpful to managers in planning for the significant changes that the Proposed Rule will impose on their businesses. We recommend that the Proposed Rule be effective no earlier than January 1, 2006, or, if later, at least one year after the Proposed Rule is adopted.

VIII. Cost-Benefit Analysis, Effects on Commission Examination Resources, Effects on Competition, Efficiency and Capital Formation

The Proposing Release requested comments concerning the impact of the Proposed Rule on efficiency, competition and capital formation. In the Introduction to this letter, we have noted the differences of opinion among the Commissioners as well as the view of Chairman Greenspan and others.³² Given the controversial and even disputed nature of these proposals and their consequences, we do not believe that we are in a position to measure their impact.

However, we note the following:

- We believe that the contents of the alternative form we have proposed would provide the Commission and the public with more relevant and material information as to the universe of private funds than might be obtained from registration, including information prescribed by Form ADV.
- We do not believe that adviser registration should be undertaken in order to provide a “level playing field” with respect to compliance infrastructures or otherwise. Those advisers who have voluntarily registered have done so because they have determined that it is in the best interests of their particular clients and themselves and because they are responsive to the requests of their investors. This is not a reason to require all advisers to private funds to register.
- Alternative and less burdensome means of dealing with many of the issues may be at least as effective as registration. The suggestion of competitive disadvantage is not an important consideration and should not be deemed relevant in determining whether all advisers to private funds should register. The reasons for registration should be compelling.

IX. Issues Raised by the Dissent

The following are our responses to certain issues raised by the dissent in the Proposing Release:

- A. *Would approaches other than hedge fund registration be effective in addressing the concerns raised by the majority?*

Yes; we propose that the Commission establish a registry of hedge funds as detailed in the Introduction. Data could be collected from a census form that would seek the information suggested in the attached document. We believe that each adviser to a private fund should be required to file the form within 45 days after the end of each calendar year.

- B. *If the Commission adopts the proposal, should it include an exemption for advisers that are registered with another government agency, e.g., the Commodity Future Trading Commission?*

There are two points of view, and no consensus, as to whether an exemption to registration should exist for advisers that are already registered with another agency such as the CFTC. Some believe the lack of an exemption would produce duplication of efforts. Others believe the actions and procedures of the CFTC and other

agencies are complementary to those of the Commission and therefore there should be no exemption.

- C. *Would the proposed rulemaking conflict with the securities laws' traditional view that sophisticated investors do not need the full oversight of the Commission?*

Yes; registration would be contrary to the traditional securities law notion that sophisticated investors do not need the full protections of the Commission. Even assuming limited retailization, the vast majority of investors in hedge funds continue to be highly sophisticated. Typically, hedge fund investors do not desire or require the Commission's full protections. Many hedge fund investors, particularly institutional investors, use professional investment advisers who are knowledgeable about the risks associated with investing in hedge funds. The industry has developed on this basis. These determinations are matters of individual choice by each investor. This is not an area in which the Commission has, or should have, an evaluative role. In particular, this should not form the basis of a determination as to which advisers should register with the Commission.

Conclusion

We recognize the concern of the majority of the Commissioners as to the consequences of the proliferation of hedge funds. We also recognize that there are significant and substantive differences of opinion as to the best means of dealing with hedge funds from the point of view of investor protection. We have concluded that it would be appropriate to require the filing by advisers to private funds of informational data which should be kept current annually. In this manner, the Commission and the public will be informed as to the basic non-proprietary and non-confidential information of private funds. It is important that this filing requirement be accompanied by clear definitions as to the advisers responsible to make the filing and the private funds which are the subject of the filing.

We do not believe that there is sufficient basis on the record to require the registration of hedge fund advisers. Alternative means may be found for dealing with certain matters of concern to the Commission. Adviser registration is an important requirement that should only be invoked when there is clear and compelling evidence that it will fulfill explicit and stated objectives.

We have expressed concern as to the unintended consequences that may arise from the change in the longstanding practice of treating the fund as distinguished from the investors as clients under the Advisers Act. While we do not address authority issues, we are concerned that such change is for jurisdictional purposes at least based on the record to date. We urge the Commission to reconsider this matter before taking any final action.

If the Commission proceeds to adopt a final adviser registration rule, it is important that interpretive issues be clarified. Otherwise, the rule will be difficult to administer and burdensome both to the Commission and advisers and their clients. We have identified a number of issues that require careful thought and clarity and answered questions posed by the Commission.

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We hope that these comments will be helpful to the Commission and its Staff. We would be pleased to discuss with the Commission or its Staff any aspect of this letter. Questions may be directed to Diane E. Ambler (202-778-9886), Robert Todd Lang (212-310-8200) or Dixie Johnson (202-639-7269).

Respectfully submitted,

/s/ Dixie L. Johnson

Dixie Johnson, Chair
Committee on Federal Regulation of
Securities

/s/ Diane E. Ambler

Diane E. Ambler, Co-Chair
Task Force on Hedge Fund Regulation

/s/ R. Todd Lang

Robert Todd Lang, Co-Chair
Task Force on Hedge Fund Regulation

Task Force on Hedge Fund Regulation:

Diane E. Ambler, Co-Chair
Robert Todd Lang, Co-Chair

John N. Ake
Jay G. Baris
Roger D. Blanc
John P. Broadhurst
Edwin D. Laurenson
Paul N. Roth
Jeffrey E. Tabak

cc: The Hon. William H. Donaldson, Chairman
The Hon. Paul S. Atkins, Commissioner
The Hon. Cynthia A. Glassman, Commissioner
The Hon. Harvey J. Goldschmid, Commissioner
The Hon. Roel C. Campos, Commissioner
Paul F. Roye, Director,
Division of Investment Management
Robert E. Plaze, Associate Director,
Division of Investment Management
Jennifer L. Sawin, Assistant Director,
Division of Investment Management
Giovanni P. Prezioso, General Counsel

Endnotes

¹ See, e.g., Wall Street Journal Online, *Debate Rages Over SEC Plan to Regulate Hedge Funds* (Sept. 10, 2004), available at <http://online.wsj.com>.

² The President's Working Group consists of four members: William Donaldson, Chairman of the Securities and Exchange Commission; Alan Greenspan, Chairman of the Federal Reserve; John Snow, Secretary of the Treasury; and James Newsome, Chairman of the Commodity Futures Trading Commission ("CFTC").

³ Chairman Greenspan recently testified that the "problem with the SEC's current initiative is that the initiative cannot accomplish what it seeks to accomplish." *The Federal Reserve's Second Monetary Policy Report to Congress for 2004: Hearing Before Senate Banking, Housing, and Urban Affairs Comm.*, 108th Cong. (July 20, 2004) (statement of Alan Greenspan, Chairman, Federal Reserve); see also "Hedge Fund Proposal Troubles Greenspan," WALL ST. J., Aug. 26, 2004, at A6 (quoting Chairman Greenspan as saying "[t]he proposal seeks to deter fraud and market manipulation, but it is unlikely to achieve those objectives.>").

⁴ As the majority of the Commissioners noted in the Proposing Release, the Commission "lack[s] basic information about hedge fund advisers and the hedge fund industry, and must rely on third party data that often conflict and may be unreliable." Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 45,172, 45,177 (July 28, 2004) (to be codified in 17 C.F.R. pt. 275, 279) (hereinafter "Proposing Release"). The dissent also acknowledged that the Commission "does not know everything it would like to about hedge funds and hedge fund advisers." *Id.* at 45,197.

We note that there have been a number of studies of the hedge fund industry. For instance, in 1969, the Commission investigated hedge funds, responding to their rapid growth and trading techniques such as leverage and selling short. 35 SEC ANN. REP. 18 (1969). In 1971, the Commission conducted an economic study of institutional investors in which it described the activities of hedge funds, the conflicts of interest hedge fund advisers experience and their continued growth. H.R. DOC. NO. 92-64 (1971). In 1992, the Commission developed and provided to the Congress information about the regulatory treatment of hedge funds under the federal securities laws. Letter from Richard C. Breeden, Chairman, SEC, to Edward J. Markey, Chairman, Subcommittee on Telecommunication and Finance of 6/12/92. In 1999, the Commission participated in the President's Working Group in response to the Long Term-Capital Management collapse. HEDGE FUNDS, LEVERAGE AND THE LESSONS OF LONG-TERM CAPITAL MANAGEMENT – REPORT OF THE PRESIDENT'S WORKING GROUP ON FINANCIAL MARKETS (Apr. 1999). In 2002, the Staff assisted in preparing proposed rules that would require hedge funds to implement anti-money laundering programs. Financial Crimes Enforcement Network; Anti-Money Laundering Programs for Unregistered Investment Companies, Department of the Treasury Release, 67 Fed. Reg. 60,617 (Sept. 26, 2002) (to be codified at 31 C.F.R. pt. 103). Finally, in 2002, the Commission requested its Staff again examine the activities of hedge funds and hedge fund advisers. In connection with this investigation, the Commission held a Hedge

Fund Roundtable on May 14 and 15, 2003. As a result, in September 2003, the Staff published a report entitled Implications of the Growth of Hedge Funds (“2003 HEDGE FUND REPORT”). The report focused on investor protection concerns raised by the growth of the hedge fund industry.

⁵ Proposing Release, 69 Fed. Reg. at 45,178-45,180.

⁶ In September 2003, the Staff found “no evidence indicating that hedge funds or their advisers engage disproportionately in fraudulent activity.” 2003 HEDGE FUND REPORT at 73. In addition, the general counsel for the CFTC testified this summer “there has been very little fraud in the hedge fund arena. In the last 5 years, less than 3% of all enforcement actions by the CFTC and the SEC (81 out of 3,035) have been against hedge funds and/or their advisers.” *Regulation of the Hedge Fund Industry: Hearing Before Senate Banking, Housing, and Urban Affairs Comm.*, 108th Cong. (July 15, 2004) (statement of Patrick J. McCarty, General Counsel, CFTC).

⁷ Proposing Release, 69 Fed. Reg. at 45,199.

⁸ MANAGED FUNDS ASSOC., 2003 SOUND PRACTICES FOR HEDGE FUND MANAGERS.

⁹ 2003 HEDGE FUND REPORT at 80.

¹⁰ Proposing Release, 69 Fed. Reg. at 45,197. Hedge fund advisers themselves have also asserted that they generally do not seek retail investors because such investors may not be suitable for the inherent risks that accompany some hedge funds. Roundtable Transcript, May 14, 2003 (statement of James R. Hedges) (“[I]t is my sense that the lion’s share of the hedge fund industry is actually not interested in the retail investor. More hedge fund managers that I talk to than not have no interest whatsoever in selling their product in a retail channel. They like being privately placed to accredited or qualified purchasers. They like the freedom that that enables them to have. And they are not interested in getting into a different type of construct in order to target the retail investor.”).

¹¹ For a discussion of the issues as to the Commission’s authority, see letters from Wilmer Cutler Pickering Hale & Dorr (Sept. 10, 2004) and Willkie Farr & Gallagher (Sept. 13, 2004), available at <http://www.sec.gov/rules/proposed/s73004.shtml>.

¹² If the Commission adopts a final rule by November 30, 2004, the first form for existing private funds would be filed by February 14, 2005. Otherwise, the filing would initially be required within 45 days after the effective date of the rule and thereafter annually on a calendar year basis.

¹³ Rules and Regulations under Exchange Act of 1934, 17 C.F.R. § 240.13d-1 (2004).

¹⁴ We do not propose that the filing obligation initially be that of the fund because that raises issues as to the Commission’s authority to establish such a requirement given the private nature of these funds. If the form will be filed by the fund, the form will need to be modified to reflect that circumstance.

¹⁵ Proposing Release, 69 Fed. Reg. at 45,199, n.35.

¹⁶ Investment Company Act of 1940, 15 U.S.C. § 80a-3(c)(1)(A) (2004).

¹⁷ The National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416.

¹⁸ Proposing Release, 69 Fed. Reg. at 45,183, n.126.

¹⁹ Investment Funds Institute of Canada, SEC No-Action Letter, 1996 SEC No-Act. LEXIS 334 (Mar. 4, 1996).

²⁰ Goodwin, Procter & Hoar, SEC No-Action Letter, 1997 SEC No-Act. LEXIS 375 (Feb. 28, 1997).

²¹ Proposing Release, 69 Fed. Reg. at 45,184, n.140.

²² *Id.*

²³ Arguably, the two-year test should not apply to each additional investment in the fund. As the Proposed Rule focuses solely on the initial lock-up period, if the investor is already subject to a two-year lock-up period with respect to its initial investment in the fund, it does not further the Commission's objectives to require each additional investment to be subject to a new two-year lock-up period.

²⁴ *Id.* at 45,183.

²⁵ *Id.*

²⁶ Proposing Release, 65 Fed. Reg. at 76,316 (2000).

²⁷ Proposing Release, 69 Fed. Reg. at 45,195.

²⁸ Investment Advisers Act, 17 C.F.R. § 275.205-3 (1995).

²⁹ Proposing Release, 69 Fed. Reg. at 45,195, n.138.

³⁰ *Id.* at 45,180.

³¹ 17 C.F.R. § 275.206(4)-7.

³² *See supra* note 2.

**INFORMATION TO BE INCLUDED IN FILING WITH THE
SECURITIES AND EXCHANGE COMMISSION¹**

Name of Investment Adviser:² _____

Address of Principal Office
of Investment Adviser: _____

Form of Legal Organization:

- Corporation
- Limited Partnership
- General Partnership
- Limited Liability Company
- Trust
- Other (specify) _____

Jurisdiction of Organization: _____

Number of Employees of
Investment Adviser:

- 0-10
- 11-50
- 51-100
- More than 100

Name of Private Fund Advised: _____

¹ "Private fund" and other terms used herein will need to be defined.

² Special consideration needs to be given with respect to the information to be completed by offshore advisers and offshore funds.

Form of Legal Organization:

- Corporation
- Limited Partnership
- General Partnership
- Limited Liability Company
- Trust
- Other (specify) _____

Jurisdiction of Organization:

Exemption from Registration
under the Investment Company
Act Claimed Under:

- Section 3(c)(1)
- Section 3(c)(7)

Name and Address of General
Partner/Managing Member/
Trustee of Private Fund (if any):

Jurisdiction of Organization:

Number of Shareholders,
Limited Partners or Members
of the Private Fund:

Identify Those Types of
Investment Activities of the
Private Fund that Represented
As of the End of the Most
Recently Completed Calendar
Year More Than 20% of the
Private Fund's Portfolio:

Aggregate Amount of Assets Under Management: \$ _____

Minimum Investment Amount for Shareholders, Limited Partners or Members of the Private Fund:³ \$ _____

Fund of Hedge Funds: Yes No

Any Investments by Pension Plans: Yes No

Does the Private Fund Provide Audited Financial Statements to Investors: Yes No

³ If the minimum investment requirement has ever been waived, please indicate separately and state the minimum amount required pursuant to the waiver, except in the case of lower amounts required in connection with investments by knowledgeable employees.