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January 25, 2011

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

Dear Ms. Murphy:

On November 19, 2010, the Securities and Exchange Commission (the **"SEC"**) proposed rules in Release No. IA-3110[1] and Release No. IA-3111[2] (collectively, the **"Proposed Rules"**) that would implement new exemptions from the registration requirements of the Investment Advisers Act of 1940 (the **"Advisers Act"**), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the **"Dodd-Frank Act"**), for foreign private advisers, advisers to venture capital funds, and private fund advisers with less than $150 million in assets under management (**"AUM"**).

O'Melveny & Myers LLP (**"we"**) is a global law firm with 14 offices in the key Asian, European, and U.S. economic and political centers. Our clients include a wide variety of financial institutions and financial market participants around the world. We have been advising our clients on the potential implications of the Dodd-Frank Act and the Proposed Rules on their business operations. In connection therewith, we are responding to the SEC's invitation for comment on behalf of the China Venture Capital and Private Equity Association[3],

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1 Rules Implementing Amendments to the Investment Advisers Act of 1940, Proposed Rules, 75 Fed. Reg. 77052 (December 10, 2010) (the **"Implementing Release"**).

2 Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, Proposed Rules, 75 Fed. Reg. 77190 (December 10, 2010) (the **"Exemption Release"**).

3 The China Venture Capital and Private Equity Association (**"CVCA"**), incorporated in 2002, is a member-based trade organization established to promote the interest and the development of the venture capital and private equity industry in the Greater China region. Currently CVCA has more than 150 member firms, which collectively manage over $500 billion in venture capital and private equity funds.

the Hong Kong Venture Capital and Private Equity Association[4] and the Singapore Venture Capital and Private Equity Association[5].

We support the SEC's efforts to enhance adviser registration and reporting requirements in order to strengthen investor protection and to increase systemic risk assessment and monitoring. We also applaud the SEC's efforts to provide regulatory relief to certain non-U.S. fund advisers which are less likely to pose systemic risk to financial markets in the United States. In particular, we support the SEC's proposal to define a "U.S. Person" generally by incorporating the definition of "U.S. Person" in Regulation S under the Securities Act of 1933, as amended. We agree with the SEC that this approach would provide a well-developed body of law. Moreover, non-U.S. managers of private funds and their counsel are familiar with the definition of "U.S. Person" under Regulation S and therefore would not have to undertake a different analysis.

We are concerned, however, that certain aspects of the Proposed Rules are not sufficiently tailored to achieve these important regulatory objectives. The Proposed Rules should be considered within the context of their application to the private fund industry and their impact on day-to-day operations of the fund managers, as well as the efficiency and continued economic viability of the asset class.

EXECUTIVE SUMMARY

We have three principal areas of concern with respect to the Proposed Rules: (1) the $25 million threshold for a "foreign private adviser" exempt under Section 202(a)(30) of the Advisers Act (the **"Foreign Private Adviser Exemption"**); (2) the timing of testing of AUM for the purposes of determining the availability of the Foreign Private Adviser Exemption and/or the "private fund adviser exemption" (the **"AUM Calculation Methodology"**); and (3) the required disclosure and publication of valuation information, including value of level 1, 2 and 3 assets and liabilities, of a private fund (the **"Fund Valuation Reporting"**). In each of these areas, the Proposed Rules' reach is more expansive than necessary and ultimately may cause an undue burden on non-U.S. advisers as well as create certain downsides for U.S. institutional investors investing in funds advised by non-U.S. advisers.

We are concerned that the $25 million threshold for the Foreign Private Adviser Exemption has been set too low to require firms that are unlikely to pose systemic risk to register as investment advisers with the SEC or become subject to significant reporting requirements.

4 The Hong Kong Venture Capital and Private Equity Association (**"HKVCA"**) was established in 1987 with the objectives of promoting and protecting the interests of the venture capital and private equity industry in Hong Kong. Currently HKVCA has more than 200 members in Hong Kong, investing in Asian venture capital and private equity funds, which collectively manage over $280 billion.

5 Established in 1992, the Singapore Venture Capital and Private Equity Association (**"SVCA"**) is a not-for-profit organization formed to foster the growth of venture capital and private equity in Singapore and around the region. SVCA's membership now exceeds 100, representing over SG$200 billion under management in venture capital and private equity funds.

By comparison to the limited benefits (if any) to be obtained by the SEC regulating some or all of these advisers' business activities, we believe that many of these small advisers will incur disproportionately high compliance costs. Without an increase in the AUM threshold, we believe, and as supported by anecdotal evidence from our clients, that the result is likely to be a decrease in investment opportunities for U.S. investors, since many small foreign advisers will limit participation by, or exclude altogether, U.S. investors to avoid the associated costs.

In addition, we are concerned that the AUM Calculation Methodology does not provide a suitable basis to determine whether a fund adviser should be subject to the SEC's regulation because an increase or decrease of such value is not necessarily correlated to any systemic risk to the U.S. financial markets. In addition, reporting AUM on a fair value basis may cause fund managers to incur additional costs, since many fund assets are illiquid in nature, to which the fair value methodology may be difficult to apply.

We are also concerned that the disclosure and publication of the Fund Valuation Reporting will make sensitive fund information available to competitors and other market participants and potentially harm the interests of a private fund and its investors. We do not believe the publication of such information would enhance the SEC's ability to assess and monitor systemic risk and this is particularly true with respect to small fund advisers.

Therefore, we respectfully request that the SEC consider the alternative approaches set forth below.

I. THE $25 MILLION THRESHOLD FOR THE "FOREIGN PRIVATE ADVISER EXEMPTION" SHOULD BE INCREASED TO $100 MILLION

We recommend raising the $25 million threshold for requiring Foreign Private Advisers to register to $100 million. A $25 million threshold is too low and should be raised to a level that is more closely aligned to the regulatory objectives of the Proposed Rules. As currently proposed, the Foreign Private Adviser Exemption would provide extremely limited relief from the registration and reporting requirements to small non-U.S. advisers who manage offshore funds outside the United States and pose little systemic risk to the U.S. financial markets.

Pursuant to the Proposed Rules, a non-U.S. adviser that has no place of business in the U.S. and advises non-U.S. funds that have assets from U.S. investors of $25 million or more will be deemed an "exempt reporting adviser" and will be subject to extensive reporting and examination requirements under the Advisers Act.

This may create an undue burden on small non-U.S. advisers that manage very little U.S. money and presents significant practical and policy concerns. Even one relatively modest U.S. investor in a non-U.S. fund could cause a non-U.S. adviser that otherwise has no connection with the U.S. to become an exempt reporting adviser. For example, because many advisers to private funds seek to provide investors two times money back, a single U.S. person who invests $12.5 million in a non-U.S. fund could cause the fund adviser to become an exempt reporting adviser.

Advisers that are deemed exempt reporting advisers will have to devote substantial time and other resources to comply with extensive reporting requirements about their businesses and the private funds they manage (other than non-U.S. funds that are not offered to U.S. persons and have no U.S. persons as beneficial owners). In our experience, many small non-U.S. advisers are leanly staffed and not sufficiently familiar with the Advisers Act and the Form ADV to be able to efficiently comply with the reporting requirements. They will likely need to hire U.S. counsel or consultants to assist in their efforts to comply with such reporting requirements and incur substantial costs associated with that assistance.

Requiring advisers with a very small amount of assets under management from U.S. persons to either register or file reports with the SEC does not serve any meaningful regulatory purpose and is not in the interest of fund investors (whether U.S. or non-U.S.). A small amount of assets under management from U.S. persons does not pose any systemic risk to the U.S. financial system or any financial institution, a matter the Congress considered important in enacting amendments to the Advisers Act in the Dodd-Frank Act.[6] In addition, U.S. investors that invest in non-U.S. funds managed by a non-U.S. adviser are typically sophisticated investors, such as endowments, pension funds and other financial institutions, who conduct extensive due diligence on non-U.S. fund managers before investing in their respective funds and the reporting requirements that are proposed to be imposed on exempt reporting advisers would not afford them more protection. The information required to be disclosed by a non-U.S. adviser will be available to such U.S. investors as part of their due diligence process before they invest and as part of ongoing fund reporting after they invest. Furthermore, such professional investors usually work with consultants and legal counsel to negotiate the terms of their investments and ensure inclusion of protective mechanisms to protect their interests.

We have been infromed that investors are concerned that an increasing percentage of time and resources will be spent filing reports with the SEC and that this will reduce the adviser's time and resources spent managing investments. Many investors are unhappy with the prospect of the increased costs of complying with the reporting requirements being charged to the funds that they have invested in. For example, a Singapore-based investment adviser that has raised a small private equity fund, comprising largely of investors based in Asia and the United States has reported to us that certain Asian investors have objected to sharing the costs of providing relatively simple reporting to U.S. investors (in the form of a U.S. Internal Revenue Service Schedule K-1, "Partner's Share of Income, Deductions, Credits, etc.[7]). It is likely that such objections will increase and that the cost of enhanced regulatory compliance may, as a commercial matter, have to be borne solely by U.S. investors, which would affect their net returns. Another possible outcome is that many non-U.S. advisers with less

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6 *See* S. Rep. No. 111–176, at 71–3 (2010); H. Rep. No. 111–517, at 866 (2010).

7 Individual partners use the form to help determine their share of income, which is to be reported on their individual tax returns.

significant amounts of U.S. assets invested in their funds may choose to restrict the participation by U.S. investors rather than attempt to comply with the Proposed Rules and, thereby, decrease the availability of potentially attractive investment opportunities to U.S. investors. We are already aware of that at least one non-U.S. adviser, in the process of raising a small fund, is already taking active steps to reduce commitments from U.S. institutional investors so as to avoid becoming an exempt reporting adviser.

We believe $100 million would be a more appropriate threshold. We note that setting a higher threshold is within the SEC's authority as the Dodd-Frank Act provided for the SEC to include the $25 million threshold "or such higher amount as the Commission may, by rule, deem appropriate in accordance with the purposes of this title."[8] We believe the public interest would be better served by adopting a threshold that is consistent with the $100 million threshold separating state regulated advisers from those regulated by the SEC. A $100 million threshold would be high enough to provide regulatory relief to the smallest non-U.S. advisers and those advisers that pose little or no systemic risk to the U.S. financial system. It will also help focus the SEC's resources on larger advisers that may pose greater systemic risk and require more attention and regulation of the SEC.

II. AN ALTERNATIVE AUM CALCULATION METHODOLOGY THAT WOULD ADDRESS THE FLUCTUATION OF ASSET AND CURRENCY VALUES SHOULD BE ADOPTED

For purposes of determining an adviser's qualification to register with the SEC rather than the states, as well as its eligibility for the "private fund adviser exemption," the SEC has proposed to require an adviser to determine the amount of its private fund assets on an ongoing basis quarterly, based on the fair value of the assets at the quarter end, and on a day to day basis for the purposes of the Foreign Private Adviser Exemption. The primary reason cited against permitting advisers to use the historic cost basis for calculating AUM (*i.e.*, the value at which the assets were originally acquired)" as cited in the Exemption Release and the Implementing Release is that "[it] could under certain circumstance understate significantly the value of appreciated assets, and thus result in advisers availing themselves of the exemption."[9]

We understand the rationale behind the proposal to implement a uniform method of calculating AUM for various purposes under the Advisers Act. We agree with the SEC that "uniformity in the method for calculating assets under management would result in more consistent asset calculations and reporting across the industry and, therefore, in more coherent application of the Advisers Act's regulatory requirements and of the SEC staff's risk assessment program."[10]

However, our concern is that this methodology does not provide a suitable basis to determine whether a fund adviser should be subject to the SEC's regulation. We are

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[8] Section 402(a)(30)(C) of the Dodd-Frank Act.

[9] *See*, Exemption Release, 75 Fed. Reg. at 77207; Implementation Release, 75 Fed. Reg. at 77057.

[10] *See*, Exemption Release, 75 Fed. Reg. at 77207; Implementation Release, 75 Fed. Reg. at 77057.

concerned that the Proposed Rules would potentially subject fund managers to registration with, or reporting to, the SEC simply because the value of fund assets has increased either due to good performance of underlying investments or as a consequence of changes in the relevant exchange rates. Conversely, it would not seem to be the right outcome should fund advisers be able to avail themselves of an exemption simply because underlying investments perform poorly or as a result of changes in the opposite direction in the relevant exchange rates. We believe that neither result would increase investor or market protection as an increase of the value of fund assets would not necessarily increase systemic risk while a decrease of the value of fund assets would not necessarily decrease systemic risk.

It is also worth noting that, with respect to advisers that manage private equity funds, their management fees are generally calculated by reference to the historical cost of their investments and not by reference to the "fair value" of fund assets. Unless a fund has accepted more investors in subsequent closings or permitted investor withdrawals following an adviser's most recent reporting, any change in value of fund assets should not impact the registration or reporting status of such adviser. Existing investors who have already committed to the fund and whose interests are not being diluted on the basis of the fund's value do not need more protection than when they first committed to the fund. In addition, the volatility of exchange rates is beyond the control of fund advisers. Furthermore, as the SEC acknowledged in the Exemption Release and the Implementation Release, although many private funds value assets based on their fair value, "some private funds do not use fair value methodologies, which may be more difficult to apply when the funds hold illiquid or other types of assets that are not traded on organized markets,"[11] and this is especially true for private equity funds. For example, certain assets such as "distressed debt" securities and certain types of emerging market securities that are not readily marketable will be difficult to value.[12] Reporting AUM on a fair value basis quarterly could distract fund advisers from devoting their full attention to investors and investment portfolios and add costs to fund operations.

For the reasons set forth above, we would respectfully recommend, in calculating AUM for purposes of the registration exemptions, that firstly the value of each fund investment be fixed at its historical cost and secondly that an adviser's AUM be adjusted only when a fund accepts new investors or permits redemptions. Where funds are denominated other than in U.S. dollars, we believe that it is appropriate for a trailing average exchange rate over a significant period (for example, one year) to be used in order to minimize the impact of exchange rate volatility.

III. FUND VALUATION REPORTING SHOULD BE KEPT CONFIDENTIAL

The other key area of the Proposed Rules that we are most concerned about is fund valuation information required to be disclosed by fund advisers.

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[11] *See*, Exemption Release, 75 Fed. Reg. at 77207; Implementation Release, 75 Fed. Reg. at 77057.

[12] *Id.*

The Proposed Rules require fund advisers to disclose on Form ADV detailed information regarding private funds they manage, including fund valuation information such as gross asset and net asset value of each relevant private fund as well as value of such fund's level 1, 2, and 3 assets and liabilities determined under U.S. generally accepted accounting principles (GAAP). The information would be publicly available as is other information on Form ADV.

We would like to seek clarification that the reporting requirement concerning level 1, 2 and 3 assets and liabilities does not require advisers to comply in accordance with GAAP standards.[13] As the SEC is aware of, some private funds advised by non-U.S. advisers as well as many underlying investee companies of private funds advised by non-U.S. advisers do not use GAAP or other international accounting standards. Should GAAP standards be mandatory, the requested information might not be readily available. Fund advisers would need to undertake a different analysis in order to satisfy the reporting requirements. In connection therewith, they would need to engage advisers to assist with such analysis, which would add costs to fund operations.

We are particularly concerned that the disclosure and publication of fund valuation information would make sensitive fund information available to competitors, potential secondary purchasers and other market participants and harm the interests of a private fund and its investors. For example, a private equity fund might only make one investment during a relatively long period. The disclosure and publication of valuation information about this single investment would affect the fund's ability to generate attractive returns to its investors at exit and pose a direct negative impact on the asset class. In addition, potential secondary purchasers such as secondary funds might use valuation information obtained from the SEC's website regarding various funds to bid for a limited partnership interest in a secondary sale. In our experience, the valuation of a limited partnership interest in a private fund depends on many factors including each type of asset according to its investment targets, funding ratio, vintage year, management team, the quality of the portfolio's assets as well as the fund manager's valuation methodology, rather than the value of fund assets alone. The disclosure and publication of fund valuation information therefore may harm a selling investor seeking to maximize value and other investors in the fund.

Based on the foregoing, we would respectfully recommend that the Fund Valuation Reporting be kept confidential. We would also recommend that Question 12 of Section 7.B.1 of Schedule D be amended to clarify that funds that do not use GAAP standards may provide equivalent information to that contained in financial statements prepared in accordance with such funds' governing documents.

IV. SUMMARY OF RECOMMENDATIONS

The goal of this comment letter is to highlight a limited number of items under the Proposed Rules where we believe that further tailoring will better serve the SEC's objectives.

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[13] *See*, Exemption Release, 75 Fed. Reg. at 77207; Implementation Release, 75 Fed. Reg. at 77057. The SEC stated that they "are not proposing to require advisers to determine fair value in accordance with GAAP."

For ease of reference, we summarize our specific recommendations for revisions to the Proposed Rules below, and look forward to the opportunity to work further with the SEC to adopt a practical, functioning regulatory structure.

The Foreign Private Adviser Exemption

With regard to the Foreign Private Adviser Exemption, we would suggest that the SEC increase the threshold from $25 million to $100 million.

AUM Calculation Methodology

We would recommend, in calculating AUM for purposes of the registration exemptions, that firstly the value of each fund investment be fixed at its historical cost and secondly that an adviser's AUM be adjusted only when a fund accepts new investors or permits redemptions. Where funds are denominated other than in U.S. dollars, we believe that it is appropriate for a trailing average exchange rate over a significant period (for example, one year) to be used in order to minimize the impact of exchange rate volatility.

Fund Valuation Reporting

We would recommend that valuation information be kept confidential. We would also recommend that Question 12 of Section 7.B.1 of Schedule D be amended to clarify that funds that do not use GAAP standards may provide equivalent information to that contained in financial statements prepared in accordance with such funds' governing documents.

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We appreciate the opportunity to provide comment on the Proposed Rules. Please do not hesitate to contact me or Barbara A. Stettner of O'Melveny & Myers LLP at (202) 383-5300, if you have any questions or comments.

Sincerely,

Christopher M. Salter

Christopher M. Salter
of O'Melveny & Myers LLP

cc: The Hon. Mary L. Schapiro, Chairman
The Hon. Luis A. Aguilar, Commissioner
The Hon. Kathleen L. Casey, Commissioner
The Hon. Troy A. Paredes, Commissioner
The Hon. Elisse B. Walter, Commissioner
Andrew J. Donohue, Director, Division Of Investment Management
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