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September 13, 2004

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Client Matter No.

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Via Email

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street N.W.
Washington, D.C. 20549-0609

Re: File No. S7-30-04
Release No. IA-2256

Dear Mr. Katz:

This letter is submitted on behalf of several of our clients who manage investments for traditional private equity and venture capital funds. We appreciate the opportunity to provide these comments on the Commission's proposal to amend the Investment Advisers Act of 1940.

In the release accompanying the Proposed Rule, the Commission indicates that it intends to exempt advisers to traditional private equity and venture capital funds from registering as investment advisers, and specifically asks for feedback on the effectiveness of the Proposed Rule in distinguishing hedge funds from other types of funds. We think the Proposed Rule could have substantial unintended reach in this respect, and would create unnecessary administrative burdens from interpretive requests, much of which could be avoided with further clarifications in the final rules.

1. Safe Harbor

One way to help the Proposed Rule achieve the Commission's intended exemption is to explicitly state such intention in the Rule itself, and create a safe harbor provision for at least some funds based on the composition of their investment portfolios. As the Commission notes in its release, hedge funds typically do not invest primarily in equity or debt securities that are not publicly traded. The opposite is true for traditional venture capital and private equity funds. Although traditional venture and private equity funds do frequently end up holding publicly traded securities (when private portfolio companies develop into more mature companies and eventually access the public markets), the initial investments of many such funds typically are made in illiquid securities of private companies.

A registration exemption based on portfolio composition might provide: “If a majority of a fund’s assets (based on their character and investment cost at the time of initial investment or acquisition) are comprised of unregistered equity securities, the fund will be considered a ‘private equity’ or ‘venture capital’ fund and not a ‘private fund.’ Such exemption is intended to be a safe harbor for funds that satisfy such test and does not imply that funds that do not satisfy such test are necessarily a "private fund."”

Please note that the foregoing proposal applies only to unregistered equity securities. We recognize that debt securities present more complicated considerations with respect to active markets for commercial paper, 144A debt securities and the like that may be more difficult to distinguish from illiquid debt securities for purposes of the objectives behind the Proposed Rule.

In short, the foregoing safe harbor would not exempt every traditional private equity and venture capital fund manager, but it should clear away a very large segment of such funds, without exempting any hedge funds that are intended to be reached by the Proposed Rule.

2. <u>Two-year redemption test</u>

An additional clarification relates to the "two-year redemption" component of the Proposed Rule. We note firstly that, unless the Proposed Rule is revised, this component is the *only* factor in the Rule itself that can be relied upon to exempt traditional private equity and venture capital funds. The other elements of the proposed definition of a "private fund" (status as a "but for" investment company, and holding out investment advisory skills and expertise) are characteristics of nearly every traditional private equity and venture capital fund. Accordingly, the "redeemability" element is the only definitional element that might be exemptive for traditional funds.

We believe the proposed redemption test is meant to be applied to a right of redemption held by an individual investor, and not to actions undertaken by a majority or super-majority of fund investors. This concern arises because of certain fund governance provisions that are very common in traditional private equity and venture funds. Such traditional funds certainly contemplate long-term commitments as indicated by the Commission, and do not generally permit unilateral redemptions by an investor on a short-term basis. But such funds also routinely include governance and investor-rights provisions based upon action by majority vote or super-majority vote of the investors (as limited partners or non-managing members of the fund). For example, it is common for traditional funds to have provisions that enable a majority (or super-majority) of the investors to vote to liquidate the fund outright, either in their absolute discretion at any time or upon the occurrence of certain events (such as the departure of "key person" managers from the investment manager). In addition, many such funds use a majority-approval process (directly with the investors or with an advisory committee composed of investor representatives) to address conflict-of-interest situations or specific investment issues (such as approving the making or the disposition of an investment where the fund manager may have a conflict because affiliated funds also have invested in the same company, or because the investment falls inside or outside of specific investment guidelines the fund generally follows). There are many variations of these terms, but the key is that each of them involves possible action, during the first two years of a fund's life as well as thereafter, which effectively causes a liquidation and distribution of all or some of the fund's investments. These rights are not exercised frequently, as a practical matter, but the issue is whether the existence of such rights, potentially exercisable within the first two years of a fund's expected life, would be construed as a redemption right that causes the manager to have to register under the Proposed Rule.

To clarify the application of the Proposed Rule in this respect, Section 203(b)(3)-2(d)(ii) could be supplemented to provide that: “A right of investors in a fund, by majority or greater vote, to terminate a fund or to approve or direct the disposition of portfolio assets, shall not in and of itself constitute a redemption right for purposes of the two-year redemption rule.”

As the release accompanying the Proposed Rule makes clear, the Proposed Rule was drafted in response to the explosive growth of hedge funds, combined with an accompanying increase in hedge fund fraud and retailization. The release further states that the Commission has not encountered significant enforcement problems with traditional private equity and venture capital fund managers, and intends to continue to exempt them from this expanded regulatory framework. Given those goals, we hope you will consider the proposals above which only seek to better give effect to such intentions, and to spare both the Commission and fund managers an unnecessary administrative burden.

Thank you for considering our comments. Please do not hesitate to contact the undersigned if we can provide you with further information.

Sincerely,

Joseph M. Barbeau