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September 14, 2004

VIA ELECTRONIC MAIL

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:Proposed Registration Under the Investment Advisers Act of Certain Hedge Fund Advisers

Dear Mr. Katz:

We are pleased to be afforded the opportunity to submit this comment letter in response to a request by the Securities and Exchange Commission (the "Commission") for comments on the above referenced proposal with regard to the registration of certain hedge fund managers under the Investment Advisers Act of 1940, as amended (the "Advisers Act).[1] (We refer to such Commission proposals as the "Proposed Rules.")

While we have a number of concerns with regard to the Proposed Rules, including without limitation, whether or not the Commission even has the power to enact the changes without Congressional action, we have focused our comments to the impact of the Proposed Rules on non-U.S. fund managers that have limited contact or operation within the United States. Furthermore, we respectfully request that the Commission clarify the application of proposed Rule 203(b)(3)-2(a) (counting clients) and proposed Rule 203(b)(3)-2(b) (looking through a registered investment company investor of a private fund for the purposes of counting clients) in the event that these proposed rules are adopted. We also support the proposed amendments to Rule 205-3 (definition of qualified client) and to Rule 206(4)-2(b)(3) (delivery of audited

[1] Securities and Exchange Commission; Registration Under the Advisers Act of Certain Hedge Fund Advisers; proposed rule. 69 Fed. Reg. 45172 (July 28, 2004).

financial statements to beneficial owners of a pooled investment vehicle) and explain why the Commission should adopt such amendments. Finally, we respectfully suggest that before any final action is adopted, another round of proposed rules based on the hedge fund industry's comments to the Proposed Rules be drafted by the Commission staff and circulated for further consideration and comment.

I. Impact on Non-US Hedge Fund Managers

The Commission is proposing that non-U.S. based fund managers that operate funds that satisfy the definition of "private funds,"[2] whether or not such funds are also located offshore, look through the funds that they manage and count investors that are U.S. residents as "clients." According to the Proposed Rules, a non-U.S. based adviser to a "private fund" that, in the course of the previous twelve months, has more than fourteen investors that are U.S. residents would generally have to register with the Commission as an investment adviser.[3]

The Setting

There are at least three types of non-U.S. manager situations involving U.S. investors:

1. Non-U.S. managers that have operations in the U.S. through one or more affiliates. We believe that such managers should be treated as other US managers to maintain a level playing field.

2. Non-U.S. managers that organize and sell U.S. products, such as interests in U.S.-domiciled limited partnerships or limited liability companies, to U.S. investors. Here too, we believe that there is ample precedent derived from such a nexus to treat such non-U.S. managers in the same manner as U.S.-based managers.

3. Non-U.S. managers that operate entirely outside of the U.S. but for the fact that their non-U.S. funds are sold to U.S. investors pursuant to the private placement

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[2] According to proposed Rule 203(b)(3)-2(d)(1), a "private fund" is defined to mean a company:

(i) that would be an investment company under Section 3(a) of the Investment Company Act of 1940, as amended (the "Company Act") but for the exception provided from that definition by either Section 3(c)(1) or Section 3(c)(7) of such Act;

(ii) that permits owners to redeem any portion of their ownership interests within two years of the purchase of such interests; and

(iii) interests in which are or have been offered based on the investment advisory skills, ability or expertise of the investment adviser.

See proposed Rule 203(b)(3)-2(d)(1)(i)-(iii); 69 Fed. Reg. at 45184-45185.

[3] See 69 Fed. Reg at 45183; proposed Rule 203(b)(3)-2(c) of the Advisers Act.

rules and Commission staff no-action letters that address the sale of interests of privately placed offshore funds in the United States.[4]

Our comment is confined to this latter case, item 3.

Registration of Certain Non-U.S. Hedge Fund Managers Is Unwarranted

In our view, the application of the Proposed Rules to non-U.S. fund managers that fall within item 3 is unwarranted. We would urge that proposed Rule 203(b)(3)-2(c) be amended to recognize those managers, certainly those who are already regulated by competent non-U.S. regulators and are in good standing in their home jurisdictions, as outside of the scope of the Proposed Rules.[5]

We have a large practice in this area, and we have found that it is rare for U.S. investors other than U.S. *tax-exempt* investors to invest in non-U.S. domiciled funds because such funds are generally treated as passive foreign investment companies (a "PFIC") under the U.S. federal income tax regulations. As a result, a taxable U.S. investor would be exposed to adverse tax treatment. Accordingly, U.S. investors that invest in such pools tend to (i) be tax exempt, (ii) have a person in power acting in a fiduciary capacity under the Employee Retirement Income Security Act ("ERISA") if it is a pension plan, or is often subject to state laws, if it is charitable entity or a foundation, and (iii) be able to conduct the level of due diligence necessary to protect their interests because they have the resources to allow them to make an informed decision whether to invest in an offshore fund. Most important is the notion that such an investor likely has no expectation whatsoever of Commission oversight in connection with such investment.[6]

USA PATRIOT Act Analogy

We respectfully suggest that the proposed look-through requirement pursuant to proposed Rule 203(b)(3)-2(c) not occur with respect to non-U.S. domiciled funds operated by non-U.S. based fund managers. There is precedent for this suggestion. In the proposed rules to require registered and unregistered investment advisers to adopt an anti-money laundering program pursuant to Section 352 of the USA PATRIOT Act, it was suggested that one of the criteria to determine whether an investment adviser must comply was whether the investment adviser has its principal office and place of business in the United States.[7] Simply because an investment adviser has U.S. clients was not sufficient. Rather, it was proposed that a local domicile element

[4] See Goodwin Proctor & Hoar, SEC Staff No-Action Letter (February 28, 1997); Touche, Remnant & Co., SEC Staff No-Action Letter (August 27, 1984).
[5] Perhaps a notice filing is sufficient in such cases.
[6] An appropriate legend could be added to the investment materials requiring that the investor be made aware that the investment manager is not registered with the SEC.
[7] See Financial Crimes Enforcement Network; Anti-Money Laundering Programs for Investment Advisers; proposed rules. 68 Fed. Reg. 23646-23653, 23648 (May 5, 2003).

be required to determine whether the proposed rule applied to an investment adviser. The Commission should adopt this approach as well with respect to determining whether a non-U.S. based fund manager that operates a "private fund" should have to register with the Commission because it creates concrete contacts within the United States.

Level of Compliance; Impact of Home Jurisdiction Registration

Furthermore, the Commission should further clarify the extent to which non-U.S. based fund managers are required to comply with the Advisers Act. Non-U.S. fund managers, especially those who are already subject to local regulation (such as U.K.-based fund managers that are regulated by the U.K.'s Financial Services Authority), will want to know to what extent they must comply with a myriad of non-local rules in addition to the rules that they are already subject to in their home jurisdiction.

We urge that the Commission give credence to the registration of a fund manager in its home jurisdiction and consider whether such registration is at least equal to U.S. oversight. Certainly the regulations in the U.K. administered by the Financial Services Authority meet U.S. standards. Perhaps a notice filing such as an expansion of Form D would be sufficient for this purpose.

Currently, the scope of compliance with the Advisers Act by a non-U.S. based registered investment adviser is based on the Unibanco no-action letter and its progeny.[8] A limitation of relying on Commission staff no-action letters is that the relief granted is based on the particular facts and circumstances described in such letters. Forced to rely on Commission staff interpretations of the Advisers Act that turn on particular facts and circumstances, non-U.S. advisers may become frustrated and ultimately confused as to how to comply with the Advisers Act. During the past two years, the Commission has released a number of rules and amendments to the Advisers Act applicable to registered investment advisers that were not present when Unibanco and its progeny were issued.[9] Although the Commission stated that "most of the substantive provisions of the Advisers Act would not apply to [a non-U.S.] adviser's dealing

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[8] See Uniano de Banco de Brasileiros S.A., SEC Staff No-Action Letter (July 28, 1992) ("Unibanco"). See also Mercury Asset Management plc, SEC Staff No-Action Letter (April 16, 1993); The National Mutual Group, SEC Staff No-Action Letter (March 8, 1993); and Murray Johnstone Holdings Ltd., SEC Staff No-Action Letter (October 7, 1994). According to the Commission staff, the substantive aspects of the Advisers Act would not apply except to the extent that there are U.S. clients.

[9] See Securities and Exchange Commission; Investment Adviser Code of Ethics; final rule. 69 Fed. Reg. 41696-41709 (July 9, 2004); Securities and Exchange Commission; Compliance Programs of Investment Companies and Investment Advisers; final rule. 68 Fed. Reg. 74714-74730 (December 24, 2003); Securities and Exchange Commission; Custody of Funds or Securities of Clients by Investment Advisers; final rule. 68 Fed. Reg. 56692-56701 (October 1, 2003); Securities and Exchange Commission; final rule. 68 Fed. Reg. 6585-6593 (February 7, 2003).

with the fund" or the adviser's non-U.S. clients, the applicability of Unibanco is presently unknown vis-à-vis the new rules and amendments to the Advisers Act.[10]

More detailed guidance is needed on the extra-territorial application of the Advisers Act because the non-U.S. community will want more explicit guidance that clearly spells out their obligations if the Commission is to achieve effective compliance with the Advisers Act by non-U.S. based fund managers. For example, if Rule 204A-1 of the Advisers Act (Code of Ethics)[11] were to apply to non-U.S. based investment advisers, would all persons that fall under the definition of "access persons"[12] be required to furnish initial and annual holdings reports[13] and quarterly transaction reports[14] or would such application be limited only to those "access persons" that advise U.S. clients? Also, as a practical matter, is it possible for access persons located abroad to furnish the same type of information that is required in an initial and annual holdings report and in a quarterly transaction report?[15]

We strongly urge the Commission to reconsider the extraterritorial impact of the Proposed Rules before further action is taken towards adopting proposed Rule 203(b)(3)-2(c). Moreover, we respectfully suggest that the Commission contact foreign regulatory officials of those jurisdictions where most non-U.S. based fund managers are domiciled (e.g. the U.K., Bermuda, the Cayman Islands, Hong Kong, Singapore, and the British Virgin Islands) to discuss to what extent regulatory redundancy is created by an extra-territorial application of the Proposed Rules and whether cooperation can be achieved without having to formally register non-U.S. based fund managers that have fifteen or more U.S. clients.

II. Proposed Rule 203(b)(3)-2(a) (Counting Clients)

Proposed Rule 203(b)(3)-2(a) requires fund managers that operate "private funds" to count each shareholder, limited partner, member, other securityholder or beneficiary of a private fund as a client.[16] If there are fifteen or more clients and the investment vehicle falls within the definition of "private fund," then a fund manager would be required to register with the Commission. We respectfully request the Commission to clarify the application of proposed Rule 203(b)(3)-2(a). Is the counting of clients to be conducted in a fund-by-fund basis or in the aggregate?

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[10] See 69 Fed. Reg. at 45184, note 135 (citing Unibanco as discussed in notes 131 and 134).
[11] See Securities and Exchange Commission; Investment Adviser Code of Ethics; final rule. 69 Fed. Reg. 41696-41709 (July 9, 2004).
[12] See Rule 204A-1(e) of the Advisers Act.
[13] See Rule 204A-1(b)(1) of the Advisers Act.
[14] See Rule 204A-1(b)(2) of the Advisers Act.
[15] See Rules 204A-1(b)(1)(i)(A)-(C) and 204A-1(b)(2)(i)(A)-(E) of the Advisers Act.
[16] See proposed Rule 203(b)(3)-2(a) of the Advisers Act.

For example, assume that a hedge fund manager is operating four "private funds," and each fund has seven beneficial owners. In this scenario, on a fund-by-fund basis, since each of the four "private funds" has seven beneficial owners, the fund manager would not be required to register with the Commission because there are fourteen or less clients in each fund. However, on an aggregate basis, there are twenty-eight beneficial owners among the four "private funds." Since there are fifteen or more clients (twenty-eight beneficial owners in total), the fund manager would be required to register with the Commission. We suggest that clarification is required on how to apply proposed Rule 203(b)(3)-2(a).

III. Proposed Rule 203(b)(3)-2(b) (Looking-through Registered Investment Companies)

The Proposed Rules contain a provision for advisers to "private funds" in which a registered investment company invests. The Commission proposes to require the fund manager of a "private fund" to count the investors in the registered investment company as clients.[17] In response to the Commission's request for comments on its "look through" approach, presuming that proposed Rule 203(b)(3)-2(b) is adopted, we believe that the Commission should consider the following issues:

- Will there be a specific statutory form for investment advisers of "private funds" to furnish to investors that are registered investment companies to obtain the number of investors? Alternatively, is obtaining an oral representation that the registered investment company has more than fourteen owners sufficient to satisfy proposed Rule 203(b)(3)-2(b)?

- What is the time period for obtaining such information from an investor that is a registered investment company? *E.g.* is the investment adviser obligated to obtain the information three days, ten days or thirty days before an investment by a registered investment company?

- Will an investment adviser have to obtain an annual re-certification from an investor that is a registered investment company to ensure that the information is not stale?

IV. Proposed Amendment to Rule 205-3 of the Advisers Act (Qualified Clients)

As a general rule, a registered investment adviser cannot charge a performance-based fee or allocation based on its fund's capital gain or appreciation unless its client is a "qualified client" as defined in Rule 205-3 of the Advisers Act. As a consequence of adopting proposed Rule 203(b)(3)-2, assuming that the criteria for "private fund" are satisfied, an unregistered fund manager that operates a "private fund" that relies on the exemption from investment company registration pursuant to Section 3(c)(1) of the Company Act would be obligated to require its

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[17] See proposed Rule 203(b)(3)-2(b) of the Advisers Act.

investors to be qualified clients in order to charge them a performance-based fee or allocation. In recognition of this potential consequence as a result of registration pursuant to proposed Rule 203(b)(3)-2, the Commission proposes to amend Rule 205-3 by adding proposed Rule 205-3(c)(2) to permit a hedge fund manager's current investors that are not qualified clients to be grandfathered into the "private fund" so that the investors may remain in the fund and that the fund manager may continue to charge them a performance fee.[18]

We support the Commission's proposal to grandfather current investors that are not currently qualified clients to remain in a "private fund" and to continue to be charged a performance fee or allocation (assuming that the fund manager is already currently charging a performance fee or allocation), assuming that proposed Rule 203(b)(3)-2 is adopted to require investment adviser registration of operators of "private funds." Adopting a grandfather clause is consistent with the Commission's prior practice of accommodating pre-existing investors that would otherwise not qualify to remain in an investment vehicle in light of statutory changes that affect the structure of a pooled investment vehicle.

In 1996, as part of the sweeping changes to implement provisions of the National Securities Markets Improvement Act of 1996, the Commission adopted Section 3(c)(7) under the Company Act and created the new standard of "qualified purchaser." Fund managers had the choice of converting their pre-existing 3(c)(1) fund into a 3(c)(7) fund. However, as a result, pre-existing investors that did not satisfy the qualified purchaser standards as defined in Section 2(a)(51)(A) of the Company Act would not have been able to remain an investor in a fund that converted into a 3(c)(7) fund. The Commission recognized such a consequence and accordingly permitted converted 3(c)(7) funds to grandfather pre-existing investors so that they could remain investors in the converted fund.[19] As such, we respectfully urge the Commission to adopt a similar approach if proposed Rule 203(b)(3)-2 is adopted by adopting proposed Rule 205-3(c)(2) to minimize the disruption that may ensue in 3(c)(1) funds and so that existing adviser-investor relations may continue.

Proposed Rule 205-3(c)(2), if adopted, raises an additional question: will grandfathered investors that are not qualified clients be permitted to make additional capital contributions without having to satisfy the qualified client standards?

V. Proposed Amendment to Rule 206(4)-2(b)(3) of the Advisers Act (Custody Rule)

We commend the Commission for proposing to amend Rule 206(4)-2(b)(3) of the Advisers Act by proposing to extend the time period for registered investment advisers that operate pooled investment vehicles to distribute financial statements audited in accordance with U.S. GAAP to the investment vehicle's beneficial owners. We support the Commission's

[18] See 69 Fed. Reg. at 45186, note 156.
[19] See Release No. IC-22597 (April 3, 1997).

proposal to extend the time period to distribute such audited financial statements from 120 days to 180 days following a fund's fiscal year-end.[20]

The 120 day time period is insufficient for operators of fund-of-funds. When an operator of a fund-of-funds is completing its year-end financial statements, it must obtain the year-end financial statements from each of its underlying funds. Quite often, the underlying funds themselves are not able to complete their year-end financial statements until close to the expiration of the 120 days period. Also, the operators of fund-of-funds have no control over the timing and delivery of audited financial statements from the underlying funds. As a result, the auditors of fund-of-funds are not able to complete the audit of the fund-of-fund until after the 120 days period has passed. As such, in practice, very few operators of fund-of-funds are able to rely on Rule 206(4)-2(b)(3). Accordingly, we believe that the Commission should amend Rule 206(4)-2(b)(3) to extend the time period to 180 days so that Rule 206(4)-2(b)(3) is a viable option available to all registered hedge fund managers.[21]

VI. Issue New Set of Proposed Rules

Finally, we respectfully suggest that before any final action is adopted, another round of proposed rules taking into account industry comments to the Proposed Rules is drafted by the Commission staff and is circulated for further consideration. The matter is important enough in our view to warrant such action and care. Such was the approach that the CFTC took prior to adopting amendments to Rules 4.13 and 4.14 of the Commodity Exchange Act.[22] The adoption of amendments to Rules 4.13 and 4.14 was a two step process whereby the CFTC released proposed amendments based on suggestions from the National Futures Association and the Managed Funds Association that were open for industry commentary.[23] A second round of proposed rules was released based on the futures industry input as to what the amendments

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[20] See 69 Fed. Reg. at 45186-45187.

[21] We submitted a comment letter to the proposed amendments to Rule 204(6)-2 of the Advisers Act. In our comment letter, we suggested that the original proposal of distributing audited financial statements within 90 days of a pooled investment vehicle's fiscal year-end was impractical and insufficient in the context of fund-of-funds. We noted that the Commodity Futures Trading Commission (the "CFTC") had recognized the difficulties of commodity pools that are fund-of-funds in obtaining the year-end financial statements of their underlying funds and therefore provided relief by extending the time period a pool operator of a fund-of-fund could file and distribute its year-end financial statements.

[22] See Commodity Futures Trading Commission; Additional Registration and Other Regulatory Relief for Commodity Pool Operators and Commodity Trading Advisors; Part Performance Issues; final rules. 68 Fed. Reg. 47221-47237 (August 8, 2003).

[23] See Commodity Futures Trading Commission; Commodity Pool Operators and Commodity Trading Advisors; Exemptions from Requirement to Register for CPOs of Certain pools and CTAs Advising Such Pools; advance notice of proposed rulemaking. 67 Fed. Reg. 68785-68790 (November 13, 2002).

should address and the CFTC invited more comments to this second release.[24] Final rules were then issued after receiving further input from the futures industry.[25]

We would be happy to meet with the Commission staff to discuss this further if requested to do so.

Respectfully submitted,

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By:____________________________
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cc: Roderick J. Cruz, Esq.

[24] See Commodity Futures Trading Commission; Commodity Pool Operators and Commodity Trading Advisors; proposed rules. 68 Fed. Reg. 12622-12639 (March 17, 2003).

[25] See Commodity Futures Trading Commission; Additional Registration and Other Regulatory Relief for Commodity Pool Operators and Commodity Trading Advisors; Part Performance Issues; final rules. 68 Fed. Reg. 47221-47237 (August 8, 2003).