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File No. 060479-61022

<u>Via E-mail and First Class Mail</u>

September 15, 2004

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street NW
Washington, DC 20549-0609

Re: File No. S7-30-04: Proposed Registration Under the Advisers Act of Certain Hedge Fund Advisers

Dear Mr. Katz:

We are submitting these comments on behalf of an unregistered offshore adviser to various private investment companies (*i.e.*, hedge funds). For various professional reasons, our client prefers not to identify itself. The comments set forth below are solely those of our client.

GENERAL COMMENTS

1. <u>The SEC Proposal is Not Reasonably Related to Its Articulated Concerns</u>

The Staff has articulated the following concerns for which investment adviser registration is sought: the need to collect important information, deter and discover fraud early, keep unfit persons from using hedge funds to perpetuate fraud (including improper valuations), adopt compliance controls, limit retailization, balanced against the Staff's view that registration imposes only minimal burdens.

Our client agrees with the Dissent of Commissioners Glassman and Atkins and for the reasons stated in the Dissent believes that the proposal of the Staff is not a solution reasonably related to the articulated concerns including those such as retailization which the Dissent has exposed being as without foundation.

Further, the Dissent is correct in stating that the proposed rule is a poorly thought out solution to an ill-defined problem. Proper consideration has not been given to viable alternative solutions that would directly address the burdens that would be placed on advisers, the limitations of the Commission's capabilities and the need to adequately protect investors.

2. Alternative Approaches Are More Appropriate

As the Dissent states, the Commission should explore alternative approaches that directly address the Commission's concerns. For example, if the Commission needs census information, that could be better accomplished with a more limited but detailed notice filing that would elicit more useful information to investors and the Commission than that provided by Form ADV. This information would allow the Commission and investors to screen individuals and keep unfit persons from using hedge funds to perpetuate frauds

Additionally, we believe that making the custody rule applicable to unregistered advisers would address the Commission's concerns about possible fraud without imposing unnecessary burdens and concomitant expenses on hedge funds. The custody rule (Rule 206(4)-2) requires the safekeeping of funds or securities in a separate account held by a qualified custodian or independent verification of the funds or securities. This would be a very effective deterrent to the kinds of fraud that have been reported. Consequently, the Commission's concerns could be addressed directly by the filing of simple information coupled with application of the custody rule, without imposing the full panoply of investment adviser registration requirements on advisers to hedge funds.

Last, registration with multiple agencies is inefficient. The proposed rule should include an exemption for advisers that are registered with another U.S. government agency while permitting the Commission to gain access to the books and records of the adviser to obtain the census information it requires and enable the early detection of fraud. This too would accomplish many of the Staff's objectives while imposing minimal additional burdens on already regulated entities.

3. The SEC Proposal Greatly Underestimates the Costs, Burdens and Complexities of Registration

We disagree with Staff's assertions throughout the commentary to the proposed rule that registration under the Investment Advisers Act would have little impact on most hedge fund managers.

The proposed rule will impose on our client a cost far in excess of that estimated in the proposed rule. Without taking into account the significant opportunity costs associated with diverting our client's attention from its job of making money for the hedge funds it advises, our client estimates that it will incur costs in excess of $300,000 to comply with the new rule in the first year. Our client estimates that significant time and expense will be required to (i) to assess the new rules and plan, (ii) engage external professional advisers, (iii) hire additional compliance staff, (iv) develop and implement new IT and other systems to meet the requirements of some of the rules under the Act, (v) educate staff and (vi) test and monitor the newly developed procedures and systems. Our client believes the process that it must follow to ensure compliance will require a period substantially greater than the 6 months proposed by the Staff.

Last, our client disagrees with the Staff's inference in footnote 128 that registration under the Investment Advisers Act would have little impact on most non-US hedge fund managers. The analysis cited states that the impact will be less significant. This is not the same as being not significant. Important differences in the substantive requirements between the U.S. rules and those of the identified jurisdictions, the extra-territorial application of the U.S. rules and the narrower interpretation of the application of non-US rules by the home jurisdiction regulators in reality means there are substantial differences that will have a major impact on non-U.S. advisers registered in the identified locations (the UK, France and Germany) and even more so in the many other jurisdictions where hedge fund managers operate.

4. Making Fund Investors "Clients" Regulates the Wrong Relationship

The Investment Advisers Act regulates persons in the business of rendering investment advice. The Act was intended to protect the investment adviser's clients by regulating the business of those "rendering personalized investment advice." *Lowe v. SEC*, 472 U.S. 181 (1985). For example, the services of investment advisers are personal and cannot be transferred without client consent.

The investment advisory relationship is between the investment adviser and the fund. While it is true that the fund is the accumulation of assets invested by its investors, the adviser does not take into account the individual circumstances of all or any one of the fund's investors when managing the fund. It is the fund and the fund assets alone that the adviser manages, and it is to the circumstances of the particular fund that the adviser manages the fund's assets. The Commission now seeks to alter the historical relationship between the adviser and a fund's investors without having given regard for its authority to do so and without considering the broader implications on the way in which investment advisers will be forced to manage their funds in light of the conflicting interests of their "new" clients. Consequently, our client endorses the positions stated in the letters of Wilmer Cutler Pickering Hale and Dorr dated September 8, 2004 and Phillip Goldstein, President Kimball & Winthrop, Inc. General Partner of Opportunity Partners, L.P., submitted September 10, 2004.

5. The SEC Proposal Will Unduly Constrain the Investment Strategies Employed by Hedge Fund Managers

Our client believes that the proposed registration of hedge fund advisers will curtail the use of lawful investment strategies by hedge fund managers and inevitably lead to a reduction in the efficiency of the capital markets. The Staff's stated concern in the proposing release (at text after footnote 63) that hedge fund advisers may be pursuing <u>improper</u> or unlawful strategies raises the prospect that the Commission might prohibit investment strategies that are not unlawful but of which the Commission somehow disapproves. In the majority of such circumstances, there is no doubt that hedge fund managers would abandon a lawful strategy that the Commission takes exception with rather than face the controversy and the associated distractions generated by the Commission's position. The Commission's sole criteria should be whether the investment strategy is unlawful.

6. **<u>Offshore Advisers</u>**

As the Staff states on page 44 of the release, "It is not uncommon for U.S. investors to acquire interests in an offshore hedge fund that has few connections to the United States other than the investors (or the securities in which they invest). The laws governing such a fund would likely be those of the country in which it is organized or those of the country in which the adviser has its principal place of business. U.S. investors in such a fund generally would not have reason to expect the full protection of U.S. securities laws." It is important for the Commission to clarify what protections U.S. investors can expect in those circumstances. In particular, the Commission should specify in detail how the substantive provisions of the Investment Advisers Act would apply to dealings between an offshore adviser, its offshore hedge funds, and those funds' U.S. and non-US investors. While our client is aware of the no-action letters on this topic, it fully supports the submissions of David Goldstein, White & Case LLP, August 31, 2004 and Jonathan Baird, Freshfields Bruckhaus Deringer, August 11, 2004 for greater clarification in this area.

COMMENTS ON SPECIFIC RULES

7. In Proposed Rule 203(b)(3)-1, the Commission has specified that offshore advisers are to count investors that are U.S. residents. Further clarification of what constitutes U.S. residency is required. For example in another context, the Commission has stated that transient visitors to the US are not US Persons for the purposes of Regulation S (see footnote 115 to the Regulation S adopting release (Sec. Act Rel. No. 6863)). However, there is little guidance as to how long and for what purpose someone may visit, work or study within the United States and still be considered "transient" and not resident for the purposes of counting investors in Rule 203(b)(3)-1.

8. In the commentary on Proposed Rule 203(b)(3)-2, the Commission has asked whether its proposal to not apply the substantive provisions of the Investment Advisers Act to an offshore adviser with U.S. investors in a non-U.S. fund is a reasonable limitation on the application of the Advisers Act. The proposal is reasonable and is consistent with the Staff's observation that U.S. investors in such a fund generally would not have reason to expect the full protection of the U.S. securities laws. The Staff then goes on to request comments on whether the exception should be available to advisers only for private funds owned primarily by non-US residents and if so, what should the appropriate threshold be. While our client does not believe any limits should apply, if the Commission wishes to impose limits on the number of U.S. investors in such funds, it would be better for monitoring purposes and more consistent with other regulations to impose limits based on numbers of investors or their qualifications (such as those under 3(c)(1) and (7) of the Investment Company Act of 1940) rather than a limit based on some percentage of assets as referred to in footnote 137.

9. The Commission is to be commended for recognizing the impracticality of requiring that advisers to offshore publicly offered mutual funds or closed-end funds register simply because more than fourteen of their investors are resident in the United States. However, further clarification is required in the proposed exception to the definition of "private fund" in proposed rule 203(b)(3)-2(d)(3) for a company that has its principal office and place of business outside the United States, makes a public offering of its securities outside the United States and is regulated as public investment company under the laws of a country other than the United States. Specifically, the US concepts of what constitutes a "public offering" and "regulated as a public investment company" do not translate well into the regulatory regimes of other countries where those concepts do not match up with the registration categories of those countries, such as when the other countries permit the securities of registered funds to be publicly promoted only to qualified members of the investing public (e.g., when there is a registration requirement for an offering to a limited category of investors).

10. In response to the request for comments on the scope of proposed rule 203(b)(3)-(2), our client believes that the two-year no-redemption exemption from the definition of a private fund should be maintained. However, time served by investors who have not redeemed any portion of their interest prior to the adoption of the proposed rule should qualify for this exemption.

11. The proposed rule effectively raises hedge fund eligibility criteria by requiring the application of Rule 205-3 despite the observation of the Staff that it "has not uncovered evidence of significant numbers of retail investors investing directly in hedge funds." The Staff has also stated "[n]evertheless, the increased number of retail investors qualifying as accredited investors raises our concern that hedge funds and broker-dealers might begin to seek out these investors as a new source of capital for hedge funds." *See* 2003 Staff Hedge Fund Report, *supra* note 1, at 80-81. Our client believes that the Staff's concern applies to all private placements under Regulation D. If the Staff is concerned that accredited investor eligibility has eroded through inflation, that should be addressed through a change in the Regulation D so that it applies equally to everyone conducting a private placement rather than selectively raising the eligibility threshold for hedge fund investors.

12. If the Commission concludes that raising the hedge fund eligibility criteria is a necessary consequence of registration, then the proposed amendment of Rule 205-3 providing for the exemption for current investors from the new eligibility threshold is entirely appropriate since current investors have already agreed to and are paying performance fees. For these same reasons, the exemption should be expanded to apply to investments in other hedge funds managed by the same adviser.

Our client respectfully requests that the Commission withdraw the proposed rule and propose an alternative solution that is within the Commission's authority and reasonably related to the Commission's legitimate concerns while recognizing the real burdens that would be placed on advisers. Barring that, our client requests that the Commission reconsider the specific elements of the proposed rules as described above.

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Respectfully submitted,

/s/

Guy P. Lander

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