September 15, 2004

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

Re: Request for Comment on Proposed Rules under the Investment Advisers Act of 1940 to Require Registration of Certain Hedge Fund Advisers; File No. S7-30-04

Dear Mr. Katz:

This letter is submitted in response to the request of the Securities and Exchange Commission (the "Commission") for comment on proposed rule 203(b)(3)-2 (the "Proposed Rule") under the Investment Advisers Act of 1940, as amended (the "Advisers Act"), which would require advisers to certain private investment pools ("private fund advisers") to register with the Commission under the Advisers Act as described in Release No. IA-2266 (the "Release").

Seward & Kissel LLP has a substantial number of clients who are advisers to private funds and who are not registered as investment advisers with the Commission.[1] These advisers are exempt from registration pursuant to Section 203(b)(3) of the Advisers Act because they advise fewer than fifteen clients and meet the other specified conditions.[2] In determining the number of clients for these purposes, these advisers rely on the Commission's current rule 203(b)(3)-1, which permits an adviser to count a private investment pool as a single client rather than "looking through" the pool to count each investor.

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1 Such advisers provide investment advice to private investment vehicles, often described as hedge funds, that are generally excepted from the definition of "investment company" under the Investment Company Act of 1940, as amended (the "Investment Company Act"), pursuant to either Section 3(c)(1) or Section 3(c)(7) of that Act. In addition, interests in these funds are privately offered typically in offerings that are exempt from registration in reliance upon Regulation D under the Securities Act of 1933, as amended (the "Securities Act"). Pursuant to these exceptions and exemptions, such funds are generally limited to a finite number of investors that meet certain accreditation and sophistication standards. Hedge fund advisers typically meet the definition of "investment adviser" under the Advisers Act.

2 Section 203(b)(3) provides an exemption from registration with the Commission to an investment adviser that provides investment advice to fewer than fifteen clients during the preceding twelve months, does not hold itself out to the public as an investment adviser, and is not an adviser to a registered investment company.

We appreciate the opportunity to comment on the Proposed Rule and Release, especially considering the broad implications that the Proposed Rule, if adopted, would have on the business of many of our clients. The views we express in this letter, however, are our own and do not necessarily reflect those of our clients.

We submit the following comments and urge the Commission to consider them before adopting the Proposed Rule. First, we provide an alternative to the Proposed Rule that we believe would substantially satisfy the Commission's objectives outlined in the Release. Second, we address a number of the Commission's specific requests for comment in the Release, as well as areas that we believe require further clarification.

I. Alternative to the Proposed Rule

A. Background

The Commission stated five principal objectives in the Release that would be met by registration of private fund advisers: (i) collection of census information; (ii) deterrence and early discovery of fraud; (iii) prevention of unfit persons from using hedge funds to perpetrate frauds; (iv) adoption of compliance controls; and (v) limitation on retailization. In addition, the Commission provided estimates for the expenses related to registration, including $20,000 for professional fees to establish the necessary compliance infrastructure and $25,000 in internal costs to cover items such as staff time. We believe that these figures vastly underestimate the costs that will be incurred by focusing only on the upfront costs of registration (and do not take into account the ongoing and recurring costs of advisory registration). Many advisers, particularly early stage and small advisers, operate with limited personnel. To properly fulfill the breadth of compliance requirements under the Advisers Act, many advisers would be required to hire at least one additional professional at a cost far greater than the estimate provided. Further, each adviser would most likely incur a substantial increase in fees to outside professionals. Accordingly, we believe that the required registration of private fund advisers would have a substantial chilling effect on the industry and will likely cause many smaller advisers to close.

We are also concerned that the Proposed Rule would greatly increase barriers to entry for early stage advisers, and, as a result, dampen the entrepreneurial spirit that has historically defined the private fund industry. Accordingly, we propose the following alternative "notice filing" approach which we believe will substantially accomplish the Commission's objectives without placing an undue burden on private fund advisers and without encumbering such advisers' general operations.

B. Notice Filing Proposal

We propose, in lieu of registration, a notice filing requirement for all unregistered private fund advisers, irrespective of assets under management. Pursuant to this requirement, each unregistered private fund adviser would file a notice with the Commission, which would require such adviser to consent to the jurisdiction of the Commission. The notice filing would seek the following data: (i) the names of the manager, its affiliates and key personnel, as well as any material disciplinary or financial events relating to any of the foregoing; (ii) principal and branch office contact information; (iii) assets under management; (iv) identification of all private funds; (v) investment strategy description; and (vi) the types of securities and financial instruments in which the adviser invests. The notice filing would be made upon a private fund adviser's commencement of operations and would be updated annually and upon the occurrence of certain material events.

C. Meeting the Commission's Objectives

The notice filing proposal would substantially accomplish the Commission's objectives set forth in the Release. Such a filing would enable the Commission to review relevant "census information." Moreover, the provision of such information coupled with the consent to the Commission's jurisdiction would give the Commission the ability to know more about hedge funds, would likely act as a deterrent to fraud and a deterrent to unfit persons entering the hedge fund business, and would likely cause advisers to adopt appropriate compliance controls. With respect to the Commission's objective about limitations on retailization, we agree with the dissent's conclusion that there are more direct (and, in our view, less burdensome) methods than adviser registration to accomplish such an objective.

II. Comments on the Proposed Rule

If the Commission elects to adopt the Proposed Rule, we respectfully submit the following comments on the Proposed Rule as drafted.

A. General

The Proposed Rule defines "private fund" as a company that (i) would be an investment company under the Investment Company Act but for Section 3(c)(1) or Section 3(c)(7) of that Act, (ii) permits its investors to redeem any portion of their ownership interests within two years of the purchase of such interest, and (iii) offers its interests based on the investment advisory skills, ability or expertise of the adviser.

B. Definition of a "Private Fund"

Proposed Rule 203(b)(3)-2 would require investment advisers to count each owner of a private fund as a client for purposes of determining the availability of the private adviser exemption of Section 203(b)(3) of the Advisers Act. The Commission has requested comment regarding the three referenced characteristics used in the definition of "private fund."

1. General Comments on the Two-Year Redemption Test

- Under the Proposed Rule, a private investment fund relying on Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act (referred to as a "company" or a "fund") will be considered a private fund unless it requires at least a two-year lock-up on each investment in the fund. A company that has restricted redemptions will not be considered a private fund if a company permits its owners to redeem any portion of their interests within two years of purchase upon the occurrence of extraordinary and unforeseeable events. The Proposed Rule does not provide any guidance on what types of events would be considered extraordinary and unforeseeable. The Release (at footnote 140 on page 46) suggests that extraordinary and unforeseeable situations might include “an owner’s death or total disability, or circumstances that make it illegal or impractical to own the interest in the fund.” We request that the Commission offer at least minimal guidance in the final rule in the interest of having some certainty concerning events that meet the “extraordinary and unforeseeable” test. We believe that such guidance should indicate that the following types of events meet the “extraordinary and unforeseeable” threshold: (i) the death or permanent disability or dissolution of the adviser (or any key principal of the adviser); (ii) a significant change to the adviser (such as a change in control or the replacement of the adviser); (iii) a significant “draw-down” (i.e. investors would be able to redeem if the performance of a fund substantially faltered); (iv) the death, disability or dissolution of an investor (as provided in the Release); and (v) redemptions necessitated to avoid the violation of any law by the fund, the adviser or the investor. We would request further clarification that if a fund adviser agrees in advance with one or more investors that the investors would be entitled to special redemption rights in the event that any or all of the foregoing events occur, it would not result in a fund being considered a private fund.

- The Proposed Rule provides an exception to the two-year redemption test for interests acquired with reinvested dividends. Funds are typically structured so that they are treated for tax purposes as “partnerships” that do not declare dividends, but rather allocate net profits and net losses to investors. Taxable income (generally consisting of realized gains from investments and dividend and interest income from investments) is taxable to investors whether or not any distributions are actually made to investors. Therefore, we believe that a fund restricting redemptions should not be considered a private fund merely because profits are distributed or withdrawn at regular redemption opportunities, including for the payment of taxes on such profits, provided that the investor maintains each investment of principal in the fund for at least two years. We request that the Commission clarify in the final rule that a fund permitting these types of redemptions will not be considered a private fund.

- Private investment pools, including private equity funds, often permit investors to transfer interests to other parties for various reasons. We urge the Commission to modify the Proposed Rule to provide that the transfer of an interest in a fund by an investor is an exception to the two-year redemption test, provided that the transferee remains subject to the remaining time in the lock-up period.

- We strongly urge the Commission to consider an exception to the two-year redemption test for investors admitted to a fund prior to the effective date of any final rules issued by the Commission.

2. Two-Year Redemption Test Per Investment vs. Per Investor

As currently drafted, the Proposed Rule defines "private fund" in part as a company that permits its owners to redeem any portion of their ownership interests within two years of the purchase of such interests. Thus, the two-year redemption test applies to each investment in the fund, not the investor. The Commission has requested comment on the length of this lock-up period. The two-year time period may result in hardship to investors, especially in light of the industry practice of imposing a lock-up period based on the investor's initial date of contribution to a fund, and not based on the date of each contribution. Therefore, we would recommend either a one-year lock-up period for each investment, or a two-year lock-up period based on the date of the investor's initial contribution to a fund.

3. Exclusion of Non-U.S. Investors from the Two-Year Redemption Test for Funds Advised by Non-U.S. Advisers

Under the Proposed Rule, in determining whether a fund is a private fund, an adviser is required to determine whether any investor (U.S. or non-U.S.) is able to redeem from the fund within a two-year period. We believe that with respect to an adviser with its principal office and place of business outside of the United States, the requirement to consider both U.S. and non-U.S. investors is inconsistent with the Commission's long-standing treatment of non-U.S. investors in other areas of the securities laws. For example, current Rule 203(b)(3)-1 under the Advisers Act provides that in determining the number of clients of an adviser with its principal office and place of business outside the United States, the adviser is not required to count clients that are not U.S. residents. In addition, in Touche, Remnant & Co., SEC No-Action Staff Letter (Aug. 27, 1984), the Commission's staff took the position that a "foreign investment company" making a private offering in the United States pursuant to Rule 506 of Regulation D under the Securities Act need only count U.S. investors in determining whether it exceeds the 100 investor threshold for the purpose of Section 3(c)(1) under the Investment Company Act. Further, a foreign investment company making a private offering in the United States is not required to count any non-U.S. investors even if the shares are offered publicly abroad. The Commission's staff adopted a similar position in Goodwin, Procter & Hoar, SEC No-Action Staff Letter (Feb. 28, 1997) ("Goodwin Procter"), with respect to a foreign investment company relying upon Section 3(c)(7) of the Investment Company Act. In these instances, in determining whether a foreign investment company is an investment company under the Investment Company Act, the company looks exclusively to its U.S. investors. Similarly, in determining whether a fund is a private fund, an adviser with its principal office and place of business outside the U.S. should only be required to look to the redemption provisions applicable to its U.S. investors. Consequently, provided that a fund advised by a non-U.S. adviser does not permit U.S. investors to redeem their interests within a two-year period, the fund would be able to permit non-U.S. investors to redeem their interests within such period without being considered to be a private fund. Further, we would request that the Commission clarify that a non-U.S. adviser may rely for this purpose on Regulation S under the Securities Act for determining U.S person and non-U.S. person status of its investors.

4. Exclusion of 3(c)(7) Funds from the Definition of "Private Fund"

In the Release, the Commission has requested comment as to whether the definition of "private fund" should be narrowed. We strongly urge the Commission to narrow the definition to exclude from the definition of "private fund" any fund excepted from the Investment Company Act pursuant to Section 3(c)(7) of that Act (a "3(c)(7) Fund"). One of the principal concerns cited by the Commission is the growing exposure of the general public, directly or indirectly, to hedge funds. A 3(c)(7) Fund requires its investors to achieve "qualified purchaser" status, thus limiting the investors who are eligible to participate to institutions and individuals with significant assets.

C. Regulated Non-U.S. Advisers

Many advisers located outside of the U.S. are required to register with a regulatory agency in their home jurisdiction and comply with the requirements attendant to such registration. Regulatory agencies of other jurisdictions, such as the Financial Services Authority of the United Kingdom, provide significant oversight of such advisers that may achieve the Commission's goals. Consequently, we recommend that the Commission provide an exemption from registration for a non-U.S. adviser that is registered with a non-U.S. regulatory agency that has substantive regulatory requirements comparable to those of the Commission.

D. Counting Clients

The Proposed Rule requires an adviser to a private fund to "look through" such fund to count each investor in the private fund as a client for the purpose of determining the availability of the private adviser exemption under Section 203(b)(3) of the Advisers Act.

- An adviser, in making a determination as to whether it meets the conditions of the private adviser exemption is permitted to rely upon Rule 203(b)(3)-1. If a private fund adviser is required to look through a private fund, we request that the Commission confirm that in counting the underlying investors in that fund, the adviser may rely on Rule 203(b)(3)-1. For example, under Rule 203(b)(3)-1, a natural person and any minor child of such natural person is considered a single client, and any person for whom investment advisory services are provided without compensation need not be counted as a client. The Proposed Rule should specifically apply these principles. Further, it is common in the private fund industry for the principals and employees of the adviser and their respective family members to make investments in funds alongside outside investors. We believe that these types of investors should not be counted as clients. We note that Rule 3c-5 under the Investment Company Act provides an exclusion from counting certain investors that are "knowledgeable employees" as beneficial owners for purposes of Section 3(c)(1) of that Act and from requiring such investors to be qualified purchasers for the purposes of Section 3(c)(7) of that Act. We urge the Commission to modify the Proposed Rule to provide a similar exclusion for such knowledgeable employees. We also urge the Commission on similar policy grounds to exclude other employees of the adviser and its affiliates, family members of all such persons (including family members of knowledgeable employees), and foundations, charitable organizations or trusts established by or for the benefit of such persons. Finally, we urge that the Commission not require an adviser to "look through" private funds to which the adviser acts as a sub-adviser, provided that the adviser is not affiliated with the manager to the private fund.

- Currently, an investment adviser must have at least $25 million under management (the "Elective Minimum Threshold") before it is eligible to register with the Commission and at least $30 million under management (the "Mandatory Minimum Threshold") before it is required to register. The Commission has requested comment on whether either minimum threshold should be higher or lower. We recommend that the Commission maintain the Elective Minimum Threshold and urge the Commission to implement a higher Mandatory Minimum Threshold for private fund "look through" purposes. Specifically, we recommend that the Commission require an adviser to a private fund to "look through" such fund and count the investors in such fund only once the adviser's assets under management exceed $100 million. As noted above, registration and the requirements attendant to registration involve a significant expense that would prove to be an impediment to early stage and small private fund advisers. The implementation of a $100 million Mandatory Minimum Threshold on the private fund level would address the Commission's concerns and balance the cost imposed on advisers. Finally, we urge the Commission to adopt identical thresholds for a non-U.S. adviser and recommend that a non-U.S. adviser need only count assets attributable to U.S. residents in determining whether it has surpassed these thresholds. We believe this approach would parallel the treatment of U.S. vs. non-U.S. residents in current Rule 203(b)(3)-1 and the Commission's staff's position in Goodwin Procter, each discussed above.

- At footnote 125 on page 40 in the Release, the Commission specifies that an adviser to a private fund must not only "look through" the private fund to count its investors ("top-tier investors"), but to the extent that any of the top-tier investors are themselves private funds, the private fund adviser must also continue the "look through" process up the chain of investors. We believe that an adviser should not have to "look through" a top-tier investor that is itself a private fund unless such private fund is formed for the purpose of investing in the fund. This analysis is consistent with the "look through" analysis for purposes of Section 3(c)(1) and Section 3(c)(7) of the Investment Company Act. In addition, it makes no sense to treat an indirect investor in a top-tier investor as a client when the adviser has no relationship with such person. We recommend that the Commission modify the Proposed Rule to reflect this analysis in the final rule. Further, in the event the Commission continues to require a "look through" of top-tier investors, we believe a private fund adviser should be able to rely on the representations of the top-tier investor at the time of the investment in the fund, and should not be required to monitor this information on an ongoing basis. We request that the Commission clarify this timing in the final rule.

E. Related Advisers

In the private fund industry for tax and other business reasons, many advisers establish one or more affiliated separate special purpose vehicles to serve as general partners to private funds or to act as a specific fund's adviser. We strongly urge the Commission to modify the Proposed Rule to provide that if an adviser is registered with the Commission, each such affiliated special purpose vehicle established by the registered adviser will not similarly be required to register, provided that such special purpose vehicle is a related person of the registered adviser and complies with all other provisions of the Advisers Act applicable to registered advisers. We believe that requiring such special purpose vehicles to separately register as an investment adviser if an affiliated entity is so registered would result in unnecessary duplication, would be overly burdensome to the adviser, and would not further the achievement of the Commission's goals.

F. Solicitation Arrangements under 206(4)-3

The Commission has also proposed amendments to certain rules under the Advisers Act to provide relief from various requirements that will apply to private fund advisers that will be required to register under the Proposed Rule, such as amendments to Rule 204-2 (relief from certain recordkeeping requirements) and to Rule 205-3 (relief to allow private fund advisers to continue to manage assets of persons that do not qualify as "qualified clients"). We commend the Commission for proposing this type of relief for advisers. Similarly, we urge the Commission to consider an amendment to Rule 206(4)-3 (Cash Payments for Client Solicitations) to provide certain relief with respect to any solicitation agreements or arrangements in existence on the date of such adviser's registration. In particular, we request that an adviser would be permitted to continue to make cash payments to a solicitor with respect to solicitation activities and arrangements that predated the adviser's registration with the Commission.

G. Effect of the Proposed Rule's Definition of "Client" on State Investment Adviser Registration Statutes

Under the current federal regulatory framework, for purposes of determining whether an adviser is subject to notice, registration or other licensing imposed by state regulatory agencies, the definition of "client" under Rule 203(b)(3)-1 is determinative. If the Proposed Rule were to be adopted as drafted, many private fund advisers would not only be required to register with the Commission, but would also face a variety of potentially inconsistent requirements in states in which fund investors reside. We request that the Commission modify the Proposed Rule to limit its applicability to defining "client" only for the purpose of Commission registration.[3] Unless this change is made, the Proposed Rule will be more costly and

[3] We note that the Commission will need to make other conforming changes, including to Form ADV.

burdensome for advisers without serving any of the Commission's goals, and would subvert the intended purposes of the National Securities Markets Improvement Act of 1996.

H. Compliance Period

The Commission has requested comment on the length of time private fund advisers would need in order to register and revise their compliance systems to meet the requirements of the Advisers Act. We believe that six months is not sufficient for advisers to develop the appropriate compliance systems and to potentially restructure to operate under the Advisers Act, and we strongly urge the Commission to adopt a phase-in period of at least twelve months.

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We appreciate the opportunity to comment on the Proposed Rule. If you have any questions regarding this letter, please contact the undersigned at the telephone numbers indicated below.

Very Truly yours,

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and

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