The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 20928

March 5, 2007

Draft Comment Letter on Proposed Investment Adviser Antifraud Rules and New Category of Accredited Investor

URGENT/ACTION REQUESTED

[20928]

March 5, 2007

TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 8-07
INVESTMENT ADVISERS COMMITTEE No. 5-07
SEC RULES COMMITTEE No. 22-07
SMALL FUNDS COMMITTEE No. 9-07 RE: DRAFT COMMENT LETTER ON PROPOSED INVESTMENT ADVISER ANTIFRAUD RULES AND NEW CATEGORY OF ACCREDITED INVESTOR

As you know, the Securities and Exchange Commission recently published for comment two rules that would create a new category of accredited investor for natural persons investing in hedge funds and other issuers that rely on Section 3(c)(1) of the Investment Company Act. At the same time, the SEC proposed a new rule, Rule 206(4)-8 under the Investment Advisers Act of 1940, which contains two new antifraud provisions that would apply to all investment advisers to "pooled investment vehicles." [1]

A draft comment letter in response is attached and briefly summarized below. We request that you provide any comments on the draft letter to Dorothy Donohue by Wednesday, March 7. Dorothy can be reached by phone (202-218-3563), email (ddonohue@ici.org), or fax (202-326-5827).

Accredited Natural Persons

The SEC proposed to require natural persons to be eligible to purchase interests in private pools only if, among other requirements, they own at least $2.5 million in investments. The draft letter strongly supports this approach. The draft letter disagrees, however, with a

proposed exception to the $2.5 million investment requirement for investors in venture capital funds.

Rule 206(4)-8 under the Investment Advisers Act

Section 206(4) of the Advisers Act gives the Commission rulemaking authority to "define and prescribe means reasonably designed to prevent such acts, practices, and courses of business as are fraudulent." Under this authority, the Commission proposed Rule 206(4)-8, which contains two fraud standards relating to investment advisers – a material misstatement or omission standard, and a general antifraud standard.

Material Misstatements and Omissions. The first standard in the proposed rule makes it fraudulent for fund advisers to make material misstatements or omissions to existing or prospective fund investors. In the draft letter, we question whether this provision is necessary for registered fund advisers, given the protections in place under Section 34(b) of the Investment Company Act. We note that the Commission has not explained, nor have we been able to identify, any circumstances under which a registered fund adviser will violate the proposed material misstatement or omission standard without also violating Section 34(b) of the Investment Company Act.

General Antifraud Provision. The second standard in the proposed rule is a general antifraud provision that prohibits advisers from "otherwise" engaging in fraudulent activities with respect to existing or prospective investors. The draft letter expresses several concerns with this provision, including whether it is consistent with the Commission's rulemaking authority under Section 206(4) of the Advisers Act, whether it is necessary for registered fund advisers, and how it will be used in practice. As a result of those concerns, we request that the Commission clarify its authority under Section 206(4) of the Advisers Act and we recommend that the Commission either not apply the rule to registered fund advisers, or explain in its adopting release the specific, additional conduct the Commission intends to pursue under the proposed standard.

Robert C. Grohowski
Senior Counsel - Securities Regulation - Investment Companies

Attachment

endnotes

[1] See Memorandum No. 20772, dated January 9, 2007.