The Asset Management Industry
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COMMENT LETTER

June 29, 2007

ICI Comment Letter on the European Commission's Call for Evidence on Private Placement Regimes in the EU (pdf)

June 29, 2007 European Commission Directorate-General for the Internal Market and Services B-1049 Brussels Belgium Re: Call for Evidence Regarding Private Placement Regimes in the EU Dear Sirs: The Investment Company Institute (ICI)1 strongly supports the efforts of the European Commission to develop a private placement regime for the European Union ("EU"). We firmly believe that the Commission can develop a private placement regime that will strengthen the single market framework without compromising investor protection, and we urge the Commission to move forward expeditiously. Our comments in response to the Call for Evidence are informed by the experiences of our member firms, which, in addition to their activities in the United States, have experience organizing, advising, and distributing investment funds in Europe, including the private distribution of investment funds. In response to the general request in the Call for Evidence for examples from a national level within or outside the EU, we include a general description of the private placement regime for investment funds in the United States. We encourage the Commission to vigorously pursue the development of a single private placement regime. We support the Commission's efforts to establish sufficiently high sophisticated investor standards to ensure that privately placed securities are only available to persons that have the ability to understand and bear the risks of such investments. We agree that the offer of securities through a private placement must be distinguishable from a public offering and strongly support 1 The Investment Company Institute is the national association of the U.S. investment company industry. The ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Institute members include 8,781 open-end investment companies (mutual funds), 665 closed-end investment companies, 428 exchange-traded funds, and 4 sponsors of unit investment trusts. Mutual fund members of the Institute have total assets of approximately $10.917 trillion (representing 98 percent of all assets of U.S. mutual funds); these funds serve approximately 93.9 million shareholders in more than 53.8 million households. European Commission June 29, 2007 Page 2 of 5 standards that would prohibit general solicitations or general advertising. Lastly, we believe that antifraud principles are important to ensure minimum standards for investor protection. We urge the Commission to identify clear and well-defined elements for the regime (e.g., definitions of sophisticated

investors and general solicitation) to minimize the possibility of divergent implementation. Benefits of a Single Private Placement Regime As described in the Call for Evidence, private placement regimes differ dramatically across EU Member States. Some Member States do not have any private placement mechanism for investment fund securities, and other Member States vary considerably in their approaches. The variety in approaches can be daunting, with no uniform definitions for key terms, such as what constitutes an open-end fund, and significant differences in basic requirements, such as the minimum subscription amount. It is cumbersome, costly, and time-consuming to identify the various requirements of Member State private placement regimes and monitor those regimes on an on-going basis to ensure sales are made in compliance with current rules. The lack of a single private placement regime in the EU results in significant costs and obstacles for investment funds and compromises the efficiencies sought under the single market framework of the EU. Distribution of both UCITS and non-UCITS investment funds on a private placement basis offers important advantages for sophisticated investors, who should benefit from greater fund selection and possibly lower costs, and for funds, which should benefit from increased distribution channels. For example, a sophisticated investor (such as a defined benefit plan) in a Member State to which a UCITS fund has not been passported would be able to select from a wider array of fund options than might otherwise be available. And a fund could obtain new investments from sophisticated investors in situations where it would not make economic sense to incur the costs of passporting the fund and engaging in a public distribution. A single private placement regime for the EU could eliminate the many inefficiencies that now exist and improve competition in the marketplace. It would allow firms to more effectively pursue business opportunities such as institutional sales and would provide additional choice to sophisticated investors. Private Placement of Investment Funds in the United States We believe that the well-established U.S. private placement regime offers an important example of how a robust and uniform private placement regime can effectively serve the needs of both the investment fund industry and institutional investors without compromising investor protection. We are not advocating that the EU adopt a private placement regime based upon the U.S. system, but believe that the U.S. regime may offer the Commission insight into important features of a private placement regime, including approaches to identify sophisticated investors, the permissible manner of offering, and the level of mandatory investor information. European Commission June 29, 2007 Page 3 of 5 In the United States, an investment fund that seeks to offer its securities through a private placement typically relies on exclusions from the definition of investment company for the fund under the Investment Company Act of 1940 (“Company Act”) and exemptions from the registration of its securities under the Securities Act of 1933 (“Securities Act”). There are no qualification or domicile requirements imposed on investment funds in order to use the private placement regime.2 Neither is the U.S. private placement regime limited to certain types of securities or investment products.3 Generally, no specific information or documents, such as a prospectus, are required for investors. Nevertheless, the general anti-fraud provisions of the securities laws apply to the offer and sale of privately placed securities so information about the offering is usually provided to investors.4 Company Act. In general, there are exclusions under the Company Act for a fund that limits its investors to 100 or fewer or that only sells securities to sophisticated investors meeting sophistication tests defined in the law (“qualified purchasers”).5 To rely on either of these exclusions, the fund must not make a public offering and instead must comply with the requirements for non-public offerings under the Securities Act (described below). A “qualified purchaser” includes a natural person who owns at least $5 million in investments or any person, acting for its own account or the accounts of other qualified purchasers, that owns or invests on a discretionary basis at least $25 million in investments.6 The exclusions under the Company Act generally reflect the policy position

that no significant public interest warrants detailed federal oversight of these privately held funds.7 2 See Question 5 of the Call for Evidence (How should the supply side of the private placement be regulated?). 3 See Question 3 of the Call for Evidence (Does it make sense to develop a private placement regime exclusively for some designated products? Or should we build a framework that is open to any type of security?). 4 See, e.g., Securities Act, Section 17(a) (unlawful when selling or offering to sell securities to make an untrue statement of material fact or make a statement which is misleading because of an omission of material fact); Securities and Exchange Act of 1934, Section 10(b) and Rule 10b-5 (unlawful in connection with the sale of security to use a manipulative or deceptive device). 5 The applicable exclusions are in Sections 3(c)(1) and 3(c)(7) of the Company Act. 6 See Section 2(a)(51) of the Company Act. Although a fund relying on this exclusion may have an unlimited number of qualified purchasers, most funds limit their investors to 499 in order to avoid the registration and reporting requirements of the Securities and Exchange Act of 1934. 7 See, e.g., Paradise & Alberts, SEC No-Action Letter (Sept. 27, 1976) (Section 3(c)(1) reflects a determination that the burden of complying with the Company Act, together with the burden on the SEC, outweigh the benefits to the public from regulation); Small Business Investment Incentive Act of 1980, H.R. Rep. No. 1341, 96th Cong., 2d Sess. 35 (1980) (Section 3(c)(1) was intended to exclude from the Company Act private companies in which there is no significant public interest and which are therefore not appropriate subjects of federal regulation); S. Rep. No. 293, 104th Cong., 2d Sess. 10 (1996) (the exemption for a qualified purchaser fund reflects the recognition that highly sophisticated investors are in a position to appreciate the risks associated with funds not regulated under the Company Act). European Commission June 29, 2007 Page 4 of 5 Securities Act. Investment funds that privately offer their securities must rely on the private offering exemption of the Securities Act, and typically utilize a “safe harbor” provided in regulations adopted under the Act.8 The non-exclusive “safe harbor” criteria contain no aggregate dollar limitation for an offering and permit sales to an unlimited number of “accredited investors.”9 Securities sold through the safe harbor benefit from a single national offering regime and are exempt from most state regulation.10 A fund making a private offering is prohibited from engaging in a general solicitation or general advertising. If the offering is only made to accredited investors, no specific information is required to be delivered to investors.11 Accredited investors include persons such as natural persons whose net worth, or joint net worth with their spouse, exceeds $1 million, or who had income in excess of $200,000 (or joint income with their spouse in excess of $300,000) in each of the two most recent years12 as well as institutional investors such as banks, insurance companies, and certain employee benefit plans with more than $5 million in assets.13 Issuers relying on the safe harbor provision are 8 Section 4(2) of the Securities Act exempts from the registration and prospectus delivery requirements of the Securities Act securities transactions not involving a public offering. The term “public offering,” however, is not defined in the Securities Act, and therefore a number of factors are considered to determine whether a public offering has occurred. See Non-Public Offering Exemption, Release No. 33-4552 (Nov. 6, 1962) available at www.sec.gov/rules/final/33-4552.htm. Because there is a fact-specific inquiry conducted under Section 4(2), funds frequently rely on Rule 506 of Regulation D under the Securities Act, which provides a safe harbor for offerings that meet specific criteria. The full text of Regulation D is available at www.sec.gov/about/forms/regd.pdf. 9 Under certain conditions, there may be up to 35 non-accredited investors in an offering conducted under Rule 506 of Regulation D. 10 States may still impose limited notice filing requirements as well as filing fees. States also continue to have jurisdiction to bring enforcement actions with respect to fraud. See Section 18 of the Securities Act. 11 Financial sophistication and disclosure requirements apply to sales to non-accredited investors. See Rules 506 and 502(b)(2) of Regulation D. 12 The SEC is proposing to revise the definition of “accredited investor” as it

relates to natural persons and offers and sales under Regulation D by certain investment funds relying on Section 3(c)(1) of the Company Act (the exclusion for funds with 100 or fewer investors). The ICI supports this proposal. Under the proposal, natural persons would be required to own at least $2.5 million in investments. The SEC stated that the investor protection that may be lacking with respect to Section 3(c)(1) funds already exists for qualified purchaser funds under Section 3(c)(7) since natural persons investing in such funds must be qualified purchasers, meaning such investors are required to own $5 million in certain investments. See Prohibition of Fraud By Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles, Release 33-8766 (December 27, 2006) available at www.sec.gov/rules/proposed/2006/33-8766.pdf; ICI Comment Letter to Nancy Morris, Secretary of the SEC (March 9, 2007) available at http://www.ici.org/statements/cmltr/2007/07_sec_adv_fraud_com.html. 13 For a more detailed discussion of private offerings by investment funds, see Staff Report to the U.S. Securities and Exchange Commission, Implications of the Growth of Hedge Funds (September 2003), available at www.sec.gov/news/studies/hedgefunds0903.pdf (Part III.A. and Part III.B.). The United Kingdom also has a private placement regime for certain sophisticated investors. See Articles 19, 48-50, 50A and 51 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005; and Articles 14, 22 and 23 of the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (as amended). European Commission June 29, 2007 Page 5 of 5 required to submit a notice filing to the U.S. Securities and Exchange Commission with general information about the offering no later than 15 days after the first sale of securities.14 * * * * We would welcome the opportunity to speak with you in more detail about the information that we have provided in response to this Call for Evidence. If you have any questions, please contact me at +1 202-326-5813 or solson@ici.org. Sincerely, /s/ Susan M. Olson Susan M. Olson Senior Counsel – International Affairs 14 See Rule 503 under the Securities Act. The form used for the notice filing (Form D) is available at www.sec.gov/about/forms/formd.pdf.
