MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

May 4, 2012

VIA EMAIL

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Request for Comments on Regulatory Initiatives Under the Jumpstart Our Business Startups Act

Dear Ms. Murphy:

Managed Funds Association ("MFA")[1] appreciates the opportunity to provide comments to the Securities and Exchange Commission (the "SEC" or "Commission") in advance of its regulatory implementation of the Jumpstart Our Business Startups Act (the "JOBS Act"). We applaud the underlying intent of the JOBS Act to improve access to capital and enhance economic growth by reducing unnecessary regulatory burdens. In particular, we strongly support the sections of the JOBS Act that directly affect managers of hedge funds and other private funds, and we are pleased to offer our preliminary views on implementation of these provisions.[2]

Title II – Access to Capital for Job Creators

Section 201(a)(1) of the JOBS Act instructs the SEC to revise Rule 506 of Regulation D under the Securities Act of 1933 (the "Securities Act") to eliminate the prohibition against general solicitation or general advertising for offers and sales of securities made pursuant to Rule 506, provided that all purchasers are accredited investors. An issuer relying on revised Rule 506 must take reasonable steps to verify that purchasers are accredited investors. In addition, Section 201(b) amends Section 4 of the Securities Act to provide that offers and sales exempt under revised Rule

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[1] The Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and all other regions where MFA members are market participants.

[2] In conducting its rulemaking, the Commission should consider, pursuant to Section 2(b) of the Securities Act, whether its action will promote efficiency, competition, and capital formation.

506 shall not be deemed public offerings under the federal securities laws as a result of general advertising or solicitation.[3]

Importantly, Section 201(b) ensures that offers and sales by all types of issuers pursuant to revised Rule 506 will continue to be treated consistently. As a result, hedge funds and other private funds will continue to be able to conduct private offerings in reliance on revised Rule 506 in the same manner as other issuers, and such offerings will be non-public offerings for purposes of the Investment Company Act of 1940 (the "Investment Company Act").[4] This provision is consistent with long-standing interpretive positions of the Commission that ensure equivalent treatment across the federal securities laws.[5] By codifying these positions, Section 201(b) provides continuity and certainty to fund managers that have relied on this legal framework for decades.

We strongly support these reforms to Regulation D, and believe they will have salutary effects for investors, policy makers, regulators and the hedge fund industry.[6] In January 2012, MFA submitted a formal rulemaking petition to the SEC requesting that it eliminate the ban on general solicitation and advertising in Rule 506 for offerings by hedge funds.[7] In the petition, we explain that eliminating the ban would improve regulation of the industry, enhance economic growth, and fulfill the objectives of recent Executive Orders[8] by:

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[3] "Securities laws" are defined in Section 3(a)(47) of the Securities Exchange Act of 1934 (the "Exchange Act") as: the Securities Act, the Exchange Act, the Sarbanes-Oxley Act of 2002, the Trust Indenture Act of 1939, the Investment Company Act, the Investment Advisers Act of 1940 (the "Advisers Act"), and the Securities Investor Protection Act of 1970.

[4] A private fund is an issuer that would be an investment company, as defined in Section 3 of the Investment Company Act, but for Section 3(c)(1) or Section 3(c)(7). Advisers Act Section 202(a)(29).

[5] The Commission regards transactions that comply with Rule 506 of Regulation D as non-public offerings for purposes of Section 3(c)(1) of the Investment Company Act, and has interpreted the public offering limitation in Section 3(c)(7) in the same manner as the limitation in Section 3(c)(1). *See* Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales, Securities Act Release No. 6389 at n. 33 (Mar. 8, 1982); Privately Offered Investment Companies, Investment Company Act Release No. 22597 at n. 5 (Apr. 3, 1997).

[6] As the SEC proceeds with implementation, we encourage the SEC and the Commodity Futures Trading Commission (the "CFTC") to coordinate so that rules regarding general solicitation activities that apply to private funds are consistent and further the policy goals of Section 201. For example, MFA intends to discuss with the CFTC its Rule 4.13(a)(3), which provides an exemption from registration as a commodity pool operator and includes limitations on marketing activities.

[7] Rulemaking Petition from Richard H. Baker, President and CEO, MFA, to Elizabeth Murphy, Secretary, SEC (Jan. 9, 2012), available at: http://www.sec.gov/rules/petitions/2012/petn4-643.pdf.

[8] In January 2011, the President issued Executive Order 13563, "Improving Regulation and Regulatory Review," which seeks to ensure that regulations protect public health, welfare, and safety while promoting economic growth, innovation, competitiveness, and job creation by using the best, most innovative, and least burdensome tools for achieving regulatory ends. In July 2011, the President issued Executive Order 13579, "Regulation and Independent Regulatory Agencies," extending Executive Order 13563 to independent regulatory agencies.

- Reducing legal uncertainty from the current regulation of private fund offerings conducted in reliance on Regulation D;

- Increasing transparency of the hedge fund industry in a manner consistent with the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") and recent regulatory initiatives;

- Facilitating capital formation and reducing administrative costs by allowing investors to more easily obtain information about private funds;

- Maintaining strong investor protections and ensuring that only sophisticated investors are able to purchase interests in private funds; and

- Reducing regulatory oversight costs and allowing the SEC staff to reallocate resources to other aspects of investor protection, including products offered and sold to retail investors.

We encourage you to review the rulemaking petition for a detailed discussion of the substantial improvements to the regulatory framework for hedge fund offerings that will follow from reforming Regulation D.

Most significantly, following implementation of Section 201, the regulatory framework for hedge funds will continue to ensure appropriate protections for investors. First, the activities of hedge fund managers in connection with offers or sales of securities will continue to be subject to the broad anti-fraud provisions of state and federal securities laws, including Section 17(a) of the Securities Act, and Section 10 of the Exchange Act and Rule 10b-5 thereunder. Hedge fund managers are also subject to the anti-fraud provisions applicable to all investment advisers in Section 206 of the Advisers Act. The Dodd-Frank Act has further strengthened oversight of hedge fund managers by requiring all managers with more than a *de minimis* level of assets under management to register with the SEC as investment advisers. As registered investment advisers, hedge fund managers are subject to a comprehensive regulatory framework under the Advisers Act, which includes periodic examinations and inspections by the SEC for compliance with the federal securities laws.

Second, and perhaps more importantly, only sophisticated investors may purchase interests in hedge funds, including those that in the future are offered and sold in reliance on revised Rule 506. Hedge funds that rely on Section 3(c)(7) of the Investment Company Act may only sell interests to "qualified purchasers," which include individuals with at least $5 million in investments, and institutions with at least $25 million in investments.[9] Hedge funds that rely on Section 3(c)(1) and conduct offerings pursuant to revised Rule 506 will only be permitted to sell interests to "accredited investors," and funds of this type managed by SEC-registered advisers generally only sell interests to "qualified clients," as defined in Rule 205-3 under the Advisers Act.

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[9] Investment Company Act Section 2(a)(51).

In July 2011, pursuant to Section 418 of the Dodd-Frank Act, the SEC substantially raised the qualification thresholds for an individual in the definition of "qualified client."[10] The Dodd-Frank Act has also strengthened the "accredited investor" standard by excluding the value of a primary residence from an investor's net worth, instructing the Commission to increase the net worth threshold above the existing level of $1 million, and permitting the SEC to undertake a broad review of the definition of "accredited investor" for the protection of investors, in the public interest, and in light of the economy.[11]

MFA has consistently supported efforts to raise these qualification standards, which ensure that only sophisticated investors with the financial wherewithal to understand and evaluate the investments are able to purchase interests in private funds.[12] These sophisticated investors also typically perform extensive due diligence prior to investing with a particular manager, which includes reviewing and evaluating the substantial information about a fund and its manager contained in the fund's offering materials.

Accordingly, for many years the SEC staff has acknowledged that the ban on general solicitation is unnecessary for offers and sales made to "qualified purchasers" that are able to purchase interests in private funds that rely on Section 3(c)(7). Twenty years ago, in its 1992 report *Protecting Investors: A Half Century of Investment Company Regulation*, the Division of Investment Management's recommendation to Congress regarding the addition of Section 3(c)(7) to the Investment Company Act did not include a prohibition on 3(c)(7) funds engaging in public offerings. More recently, in its September 2003 report entitled *Implications of the Growth of Hedge Funds*, the SEC staff recommended that the Commission consider eliminating the general solicitation prohibition for 3(c)(7) funds, explaining that this change would not raise investor protection concerns.[13]

This long-standing staff position continues to be compelling with respect to not only 3(c)(7) funds, but also funds in which all purchasers meet the heightened qualification thresholds in the definition of "accredited investor." These investor restrictions ensure that only sophisticated institutions and individuals may purchase interests in these funds, which eliminates the risk that other

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[10] Order Approving Adjustment for Inflation of the Dollar Amount Tests in Rule 205-3 under the Investment Advisers Act of 1940, Investment Advisers Act Release No. 3236 (July 12, 2011) (adjusting the required assets under management from $750,000 to $1 million, and the required net worth from $1.5 million to $2 million). The SEC has also excluded the value of an individual's primary residence from the net worth calculation, and will adjust such amounts to account for inflation every five years. Investment Adviser Performance Compensation, Investment Advisers Act Release No. 3372 (Feb. 15, 2012).

[11] Section 413 of the Dodd-Frank Act.

[12] *See* Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, to Elizabeth Murphy, Secretary, SEC (July 8, 2011), available at: http://www.managedfunds.org/wp-content/uploads/2011/09/MFA-Comments-on-Qualified-Client-Proposal.pdf; Letter from Richard H. Baker, President and CEO, MFA, to Elizabeth Murphy, Secretary, SEC (Mar. 11, 2011), available at: http://www.managedfunds.org/wp-content/uploads/2011/06/3.11.11-MFA-Letter-on-Accredited-Investor.pdf.

[13] Available at: http://www.sec.gov/news/studies/hedgefunds0903.pdf.

types of investors could be defrauded and lose money by investing in these funds as a result of a manager engaging in general solicitation or advertising.

Knowledgeable Employees

As described above, Section 201 of the JOBS Act is designed to permit general solicitation and advertising in connection with offers and sales under Rule 506 as long as all purchasers are sophisticated investors. In light of this policy objective, as part of its rulemaking the Commission should include in the definition of "accredited investor" an additional category of investor – a "knowledgeable employee" under the Investment Company Act – that Congress has determined possesses the requisite knowledge and sophistication to purchase interests in private funds.

In the National Securities Markets Improvement Act of 1996 ("NSMIA"),[14] Congress directed the SEC to adopt rules to permit the ownership of securities by knowledgeable employees of a 3(c)(1) fund or 3(c)(7) fund, or its affiliate.[15] In 1997, the SEC adopted Rule 3c-5 under the Investment Company Act to define the term "knowledgeable employee" to include two categories of employees of a private fund or its affiliated investment manager: (i) any person who is an "executive officer," director, trustee, general partner, advisory board member, or person serving in a similar capacity, and (ii) any employee who, in connection with his or her regular functions or duties, participates in the investment activities of the 3(c)(1) fund or 3(c)(7) fund, other private funds, or certain other investment companies.[16]

Pursuant to Rule 3c-5 and interpretive guidance issued by the SEC staff, many employees of hedge fund managers who are "knowledgeable employees" own interests in a 3(c)(1) or 3(c)(7) fund for which they perform investment functions. In the case of a 3(c)(7) fund, these employees are permitted to invest in the fund notwithstanding the wealth requirement in the definition of "qualified purchaser," which is substantially higher than the comparable requirement in the definition of accredited investor. Some of these knowledgeable employees, such as those who have been recently hired by a fund manager, do not qualify as accredited investors. In our view, it would be inconsistent to effectively prohibit these employees from investing in private funds as a result of the accredited investor standard, when Congress has explicitly determined that they may invest in private funds available only to investors that meet the higher "qualified purchaser" standard.

This long-standing policy of permitting knowledgeable employees of an investment manager to invest in a private fund is critical to meeting the demands of institutional investors, which seek to

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[14] Pub. L. No. 104-290, 110 Stat. 3416 § 209(d)(3).

[15] A fund may rely on Section 3(c)(1) if its outstanding securities are beneficially owned by not more than 100 persons and it is not making and does not presently propose to make a public offering of its securities. A fund may rely on Section 3(c)(7) if its outstanding securities are owned exclusively by qualified purchasers, and it fund is not making and does not at that time propose to make a public offering of such securities.

[16] Rule 3c-5 effectively modifies the requirements imposed by Sections 3(c)(1) and 3(c)(7) by permitting a "knowledgeable employee" to acquire securities issued by a 3(c)(1) fund without being counted for purposes of the 100-person limit in Section 3(c)(1), and regardless of whether the knowledgeable employee is a qualified purchaser for purposes of Section 3(c)(7).

have their interests aligned with the interests of the fund's principals and the employees of the fund's manager. A primary method of achieving this alignment of interests is by permitting investment manager employees to make investments in funds they advise along with the investors. Our members generally have observed, over the past decade, an increasing number of institutional investors that look specifically to invest in funds in which the funds' principals and investment manager employees are significantly invested. In some cases, such institutional investors expect to receive investment terms that require a fund to provide notification if a certain amount of principal or employee investment is withdrawn from the fund. As a response, many of our members attempt to satisfy institutional investors by requiring investments by fund principals and investment manager employees as a means to encourage long-term risk-adjusted returns and to discourage undisclosed risk taking. It would be disruptive to private funds and their investors if a manager were no longer able to permit certain of its employees who participate in the investment activities of the fund to own interests in the fund.

We believe such "knowledgeable employees" of a private fund manager have an equivalent level of sophistication and financial wherewithal as accredited investors, and are therefore of the type that Congress intends to be eligible to purchase interests in offerings conducted pursuant to revised Rule 506. Accordingly, we recommend that as part of the implementation of Section 201, the SEC amend the definition of "accredited investor" to include those individuals who meet the definition of "knowledgeable employee" in Rule 3c-5 under the Investment Company Act.[17]

Reasonable Steps to Verify that Purchasers are Accredited Investors

Section 201(a)(1) directs the SEC to include in its rule a requirement that an issuer take reasonable steps to verify that purchasers of securities offered and sold under revised Rule 506 are accredited investors. We support this requirement and agree that it is important to ensure that only sophisticated investors are permitted to purchase interests in the types of offerings that will be conducted pursuant to revised Rule 506.

For many years, hedge fund managers have implemented procedures to ensure that funds meet the requirements in Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act, which include investor qualification standards. As a result of these requirements, hedge fund managers have extensive experience, as compared to other types of issuers that may rely on Rule 506, assuring themselves that investors in private funds meet applicable qualification standards. In general, each potential hedge fund investor must complete a subscription document provided by the fund's manager that provides a detailed description of, among other things, the qualification standards that a purchaser must meet under the federal securities laws. In completing the subscription materials, each investor must identify which applicable qualification standard it meets. In addition to these procedures, many hedge funds managed by MFA members obtain further assurance of the qualification of their investors by virtue of minimum investment thresholds that meet or exceed the net worth requirement in the definition of accredited investor.

These procedures have functioned effectively for private fund managers and investors and have appropriately facilitated capital formation, and we believe similar methods would achieve the

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[17] We note that under Section 413 of the Dodd-Frank Act, the Commission has authority at this time to amend the definition of "accredited investor," other than the net worth threshold.

comparable objectives of Section 201. We would be happy to further discuss these procedures with SEC staff as they proceed with implementation of Section 201.

Advisers Act Advertising Rules

In light of the elimination of the ban on general advertising and general solicitation for offers and sales made pursuant to revised Rule 506, it is also important to reconsider the advertising limitations created by the Advisers Act and rules promulgated thereunder.[18] In particular, MFA believes greater guidance and flexibility is necessary as to the types of information that registered or exempt private fund managers can provide in advertisements to existing or potential investors. Although the SEC and its staff have provided guidance on various advertising limitations in Section 206 and Rule 206(4)-1 of the Advisers Act,[19] uncertainty remains as to the scope and application of these limitations to private fund advisers. MFA's understanding is that the original intent of these restrictions was to address investor protection concerns related to adviser advertisements provided to *retail* investors. We fully support the need to protect investors and to ensure that the advertising materials that they receive are not deceptive or fraudulent. However, we believe that in the context of private fund advisers, which provide their advertisements solely to *sophisticated* investors, the current SEC no-action letter and legal guidance is counterproductive to this investor protection goal in that it makes it harder for private fund advisers to communicate effectively with their investors.

In the JOBS Act, by eliminating the general advertising and general solicitation restrictions, Congress expressed an intention to permit greater visibility of and transparency into entities, including private funds, which offer and sell securities pursuant to revised Rule 506.[20] It seems consistent with this policy of transparency (*i.e.*, allowing private funds to advertise broadly to the public), to also expand the information that private fund advisers can provide to their sophisticated investors. Moreover, MFA notes that potential investors desire to have, and frequently request, the types of information limited by these advertising restrictions and discussed in the SEC staff's guidance[21] because it ensures that they have a complete and robust view of any private fund manager

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[18] Section 206(4) of the Advisers Act generally prohibits any registered or exempt investment adviser from engaging in any act, practice or course of business, which is fraudulent, deceptive or manipulative. Rule 206(4)-1 under the Advisers Act further defines such activities and limits advisers' ability to, among other things, publish, circulate or distribute advertising materials that refer to any testimonial or past specific recommendations of such adviser and places restrictions on the presentation of performance data in such advertising materials.

[19] *See e.g.*, Franklin Mgmt., Inc., SEC No-Action Letter (Dec. 10, 1998), which provides guidance related to the use of past specific recommendations in advertisements; Munder Capital Mgmt., SEC No-Action Letter (Aug. 28, 1997), which clarifies that investment adviser communications are advertisements if they are designed to maintain existing clients or solicit new clients; Clover Capital Mgmt., Inc., SEC No-Action Letter (Oct. 28, 1986), which provides specific guidance for advisers to follow related to advertisements that contain performance information.

[20] Reducing the restrictions on private fund managers' advertisements to sophisticated investors would be consistent with the policy objective of Section 201(a)(1) of the JOBS Act to permit general solicitation or general advertising for offers and sales pursuant to Rule 506, provided that all purchasers are accredited investors.

[21] We note that private fund managers provide such information only upon an unsolicited request from a potential investor. *See* Investment Counsel Association of America, Inc., SEC No-Action Letter (Mar. 1, 2004).

with which they have or expect to invest. Therefore, MFA believes it is consistent with Congressional intent and the protection of private fund investors to permit greater disclosure of information related to registered or exempt private fund managers in advertising materials; provided that, such information remains subject to the anti-fraud provisions otherwise applicable under the federal securities laws.[22] To assist the SEC with creating the necessary regulatory consistency, MFA will separately provide further recommendations for aligning the advertising rules in the Advisers Act with the JOBS Act and ensuring that private fund managers have greater clarity as to the types of information that they can provide to existing or potential investors.

Title V – Private Company Flexibility and Growth

Section 501 of the JOBS Act amends Section 12(g)(1)(A) of the Exchange Act by increasing the number of record holders of a class of equity security that will trigger registration, from 500 persons to: (i) 2,000 persons or (ii) 500 persons who are not accredited investors. MFA supports this amendment, which will help to resolve an unintended inconsistency in the regulation of private funds and mitigate an artificial burden to capital formation.

In 1996, Congress enacted Section 3(c)(7) to provide an additional method by which hedge funds and other private funds could be exempt from registration under the Investment Company Act. Prior to 1996, hedge funds could only rely on Section 3(c)(1), which exempts an issuer whose securities are beneficially owned by not more than 100 persons. Section 3(c)(7) takes a different approach than Section 3(c)(1) to the types of issuers that are not subject to the Investment Company Act. As described above, rather than limiting the number of investors in the fund, Section 3(c)(7) excludes any issuer whose outstanding securities are owned exclusively by persons who are "qualified purchasers." We believe that Congress's intent in adopting Section 3(c)(7), in addition to the then-existing Section 3(c)(1), was to permit a hedge fund relying on that Section to have an unlimited number of investors in the fund, as long as such investors were "qualified purchasers" or "knowledgeable employees."

Prior to the enactment of the JOBS Act, Section 12(g) of the Exchange Act frustrated this objective and impaired the capital raising activities of 3(c)(7) funds by requiring that a fund with more than 499 investors register its securities with the Commission. Registration of a class of equity security subjects domestic registrants to, among other things, the periodic reporting requirements of Section 13 of the Exchange Act, proxy requirements of Section 14, and insider reporting and short swing profit provisions of Section 16. These provisions are not appropriate to apply to hedge funds, and would provide little, if any, useful information to markets or regulators. Furthermore, as described above, investors in hedge funds are sophisticated individuals and institutions that often conduct extensive due diligence prior to investing, and also generally receive regular periodic reports about funds, including annual audited financial statements. Such investors generally do not require, nor would they expect, a hedge fund to provide the type of information about its operations that would be triggered by registration under the Exchange Act. As a result, hedge fund managers only permit up to 499 record holders of a class of fund interests.

[22] For example, the prohibitions on deceptive or fraudulent devices and schemes in Section 10(b) of the Exchange Act, Section 206 of the Advisers Act, and the related rules under each provision would continue to apply.

The increased shareholder threshold in Section 501 of the JOBS Act removes this artificial limitation and permits 3(c)(7) funds and other issuers to raise capital from more than 499 investors without triggering the registration requirement in Section 12(g). We believe this determination by Congress is appropriate as a result of the significant changes in the securities markets that have taken place since it enacted the original 499-person limitation in Section 12(g).

Section 504 of the JOBS Act directs the Commission to review whether additional tools are needed to enforce the anti-evasion provision in Rule 12g5-1 under the Exchange Act, and provide its findings to Congress. The anti-evasion provision applies to an issuer that knows or has reason to know that the form of holding securities of record is used primarily to circumvent the provisions of Section 12(g), and deems the beneficial owners of such securities to be the record owners thereof. MFA supports the objectives of the anti-evasion provision in Rule 12g5-1, and believes that the SEC should have the appropriate tools needed for enforcement of the provision. We note that hedge funds that rely on Section 3(c)(7) are already subject to a similar anti-evasion provision in Rule 2a51-3 under the Investment Company Act, which deems a company formed for the specific purpose of investing in a 3(c)(7) fund to be a qualified purchaser only if each beneficial owner of the company's securities is a qualified purchaser.

We would be pleased to respond to any questions related to the hedge fund industry that the Commission may have as it conducts its study pursuant to Section 504.

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MFA appreciates the opportunity to provide comments to the Commission regarding implementation of the JOBS Act. If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact Matthew Newell, Associate General Counsel, or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director,
General Counsel

Cc: The Honorable Mary L. Schapiro
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes
The Honorable Daniel M. Gallagher

Meredith Cross, Director, Division of Corporation Finance
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