



January 6, 2012

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

Re: Petition for Rulemaking on Rule 502 of Regulation D under the Securities Act of 1933

Dear Ms. Murphy:

Managed Funds Association (“MFA”)¹ respectively submits this petition for rulemaking² to the Securities and Exchange Commission (“SEC” or “Commission”) requesting that the Commission amend Rule 502(c) of Regulation D to eliminate the prohibition on offers or sales securities by general solicitation or general advertising with respect to private funds.

MFA commends the Commission for its ongoing efforts to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”). MFA supports many of the reforms in the Dodd-Frank Act that are designed to strengthen the financial system, increase transparency of financial institutions to the public and regulators, and mitigate systemic risk. Among other things, the Act establishes a comprehensive framework for the registration of private fund managers that will enhance regulation by the Commission and enable policy makers to obtain information about private funds for a variety of regulatory oversight purposes.

As implementation of the Dodd-Frank Act proceeds, we are aware that policy makers are increasingly focused on identifying additional measures that would promote investment and enhance economic growth. In January 2011, for example, 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.

¹ MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately \$1.9 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

² Rule 192(a) of the Rules of Practice, Securities and Exchange Commission.

In response, the SEC announced that it is seeking suggestions from the public on “modifying, streamlining, expanding or repealing [its] existing rules to better promote economic growth, innovation, competitiveness and job creation while still achieving our mandates to protect investors and maintain fair, orderly and efficient markets.”³ The SEC also recently requested public comment to assist it with establishing a plan for the Commission to begin to regularly conduct retrospective reviews of its existing regulations.⁴ We applaud these efforts to re-evaluate the effectiveness of the existing regulatory landscape, and offer our views below.

I. EXECUTIVE SUMMARY

We share the concerns of policy makers with current market conditions, and believe that targeted reforms of existing securities regulations could achieve the objectives articulated in the Executive Orders while maintaining strong investor protections. We believe that policy makers and regulators should focus on reforms designed to modernize securities laws in response to technological innovations and the evolving manner in which investors, issuers and other market participants interact.

Specifically, we urge the Commission to eliminate the prohibition on general solicitation and advertising in Regulation D under the Securities Act of 1933 (“Securities Act”) for offerings or sales by private funds. The framework for issuers to raise capital through private offerings under Regulation D dates back almost thirty years, during which time the securities markets, issuers, investors and securities regulation have undergone extensive change.⁵ Private funds and regulatory oversight of the industry, in particular, would be unrecognizable to the original drafters of Regulation D.

Eliminating the ban on general solicitation and advertising in Regulation D would enhance the regulation of private fund offerings and fulfill the objectives of the Executive Orders by:

- Reducing the legal uncertainty resulting 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 Act and recent regulatory initiatives;
- Facilitating capital formation and reducing administrative costs by allowing investors to more easily obtain information about private funds;

³ Available at: <http://www.sec.gov/spotlight/regulatoryreviewcomments.shtml>.

⁴ Available at: <http://www.sec.gov/news/press/2011/2011-178.htm>.

⁵ Of course, the Securities Act’s original restrictions on offerings date back to 1933.

- Maintaining strong investor protections and ensuring that only sophisticated investors are able to purchase interests in private funds;⁶ 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.

The importance and timeliness of this issue is underscored by the significant support it has received in the United States Congress. The House of Representatives recently passed a bill that would amend Section 4(2) of the Securities Act and instruct the SEC to amend Regulation D to eliminate the ban on general solicitation and advertising, and an identical bill has subsequently been offered in the Senate for consideration.⁷

II. BACKGROUND

Hedge funds typically rely on the exemptions from the definition of investment company in either Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act of 1940 (“Investment Company Act”). Among other things, a fund may rely on Section 3(c)(1) if it is “not making and does not presently propose to make a public offering of its securities,” and may rely on Section 3(c)(7) if it is “not making and does not at that time propose to make a public offering of such securities.”⁸ The Commission regards transactions that comply with Rule 506 of Regulation D as non-public offerings for purposes of Section 3(c)(1),⁹ and has interpreted the public offering limitation in Section 3(c)(7) in the same manner as the limitation in Section 3(c)(1).¹⁰ Under this interpretive framework, hedge funds that offer and sell their securities according to the terms of Rule 506 will also be in compliance with the public offering restrictions in Section 3(c)(1) and Section 3(c)(7).

⁶ To be clear, we do not propose that anyone other than sophisticated investors be permitted to invest in hedge funds, and we have consistently supported efforts to raise the qualification standards for hedge fund investors. *See* Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, to Elizabeth Murphy, Secretary, Securities and Exchange Commission (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>.

⁷ Access to Capital for Job Creators Act, H.R. 2940 and S. 1831, 112th Cong., 1st Session (2011).

⁸ In addition, a fund that relies on Section 3(c)(1) must not have more than one hundred beneficial owners of its securities, and a fund that relies on Section 3(c)(7) generally must have only “qualified purchasers” as owners of its securities.

⁹ *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).

¹⁰ *See* Privately Offered Investment Companies, Investment Company Act Release No. 22597 at n. 5 (Apr. 3, 1997).

An issuer seeking to comply with Rule 506 must also satisfy the conditions of Rule 502(c), which prohibits an issuer, or any person acting on its behalf, from offering or selling securities by any form of general solicitation or general advertising, including, but not limited to: (i) any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio; and (ii) any seminar or meeting whose attendees have been invited by any general solicitation or general advertising. Hedge funds must therefore avoid engaging in any “general solicitation” or “general advertising” in connection with offers or sales of their securities.¹¹

The terms “general solicitation” and “general advertising,” however, are not otherwise defined in Regulation D or elsewhere in the federal securities laws, and therefore have an uncertain and potentially broad application. The SEC has indicated that an issuer seeking to comply with these limitations should determine whether a particular manner of securities offering constitutes a “general solicitation” or “general advertising” based on relevant facts and circumstances.¹²

As a result of this framework, Rule 502(c) subjects hedge funds to a sweeping prohibition on a range of activities and communications, and as a practical matter, fund managers only engage in activities which the SEC staff has identified as permissible. Guidance issued by the staff, however, such as no-action letters, is dependent on the specific facts and circumstances of the entity making a request, and therefore generally offers only narrow, limited relief upon which other issuers may rely. Despite the best of intentions by the staff to provide clear, workable guidance, by its nature this approach leads to uncertainty for hedge fund managers in assessing whether the facts associated with a range of communications – including discussions with potential investors, participation at industry events, and making public statements – would comply with the terms of previous guidance issued to another entity in a distinct set of circumstances. This uncertainty is exacerbated by the potentially severe consequences to a hedge fund that would threaten its survival if it engages in conduct that is deemed to violate Regulation D.¹³

For example, the SEC staff has indicated that an important factor in assessing if an offering is in compliance with Regulation D is whether an issuer, or a selling agent or other person acting on its behalf, has a “pre-existing substantive relationship” with an offeree so that the issuer or agent could form a reasonable belief that it meets the investor eligibility requirements.¹⁴ This condition is

¹¹ General solicitation activity is also inconsistent with a private offering made under Section 4(2) of the Securities Act. *See e.g.*, Non-Public Offering Exemption, Release No. 4552 (Nov. 6, 1962) (“Negotiations or conversations with or general solicitations of an unrestricted and unrelated group of prospective purchasers for the purpose of ascertaining who would be willing to accept an offer of securities is inconsistent with a claim that the transaction does not involve a public offering.”).

¹² *See e.g.*, Use of Electronic Media, Securities Act Release No. 7856 at n. 87 (Apr. 28, 2000).

¹³ For example, a hedge fund that inadvertently conducts a public offering of its securities would be in violation of the Investment Company Act. Under such a scenario, each of the contracts entered into by the fund could become voidable. Investment Company Act Section 47.

¹⁴ *See, e.g.*, *E.F. Hutton Co.*, SEC No-Action Letter (Dec. 3, 1985); *Woodtrails - Seattle, Ltd.*, SEC No-Action Letter (Aug. 9, 1982). *See also IPONET*, SEC No-Action Letter (July 26, 1996); *Bateman Eichler, Hill Richards, Inc.*, SEC No-Action Letter (Dec. 3, 1985).

particularly difficult for hedge fund managers to interpret and apply to their businesses because they generally conduct continuous offerings of securities. As a result, managers must carefully analyze whether they, or a selling agent acting on behalf of a fund, have established a substantive relationship with an offeree prior to, or in the course of, an offering.

As you know, the SEC staff has provided no-action guidance to issuers seeking to comply with the pre-existing relationship doctrine. In the 1980's, the staff provided relief to an issuer that made offers to persons to whom it had previously made offers to purchase interests in prior limited partnerships,¹⁵ and to persons who had established a pre-existing relationship with a broker by completing a questionnaire indicating the person's level of financial sophistication.¹⁶ In the 1990's, the staff interpreted the manner of offering restrictions in Regulation D in relation to communications with offerees through the internet, and permitted the posting of a notice of a private offering on a website when pre-qualification and password-protection procedures designed to limit access to the website to "accredited investors" were in place.¹⁷ Soon after, the staff permitted a website that used similar procedures to provide information about private funds to accredited investors, as long as such investors did not invest in any posted private fund for at least 30 days following their qualification.¹⁸ These and other letters serve as critical points of reference for managers seeking to comply with the pre-existing relationship doctrine.¹⁹

While this guidance is useful to issuers, there remains a wide range of other communications with potential investors that are not explicitly addressed by these or other letters. As a result, hedge fund managers are faced with the difficult choice of either attempting to predict that the staff would view a particular communication as permissible and assume the risk of an incorrect legal analysis, or simply refraining from communications that could in any way be deemed to violate Regulation D. Many managers choose a conservative approach to minimize risk and reduce costs, and strictly limit the circumstances under which they establish relationships with otherwise qualified potential investors and offer securities.

In addition to limits on offering activities, the ban on general solicitation or general advertising in Regulation D potentially applies to any type of public communication by a fund manager, including statements to investors or potential investors, responses to media inquiries, or comments made at industry conferences or events. Outside of the definitions of "general solicitation" and "general advertising" in Regulation D, there is relatively sparse guidance for

¹⁵ *Woodtrails - Seattle, Ltd.* (Aug. 9, 1982).

¹⁶ *E.F. Hutton Co.* (Dec. 3, 1985).

¹⁷ *IPONET* (July 26, 1996).

¹⁸ *Lamp Technologies, Inc.*, SEC No-Action Letter (May 29, 1998) and *Lamp Technologies, Inc.*, SEC No-Action Letter (May 29, 1997) ("*Lamp Technologies*").

¹⁹ We have not tried to identify each applicable letter issued by the Commission providing guidance in this area, but rather have highlighted some of the more important letters that managers look to in assessing their compliance with the pre-existing relationship doctrine.

managers and outside counsel to consult in determining which activities are permissible for a private fund engaged in a continuous offering. Managers generally take a cautious approach based on the advice of outside counsel, as noted above, and strictly limit all types of communications about their businesses. For example, private fund managers generally will not respond to press inquiries, even to correct inaccurate reports that will be published and could potentially harm their firms. Similarly, managers will carefully limit the scope of their comments at industry events and will avoid providing any type of information about their businesses through publicly available media, including websites.

This regulatory framework is costly and inefficient for regulators and the private fund industry. Regulators receive less information about the industry, and the information they do receive is less reliable because it often has not been verified. At the same time, the SEC staff must devote resources to interpreting the restrictions in Regulation D and applying them to ever-changing practices in the securities markets, often on a case-by-case basis. Fund managers, on the other hand, face heightened legal costs to offer securities, are prevented from communicating information about their businesses, and are perceived as not forthcoming about their business practices.

We believe that the significant changes to the securities markets, technology and regulation have called into question the effectiveness of the existing framework for conducting offerings under Regulation D, and the need to regulate such offerings, rather than actual sales. Indeed, the amount of resources devoted to determining the scope of Rule 502(c) over the last thirty years suggests that there may not be an effective solution, and that the line between general and private solicitation may be inherently unclear in practice. Technological changes have made such distinctions increasingly difficult to draw.

III. POLICY DISCUSSION

A. ELIMINATING THE BAN WOULD INCREASE TRANSPARENCY OF THE HEDGE FUND INDUSTRY

The restrictions in Regulation D reduce the transparency of hedge funds to policy makers, regulators, and the public, and lead to inaccurate information and misperceptions about the industry. As a result, the industry is viewed as secretive, creating an unwarranted negative inference by investors and regulators, impeding understanding of the industry, and discouraging investors from considering investments in private funds based on inaccurate information. Allowing managers to provide general information about their businesses would be an important step in allowing a wider audience to learn about the industry, which we believe would be of substantial benefit to investors, regulators and managers.

These objectives are consistent with the policy goals of the Dodd-Frank Act to enhance the transparency of the hedge fund industry to regulators and the public. Among other things, the Dodd-Frank Act requires private fund managers to register with the SEC, publicly disclose significant information about their businesses, and report highly sensitive, proprietary investment data to regulators for systemic risk assessment.

MFA continues to support the core elements of the regulatory framework that the Dodd-Frank Act imposes on the hedge fund industry, including mandatory registration of private fund managers, reporting systemic risk information on a confidential basis to regulators, and reforms to the over-the-counter derivatives markets, that will enhance the data that regulators and the public

receive about the industry and financial markets. While it is important that reporting requirements are carefully designed to obtain relevant information and avoid unnecessary costs, and for sensitive information to remain confidential, we agree with the underlying goals of the Dodd-Frank Act to improve transparency.

Eliminating the restrictions in Regulation D would further these policy objectives by leading to disclosure about hedge funds of a different type than regulatory filings. At a minimum, managers could ensure that information reported about a fund by the media or a third-party, such as investment activity or performance data, is accurate. Investors would directly benefit, for example, from managers reporting performance information to databases designed to allow comparisons across funds. Permitting private fund managers to communicate publicly would ensure that investors are better informed, and regulators would have an additional resource in seeking to monitor industry trends, understand hedge fund activity, and conduct oversight.

Eliminating the ban would also be consistent with the approach the SEC's Division of Investment Management has taken separate from the Dodd-Frank Act in requiring private fund managers to publicly disclose extensive information about their businesses. Recently, the SEC adopted significant changes to Part 2 of Form ADV to require registered investment advisers, including private fund managers, for the first time to publicly disclose information about their firms, investment activities, clients, affiliations, and business practices. Beginning in March 2011, this information is now publicly available on the SEC's website.²⁰ In addition, the SEC recently adopted substantial changes to Part 1 of Form ADV that will require registered investment advisers to publicly disclose information about private funds they manage.²¹ Previously, a fund manager would not publicly disclose this information to avoid endangering a private offering.

Commenters to these amendments to Form ADV expressed concern that public disclosure could jeopardize a fund's reliance on Regulation D. In adopting changes to Part 2, the SEC explained that in its view such public disclosure would be permissible, but strongly cautioned that including any additional information on the Form may be viewed as constituting a public offering or conditioning the market for interests in a private fund.²²

In addition to public disclosure, the removal of the "private adviser" exemption in Section 203(b)(3) of the Investment Advisers Act of 1940 ("Advisers Act") may lead to uncertainty for managers seeking to rely on Regulation D. Currently, a private fund manager that relies on the "private adviser" exemption from registration with the SEC may not hold itself out generally to the public as an investment adviser. As of March 30, 2012, most private fund managers will be registered with the SEC, and will therefore not be subject to the limitation in the exemption. While

²⁰ Amendments to Form ADV, Investment Advisers Act Release No. 3060 (July 28, 2010).

²¹ Under the new rules, an adviser must indicate for each private fund it manages: (i) the type of private fund; (ii) each investment adviser to the fund; (iii) the ownership percentages and types of investors in the fund; (iv) the minimum investment required in the fund; and (v) the fund's marketing agents, prime brokers, auditors and other key service providers. Rules Implementing Amendments to the Investment Advisers Act of 1940, Investment Advisers Act Release No. 3221 (June 22, 2011).

²² Amendments to Form ADV.

the restrictions in Regulation D apply to the offering and sale of hedge fund interests, as opposed to communications about a fund manager, it may be difficult to distinguish whether communications by a manager about its advisory business could nevertheless be deemed a general solicitation or general advertising of a private fund offering, particularly if the investment adviser only has clients that are private funds. At a minimum, a manager would need to carefully analyze the types of communications that would be deemed to involve holding itself out to the public, but not general solicitation about a fund offering.

For these reasons, we believe eliminating the ban would enhance hedge fund transparency, provide additional information to regulators, further the policy goals underlying the Dodd-Frank Act and SEC rulemaking, and provide increased legal certainty for managers.

B. REGULATION D WOULD CONTINUE TO PROTECT INVESTORS

The general solicitation and advertising ban is designed to ensure that issuers attempting broadly to reach retail investors are subject to greater regulation than issuers selling only to those who are more capable of determining the information required to invest. The ban makes it more difficult for those intending to commit fraud to communicate with unsophisticated investors, or to condition the market in a misleading manner.

While we fully appreciate these considerations, we believe eliminating the ban would not raise investor protection concerns in the case of offerings by hedge funds, in particular those that rely on Section 3(c)(7) of the Investment Company Act. Private funds that rely on Section 3(c)(7) may not make a public offering of securities, and 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.²³ These standards ensure that only sophisticated investors with the financial wherewithal to understand and evaluate the investments are able to purchase interests. These sophisticated investors also typically perform extensive due diligence prior to investing with a particular manager.

Accordingly, for many years the SEC staff has acknowledged that the ban on general solicitation is unnecessary for offerings 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:

We question whether the restrictions on general solicitation for private placement offerings of interests in funds relying on Section 3(c)(7) of the Investment Company Act should be retained. Unlike a Section 3(c)(1) fund, a Section 3(c)(7) fund can be

²³ Investment Company Act Section 2(a)(51).

sold to an unlimited number of investors, so long as they are “qualified purchasers.” There seems to be little compelling policy justification for prohibiting general solicitation or general advertising in private placement offerings of Section 3(c)(7) funds that are sold only to qualified purchasers.

The staff would be reluctant to ease or eliminate the prohibition on general solicitation for hedge funds or other funds that use the accredited investor standard as their minimum investor criteria. We believe that such an arrangement could increase the level of risk of investment interest by less wealthy investors. On the other hand, permitting funds, including hedge funds, that limit their investors to a higher standard (e.g., “qualified purchasers”) to engage in a general solicitation could facilitate capital formation without raising significant investor protection concerns.²⁴

This long-standing staff rationale continues to be compelling with respect to 3(c)(7) funds. Simply stated, the restrictions in Section 3(c)(7) ensure that only sophisticated institutional and high net worth investors may purchase interests in these funds, which eliminates the risk that other 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. As the Division of Corporation Finance conducts its review of Regulation D, we encourage it to consult with the staff of the Division of Investment Management to confirm they continue to take this position with respect to 3(c)(7) funds.

The activities of hedge fund managers in connection with an offering or sale of securities would continue to be subject to the broad anti-fraud provisions of the securities laws, including Section 17(a) of the Securities Act and Section 10 of the Securities Exchange Act of 1934 (“Exchange Act”) and Rule 10b-5 thereunder. As investment advisers, hedge fund managers are also subject to the general anti-fraud provisions in Section 206 of the Advisers Act, regardless of whether they are registered with the SEC. In addition, Rule 206(4)-1 and related interpretive guidance apply specifically to the use of advertisements by registered investment advisers, and set out a framework to ensure that such advertisements are not misleading.

We believe it would also be appropriate for the SEC to reconsider the policy justification for subjecting funds that rely on Section 3(c)(1) to the ban, in light of the significant investor protection enhancements in the Dodd-Frank Act. In July 2011, pursuant to Section 418 of the Act, the SEC substantially raised the qualification thresholds for an individual to meet the definition of “qualified client” in Rule 205-3 under the Advisers Act, and be eligible to invest in a 3(c)(1) fund managed by a registered investment adviser.²⁵ In addition to the qualified client standard, the Dodd-Frank Act strengthens the accredited investor standard by excluding the value of a primary residence from an investor’s net worth, instructing the SEC to increase the net worth threshold above the existing level

²⁴ Available at: <http://www.sec.gov/news/studies/hedgefunds0903.pdf>.

²⁵ 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 proposed to exclude the value of an individual’s primary residence from the net worth calculation, and adjust these amounts to account for inflation every five years. Investment Adviser Performance Compensation, Investment Advisers Act Release No. 3198 (May 10, 2011).

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.²⁶

MFA strongly supports these increased thresholds, which will further strengthen investor protection by ensuring that investors in 3(c)(1) funds meet these minimum wealth tests. As a result, we believe similar policy reasons apply to eliminating the ban on general solicitation and advertising for 3(c)(1) funds managed by a registered investment adviser as apply for 3(c)(7) funds.

C. ELIMINATING THE BAN WOULD REDUCE COSTS OF REGULATORY OVERSIGHT

As described above, under the existing framework the SEC staff must determine whether activity constitutes a general solicitation or general advertising on a case-by-case basis. This approach requires the staff to expend scarce resources to evaluate an issuer’s conduct in connection with a broad range of activity. As securities markets and technology continue to evolve, and sophisticated investors seek more efficient methods to identify a range of investment options, these determinations continue to become more difficult and time-consuming. Moreover, the process for responding to formal requests for interpretive guidance is resource-intensive, in part because the staff analysis is typically fact-specific, limiting the usefulness in applying the guidance across the industry. In some cases, guidance that has been issued after careful consideration can soon become dated because of technological developments and market innovations.

Eliminating the ban would allow the SEC staff to reallocate resources to other important aspects of investor protection, including oversight of products that are offered and sold to retail investors. As the staff must fulfill a number of new wide-ranging obligations, including implementing provisions of the Dodd-Frank Act, developing a plan to begin regularly reviewing existing regulations, and considering improvements to the federal securities laws that could enhance capital formation and strengthen economic growth, reforming Regulation D would free valuable resources while maintaining appropriate investor protections.

D. ELIMINATING THE BAN WOULD ENHANCE CAPITAL FORMATION AND REDUCE ADMINISTRATIVE COSTS

Eliminating the ban would achieve many of the goals described in the Executive Orders to enhance capital formation and economic growth. In addition, we note the correspondence between Chairman Schapiro and Congressman Darrell Issa, Chairman of the House Committee on Oversight and Government Reform,²⁷ and the testimony of Ms. Schapiro during a hearing held in May 2011 on the promotion of capital formation.²⁸ We agree with the SEC’s statement that companies seeking

²⁶ Section 413 of the Dodd-Frank Act.

²⁷ Available at: <http://www.sec.gov/news/press/schapiro-issa-letter-040611.pdf> (“April Letter”).

²⁸ Testimony on the Future of Capital Formation, Mary L. Schapiro, Chairman, Securities and Exchange Commission, Before the U.S. House of Representatives Committee on Oversight and Government Reform (May 10, 2011). Available at: http://oversight.house.gov/images/stories/Testimony/5-10-11_Schapiro_Capital_Formation_Testimony.pdf.

access to capital in U.S. markets should not be overburdened by unnecessary or superfluous regulations, and at the same time, all offerings must provide the necessary information and protections to give investors the confidence they need to invest.²⁹ We are also encouraged that the SEC staff indicated in the correspondence that it is reviewing the ban on general solicitation and advertising and its effect on investor protection and capital formation, including the cost of capital and the availability of investment opportunities.³⁰

We believe eliminating the ban would reduce the cost of capital for private funds and lead to greater efficiency in private offerings, which in turn would facilitate the allocation of capital and investment by private funds throughout the financial markets and economy. Private fund managers face significant costs in seeking to comply with the ban due to its broad application, the limited scope of existing guidance, and the severe consequences of an inadvertent violation. Managers expend considerable time and resources when making any sort of communications or participating in industry events, and often take a conservative approach and refrain from such activity. These effects impose administrative burdens for managers and unnecessarily limit communications with potential investors, increasing the cost of obtaining capital for private funds.

The ban often leads managers to prevent investors from purchasing interests in a private fund until the expiration of a pre-determined waiting period to ensure that the offeree has the required pre-existing relationship with the issuer. Such a waiting period unnecessarily delays private funds from putting capital to use and investors from receiving the benefits of their investment decisions. As a result, private offerings are less efficient and fund managers are precluded from quickly raising capital when they have identified investment opportunities or when market conditions change. Investments by hedge funds could be particularly beneficial in the current economic climate, since they often seek exposure to risks that traditional investors may avoid, such as investing in troubled companies or issuers in need of additional capital.

More generally, the lack of publicly available, verified information about hedge funds and the perception of the industry as secretive likely discourage institutional investors from allocating capital to private funds. Institutional investors must dedicate significant resources to searching for private fund investments because information they need to make informed investment decisions is not easily accessible. Often these investors have little choice but to engage consulting firms to conduct expensive searches on their behalf, the costs of which are borne by the investors and their beneficiaries, reducing the amount of money that can be put to productive use.³¹ Eliminating the general solicitation ban would enable these investors to begin to gather information about private funds at relatively low cost and lead to the more efficient allocation of capital.

²⁹ April Letter.

³⁰ Letter from Chairman Schapiro to Chairman Issa (May 25, 2011).

³¹ As a result, we believe eliminating the ban would be consistent with the federal securities laws requiring the Commission to consider the promotion of capital formation when engaging in rulemaking. *See* Securities Act Section 2(b), Exchange Act Section 3(f), Investment Company Act Section 2(c), and Advisers Act Section 202(c).

IV. RECOMMENDATION

For the reasons set out above, we believe the SEC should exempt private funds from the ban on general solicitation and advertising in Regulation D by amending paragraph (c) of Rule 502. As a result, these funds could engage in public communications and offering activity while remaining in compliance with Regulation D and the Investment Company Act. These funds, however, would continue to generally be prohibited from selling interests to persons other than either qualified purchasers in the case of 3(c)(7) funds, and qualified clients in the case of 3(c)(1) funds managed by registered investment advisers. In addition, the SEC staff should confirm its existing guidance that private offerings that comply with Rule 506 and the amended Rule 502 of Regulation D would continue to be non-public offerings for purposes of Section 3(c)(1) and Section 3(c)(7).

In the alternative, the SEC could amend Rule 502 to narrow the scope of activities by a private fund that would be considered an offering under Regulation D and subject to the prohibition on general solicitation and advertising. In particular, the Commission could amend the Rule to provide that an offering by a private fund occurs when the fund delivers offering materials or a subscription agreement to a potential investor, and that general communications prior to such delivery are not an offering of securities. This approach would provide certainty to both issuers and regulators in determining the types of activities that would be deemed to be an offering by a private fund.

We strongly believe either amendment would reduce uncertainty, facilitate capital formation, and enhance transparency of the private fund industry, while maintaining appropriate investor protection.

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If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact Stuart Kaswell, Matthew Newell or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Richard H. Baker

Richard H. Baker
President and CEO

Cc: The Hon. Mary Schapiro, SEC Chairman
The Hon. Elisse B. Walter, SEC Commissioner
The Hon. Luis A. Aguilar, SEC Commissioner
The Hon. Daniel M. Gallagher, SEC Commissioner
The Hon. Troy A. Paredes, SEC Commissioner

Meredith Cross, Director, Division of Corporation Finance
Eileen Rominger, Director, Division of Investment Management