Alternative Investment Management Association

Ms. Nancy M. Morris,
Secretary,
U.S. Securities and Exchange Commission,
100 F Street, NE,
Washington, DC 20549-1090.
USA

(and by email to rule-comments@sec.gov)

16th May 2008

Dear Ms. Morris,

"Amendments to Form ADV" - Investment Advisers Act Release No. 2711 (the 'Release') - File No. S7-10-00

The Alternative Investment Management Association Limited ("AIMA") is – some 18 years after its establishment - the only professional trade association representing the hedge fund industry with worldwide membership. It is also the only such association which represents all practitioners in the alternative investment management industry – whether hedge fund managers, managers of futures or currency funds or those providing other specific services such as prime brokerage, administration, legal or accounting, auditing and tax advisory services. We are a not-for-profit educational and research body. Our membership is corporate and now comprises over 1,280 firms, in 49 countries. Hedge fund manager firms around the world who are AIMA members total 472, of whom 50 are based in the US and 422 elsewhere. AIMA's members represent over 75% of global hedge fund assets and over 70% of global fund of funds assets.[1]

1) Preliminary comments

In providing our comments on the proposals contained in the Release, we wish to emphasise that, of the 10,923 'advisers' registered with the Commission as at 1 March 2008, 587 are incorporated in one of more than 25 non-US jurisdictions. The portfolios entrusted to these non-US advisers - or 'managers' - are just as substantial as those managed by US advisers and the numbers of funds managed - in particular, hedge funds - may be greater.

The legal and regulatory requirements to which non-US managers are subject vary among jurisdictions and may include obligations imposed by regulatory frameworks such as the European Union's Markets in Financial Instruments Directive ("MiFID"). Despite current market conditions, the US remains one of the world's leading jurisdictions for investing - for both inward and outward investments. To help ensure that remains so, regulators should, we suggest, ensure that the requirements they impose on market participants facilitate not only efficient markets and investor protection but also proper standards with which those participants can operate. Mutual recognition can achieve this and today, more than ever, mutual recognition is not merely 'an end result' but a means to that goal.

[1] The four 'pillars' of AIMA are: Policy, Education, Regulation and Sound Practices. AIMA's objectives are specifically: to provide an interactive and professional forum for our membership and act as a catalyst for the industry's future development; to be the pre-eminent voice of the industry to the wider financial community, institutional investors, the media, regulators, governments and other policy makers; and to offer a centralised source of information on the industry's activities and influence, and to secure its place in the investment management community.

The clients of advisers registered with the Commission are both US persons and non-US persons. They are funds, funds of hedge funds, managed accounts, high net worth individuals, trusts, pension funds, endowments and foundations. Each has its own needs and appoints advisers to manage its assets and provide it with advice. Those clients require information about the adviser who provides such services and also about the individuals who are entrusted with their assets. Full and fair disclosure is a worthy result. However, in achieving all of this, it is necessary to place the Commission's proposals in context.

We note that - as the Commission points out in the Release - as of 30 September 2007, 82% of registered advisers had 10 or fewer employees who perform advisory functions and 67% had five or fewer such employees.[2] The thrust of the proposals in the Release is to move to narrative, plain English disclosures, in order to provide clients with more and more detailed, but meaningful, disclosure to assist them to select an adviser, negotiate fee arrangements and evaluate the adviser's conflicts. In our view, the Commission's proposals only partially achieve this. For example, we have not seen any evidence that the current format of information provided in Form ADV Part II disclosures – i.e., 'box ticking' and discussion of certain points – fails to achieve this or is unworkable. Similarly, no alternatives are presented against which to evaluate the proposals. We note, also, that market conditions in 2000 (when the Commission's original proposals were made) were different from those today: there is now much more reliance on the internet, cross-border trading, dealings in more sophisticated investments and enhanced financial engineering. Given these developments and noting that many advisers are small entities, we would ask the Commission not to impose burdens which would require those and other advisers to devote large amounts of time to drafting and keeping current their disclosure documents.

With consideration of both internationalisation and, in particular, the unique role which alternative investments and their advisers play, we suggest that the correct approach would be to move towards a Form ADV in which Parts I and II are based on identical requirements and defined terms, combine box ticking and narrative disclosure and provide for simplistic on-line registration and filing and amendment. In particular, we recommend that, prior to adopting any changes to Form ADV Part II, the Commission consider a review of the disclosures in Form ADV Part I, the glossary to both parts and the accompanying notes and instructions as it considers the proposed amendments to Form ADV Part II, and that it adopt a revised Form ADV at one time. We see no need to break Part II into sections: it is preferable to have a single document filed electronically (Form ADV Part I) and supplemented with a single additional document (Part II, as is presently the case). As plain English should govern disclosure, we suggest simplicity should rule as regards format. It would not be desirable to have the Commission devote considerable staff resources to resolve differences between Form ADV Parts I and II through interpretations, 'no-action letters' or even further rule-making. Any changes should be made to Form ADV as an 'organic' whole.

We do, however, wish to raise the matter of a non-US based adviser whose only clients in the US are funds. Under the proposed amendments, an adviser in these circumstances would be required to prepare a brochure and then file the brochure on the IARD, but not to deliver the brochure to investors. Having regard to how comprehensive a document the brochure will need to be to satisfy the proposed amendments, it does not seem appropriate to require an adviser to prepare the brochure if it will, in fact, not be delivered to the investors. In this respect, the requirements with respect to Form ADV Part II should be the same, whether the clients are hedge funds, registered investment companies or business developments companies.

Another consideration with respect to applying the proposed new brochure amendments to non-US advisers is that such advisers may be subject to varying legal requirements and prohibitions in jurisdictions around the world. Requiring such advisers to make their brochures publicly available on-line might implicate some of these laws. We would suggest that the Commission analyse this issue and confirm that an on-line posting requirement would not violate the laws of other jurisdictions before imposing such a requirement on non-US advisers.

[2] We do not know the number of such advisers who advise on alternative investments but suspect that this may be a not insignificant number.

With respect to delivery of the ADV, we support a modified version of the current system.

Currently, only Part I of Form ADV is filed on-line with the IARD, and Part II is provided when an advisory agreement is entered into and then on an annual basis or when there are material updates. We advocate a modification of the current approach: file Form ADV Part I with the IARD and post Form ADV Part II on the adviser's web site (or if no web site is available, then by hard copy). Amendments to the Part II could be made in most cases on the adviser's web site. The method of communication would be decided by the client or investor, who could choose to receive communications by regular mail or by email.

We believe that the provision of Form ADV Part II at or before the time the client enters into an advisory agreement and providing this or offering to make it available annually or in the case of a material development is the proper way to deliver information to clients. We are aware that the Commission has recently adopted several proposals based on the concept of “access equals delivery” and that the internet is a powerful tool with which to deliver or make available information. We see no difference or any advantage in having advisers, particularly those in the alternative investments arena, file all of their disclosure forms electronically. If it were established that prospective clients and clients actually did log into the IARD and reviewed all of an adviser’s filings, our concerns would be lessened.

We suggest also that moving toward a solely narrative-based system might bring with it ‘unintended consequences’. By this, we mean that the disclosures provided by advisers will vary from concise or even terse representations to more lengthy disclosures written, for the most part (although we hope not), more with a view to exclude liability rather than to provide meaningful information. We would certainly see prospective clients and clients comparing disclosures among advisers and identifying gaps with a view to exploit these. We are concerned that the approach taken here might result, eventually, in Form ADV Part IIs becoming akin to offering memoranda not only in completeness but in length also.

Finally, there is the prospect that certain advisers, in particular, non-US advisers, might seek to exclude certain disclosures or make disclosures to satisfy Advisers Act requirements but which might be inconsistent with those provided to ‘home country’ regulators (any such disclosures would, of course, conform with Advisers Act requirements). We note that, in another context, the Commission is considering amendments to the regime for foreign private issuers in the context of relaxed requirements to be eligible for the information-supplying exemption under Exchange Act Rule 12g3-2(b). We would, therefore, urge the Commission to consider an approach that is parallel to this and that would, in the context of mutual recognition, provide meaningful disclosure for non-US advisers and, in particular, for those in the alternative investments industry, provide meaningful disclosures.

Although not specifically included in the Release, we see no reason why the Commission cannot utilise the concept of incorporation by reference, to permit an adviser registered with the Commission to be able to incorporate into its Form ADV Part II any materials that are filed with the Commission, with a home country regulator or which are publicly available on the adviser’s web site.

2) Discussion of Form ADV Part II

A. Part 2A: The Firm Brochure

1. Proposed format

As noted above, we advocate a modification of the current approach: file Form ADV Part I with the IARD and post Form ADV Part II (the “Brochure”) on the adviser’s web site or, if no web site is available, provide a hard copy to prospective clients and investors. As regards the timing of disclosures, we agree that both should be amended (and filed or made available) at least annually

and in the case of a material development. However, the annual amendments should be made at the same time - i.e., 90 calendar days after the adviser's fiscal year end and not the proposed bifurcated approach of 90/120 days.

2. Brochure items

We believe that there is merit in the current format of Form ADV Part II - with information confirmed by way of ticking a box and supplemented, where necessary, by enhanced disclosure. Given this, however, we believe that, subject to the following, the Commission's proposals generally would result in more meaningful disclosure.

Conflicts of interest
We believe that the Commission should make clear that the conflicts to be disclosed should be those that are material to the adviser-client relationship. We would also express our concern that advisers should be encouraged to provide all of the information on the basis of materiality and with a view to help avoid turning a Form ADV into an offering memorandum.

Item 2 - Material Changes
We would like to see disclosure standards which encourage full and fair disclosure, without involving advisers in an ongoing due diligence exercise. To this end and within the approach that we advocate for Form ADV disclosure (noted above), we recommend that the Commission permit advisers to change only those portions of their Form ADV Part II which require amendment in the case of a material event and to provide clients with that information in a format that is most appropriate to the adviser. The adviser could then add that information into the form and display the amended form on its web site. Given the Commission's own acknowledgment that the internet is becoming the communications tool of choice and that almost all investors will have access to the internet and an e-mail address, we believe that the method of communication should be the choice of the investor: by post, delivery, e-mail or adding to a web site and sending clients a notice with a hyperlink to the materials. Our comments here are also relevant as regards section 3 of the Release, "Delivery and Updating of Brochures".

Item 6 - Performance Fees and Side-by-Side Management
In considering the Commission's position, we note that the issue presented here is one that many non-US regulators have considered. We believe that the Commission should, and within the context of its articulated position on "conducts and effects" under the Advisers Act as articulated in *Unibanco de Banco de Brasileiros S.A.* (28 July 1992) and cases which followed,[3] permit non-US advisers to address this issue in the manner applicable to the adviser – in other words, if it would not constitute a conflict in the adviser's home jurisdiction or if there is another means by which the situation would be addressed, the adviser should be free to act accordingly.

Item 7 - Types of Clients
Having it settled that a fund (not the underlying individual investors) is the %client+ of an adviser provides clarity[4]. However, we believe that consistency is desirable. Non-US managers' clients are usually pooled investment vehicles, managed accounts and individual mandates. Those managers may also serve as sub-advisers to SEC registered advisers and participating affiliates to entities with whom they may be affiliates or in a control relationship and which are SEC registered advisers. Currently, Advisers Act Rule 203(b)(3)-1 and certain 'no-action letters'[5] comprise the basis for identifying who is a client of an adviser. We note that the Commission and the SEC Staff employ a definition of "client" for the purposes of registration under the Advisers Act and a slightly different approach to counting clients and identifying assets for the purposes of Form ADV disclosure.

[3] See also Mercury Asset Management, plc (16 April 1993) and The National Mutual Group (8 March 1993).
[4] We note that footnote 201 of Release 2333 included a definition of the term US person for purposes of the Advisers Act but, given Goldstein, it may be the case that this may no longer be relied upon (Goldstein v SEC, 451 F.3d 873 (D.C.Cir. 2006). We refer also to adoption of Advisers Act Rule 206(4)-8.
[5] See e.g. *Copeland Financial Services, Inc.* (21 September 1992) and *Savoy Capital Management Inc.* (15 November 1989).

A related issue is the definition of "US person". Today, the industry is working with a residence-based definition (*see* Rule 203(b)(3)-1(b)(5)). For non-US managers, ensuring that both of these terms are clearly defined and are consistent is of great importance. We would urge the Commission to move to a single standard of defining and applying "client" for the purposes of both registration and Form ADV disclosure, and to address this issue in the release which adopts any changes to Form ADV Part II. We also request that the Commission clarify that its definition of the term "US person" will continue to be based on residence for all purposes under the Advisers Act and would be interpreted consistently with the definition of the term "client".

Item 8 - Methods of Analysis, Investment Strategies and Risk of Loss
We concur with the Commission's view that Form ADV Part II should treat methods of analysis and investment strategies. However, we are concerned that requiring this to be done in a discussion format and with the requirement to discuss risk factors, (both of which are relevant to prospective clients and clients) might result in disclosures that are lengthy and written more with an eye towards exclusion of liability rather than the provision of information. In making this comment, we are mindful of the types of disclosures that are contained in the offering memoranda used to offer the securities of pooled investment vehicles which are registered under the 1940 Act or are exempt from registration, in reliance on one of the 1940 Act exemptions, namely Sections 3(c)(1) and 3(c)(7). Disclosure is important to provide prospective clients and clients with meaningful information in order to select (or discharge) their adviser, negotiate fee arrangements and evaluate conflicts; a balance must be struck in the impact of such disclosures, in order to avoid having Form ADV Part IIs become, effectively, lengthy offering memoranda.

Item 9 - Disciplinary Information
If the Commission is minded to continue to incorporate into the Brochure the disciplinary information currently required by Rule 206(4)-4, we see no reason why the current tick box format and Form ADV Part I disclosures cannot remain unchanged. Since the Form ADV Part I disclosures would presumably remain unchanged, duplicative disclosures of such information are not required.

We do express concern at the requirement to include the disclosure of arbitration awards, settlements or claims, as well as the results of litigation. Although such information is relevant, the thrust of the Commission's proposals is to provide more information to prospective clients and clients, and in a narrative format. Again, we believe that the Commission must strike a balance between meaningful disclosure and turning the Form ADV Part II into a lengthy document that would, over time, resemble an offering memorandum.

Item 11 - Code of Ethics
We believe that the Commission should consider reconciling the various definitions used in Form ADV and in Rule 204A-1 - in particular, "advisory affiliates", "access persons", "associated persons" (in the context of the participating affiliates letters), "related persons" and "supervised persons". There are difficulties encountered in reconciling and applying these definitions. "Advisory affiliates" encompasses much of the substance of "supervised persons". "Related person" could be deleted, in favour of reaching relevant classes of persons (such as banks, brokers and dealers) by stating that such persons would be covered if they were affiliates of and under common control with the registered adviser.

B. Part 2B: The Brochure Supplement

We are concerned that the obligation to deliver documents to clients is bifurcated, in the sense that all clients would receive a Form ADV Part II but not all clients would receive supplements. From our members' standpoint, the delivery of all information to clients must be equal. This is one reason why we believe that the delivery obligation should be to deliver all information and that the adviser should be given the option to do so by mail or posting on its web site with an e-mail to clients providing them with a hyperlink to access the document.

'Carving out' the delivery obligation on the basis of type of client is a difficult proposition. Differences in the various defined terms referred to in the Release present obstacles in themselves in other contexts - for example, in exemptions for private placements under the Securities Act of 1933, exemptions under the 1940 Act and the safe harbour from broker-dealer registration under

the Exchange Act. There are differences in the effects of these terms and it would add a further layer of difficulty if delivery obligations are conditional upon type of client.

We hope that our comments here are helpful to the Commission in its consideration of industry participants' responses to and suggestions in respect of the proposals contained in the Release. We will be happy to provide any further information and to engage in further discussions which the Commission and the Staff may consider useful.

Yours sincerely,

Mary Richardson
Director
Regulatory & Tax Department