WILLKIE FARR & GALLAGHER LLP

CLIENT MEMORANDUM

SEC PROVIDES RELIEF RELATING TO THE VACATED HEDGE FUND ADVISER REGISTRATION RULE

I. Introduction

On June 23, 2006 the United States Court of Appeals for the District of Columbia Circuit in *Goldstein v. U.S. Securities and Exchange Commission* invalidated Securities and Exchange Commission Rule 203(b)(3)-2 and related rule amendments (the "Hedge Fund Adviser Rule") that were designed to require most hedge fund advisers to register under the Investment Advisers Act of 1940. Yesterday, the SEC's Division of Investment Management, in a response to a July 31, 2006 request from the ABA Subcommittee on Private Investment Entities, provided relief from a number of adverse consequences that otherwise could have arisen from the Court's decision.

II. Advisers That Remain Registered

A. Offshore Advisers to Offshore Funds

The staff confirmed that advisers having a principal office and place of business outside the United States that remain registered will continue to be exempt from the substantive provisions of the Advisers Act with respect to a private fund organized and incorporated in a country other than the United States or other non-U.S. clients.

B. Relief Permitting Continued Advertising of "Track Records"

Under Rule 204-2(e)(3), a registered adviser that makes claims concerning its performance must maintain documentation supporting those performance claims. The staff stated it would not recommend enforcement action if a registered adviser continues to rely on the relief that had been provided in the Hedge Fund Adviser Rule and uses performance information for periods prior to its registration even if the adviser has not retained the necessary supporting information. The relief only covers periods prior to February 10, 2005 (the effective date of the Hedge Fund Adviser Rule) and applies only to advisers to private funds that registered as a result of the adoption of the Hedge Fund Adviser Rule.

C. Relief from Prohibition on Performance Fees

Registered investment advisers are generally prohibited from charging a performance fee to clients who are not "qualified clients," *i.e.*, investors that invest at least $750,000 with an investment adviser or have a net worth of $1.5 million or more. The staff confirmed it would not recommend enforcement action if an adviser relies on the amendments in the Hedge Fund Adviser Rule which "grandfathered" from this requirement investors in a private fund that were investors before February 10, 2005, provided that the adviser was not required to register with the SEC before that date. Again, this relief is available only to advisers that registered as a result of the adoption of the Hedge Fund Adviser Rule.

D. Custody Rule Relief for Funds of Funds

The staff confirmed it would not recommend enforcement action if a fund of funds that seeks to avail itself of an exemption from certain aspects of the SEC's custody rule by delivering audited financial statements to its investors delivers such financials within 180 days after its fiscal year-end (as had been permitted by the Hedge Fund Adviser Rule) rather than the 120-day period generally required by the custody rule.

III. Advisers That Withdraw Their Registrations

A. "Holding Out" as an Adviser and Having More Than 14 Clients While Registered

Prior to the adoption of the Hedge Fund Adviser Rule, most hedge fund advisers relied on an exemption from registration under Section 203(b)(3) of the Advisers Act available to an adviser who during the course of the preceding 12 months had fewer than 15 clients *and* who did not hold itself out generally to the public as an investment adviser. During the period it was registered with the SEC, a hedge fund adviser may have held itself out generally to the public as an investment adviser, or taken on additional clients so that it had more than 14 clients even if each private fund was counted as a single client.

The staff confirmed it would not recommend enforcement action against a hedge fund adviser that registered as a result of the adoption of the Hedge Fund Adviser Rule and that withdraws from registration in reliance on the Section 203(b)(3) exemption without regard to whether the adviser (i) held itself out generally to the public while it was registered, and/or (ii) had more than 14 clients while registered (counting each private fund as a single client). An adviser relying on this staff position must withdraw its registration with the SEC *no later than February 1, 2007*. For the first 12 months following withdrawal from SEC registration, the adviser, for purposes of assessing its eligibility for the Section 203(b)(3) exemption, may determine the number of clients it has had (and thus the availability of the exemption) by reference to a period of time beginning on the date of withdrawal, which may be a period of less than 12 months.

B. Form ADV-W Balance Sheet Requirement

Form ADV-W (the form filed by an adviser that is withdrawing its registration) requires certain balance sheet information for the withdrawing adviser if the adviser has custody of client assets. Most hedge fund advisers are deemed to have custody of client assets under the Advisers Act's custody rule. Nevertheless, the staff confirmed that it would not recommend enforcement action if a hedge fund adviser that registered as a result of the SEC's adoption of the Hedge Fund Adviser Rule and that withdraws from registration with the SEC in reliance on the Section 203(b)(3) exemption from registration *by February 1, 2007* does not provide any balance sheet information.

IV. **Additional Items**

Upon the adoption of the Hedge Fund Adviser Rule, certain questions were added to Form ADV requiring information on "private funds." These changes appear to have been vacated by the Court's decision. Although not mentioned in the ABA letter, the staff indicated that it will post instructions on the SEC's website providing guidance on the completion of Form ADV until the form is changed.

The staff also indicated that even though the Hedge Fund Adviser Rule provisions which specified that records of a private fund are records of the adviser (and thus subject to SEC inspection) were vacated, an adviser must make records available to the SEC in accordance with Section 204 of the Advisers Act (the general books and records rule), and may not evade the requirement by holding records through any other person, including a private fund.

* * * * * * * * * * * * * * * * * * * *

If you have any questions concerning this memorandum, please contact Barry P. Barbash (202-303-1201, bbarbash@willkie.com), Roger D. Blanc (212-728-8206, rblanc@willkie.com), Margery Neale (212-728-8297, mneale@willkie.com), Daniel Schloendorn (212-728-8265, dschloendorn@willkie.com), Martin R. Miller (212-728-8690, mmiller@willkie.com), or the attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019-6099 and has an office located at 1875 K Street, NW, Washington, D.C., 20006-1238. Our New York telephone number is (212) 728-8000 and our facsimile number is (212) 728-8111. Our Washington, D.C. telephone number is (202) 303-1000 and our facsimile number is (202) 303-2000. Our website is located at www.willkie.com.

August 11, 2006