Prudential Financial

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Judith R. Starr, Chief Counsel
Office of the Chief Counsel
Financial Crimes Enforcement Network
Department of the Treasury
PO Box 39
Vienna, VA 22138-1618

Re: NPRM - Section 352 Unregistered Investment Company Regulations

Dear Ms. Starr:

Prudential Investment Management is pleased to offer comments on FinCEN's proposed regulations concerning anti-money laundering ("AML") programs for unregistered investment companies, published at 67 Fed. Reg. 60617 (September 26, 2002).

Prudential Investment Management ("PIM"), the asset management business of Prudential Financial, Inc. ("Prudential Financial") (NYSE:PRU)[1] offers a range of investment products to institutional and retail clients around the world, managed by specialized investment managers with strong market positions in each asset class -- equity, fixed income, private fixed income, real estate and commercial mortgages. As of September 30, 2002, PIM managed approximately $277 billion in assets under management, including $80 billion for more than 650 institutional clients that include corporations, public funds, Taft-Hartley plans, insurance companies, foundations and endowments. PIM's investment products include U.S. mutual funds, offshore retail funds, hedge funds, collateralized debt obligations and private funds investing in real estate, private equity, commercial mortgages and private debt securities.

Prudential Financial strongly supports the efforts of FinCEN and other Federal regulators in implementing the USA Patriot Act and is committed to effective participation, along with the financial services industry as a whole, in combating money laundering and terrorism.

We offer four comments for your consideration. The first three relate to private unregistered investment companies that are domiciled or sold in the United States, and the fourth relates to offshore retail funds.

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[1] Prudential Financial companies, with approximately $533 billion in total assets under management and administration as of September 30, 2002, serve individual and institutional customers worldwide and include The Prudential Insurance Company of America, one of the largest life insurance companies in the U.S. These companies offer a variety of products and services, including life insurance, property and casualty insurance, mutual funds, annuities, pension and retirement related services and administration, asset management, securities brokerage, banking and trust services, real estate brokerage franchises and relocation services. For more information, visit www.prudential.com.

1. Scope of Proposed Rule -- Redeemability

The proposed rule, under Section 103.132(a)(6)(i)(B), would apply to an unregistered investment company that "permits an owner to redeem his or her ownership interest" within two years of purchase.[2]

Although the proposed rule provides that it would apply only to a fund that "permits" redemption, footnote 16 in the proposing release says that a fund would be excepted "only if it precluded an investor from redeeming each and every investment (*i.e.* imposed a 'lock-up' period) for two years . . . ."

If the final rule is interpreted in accordance with this footnote, it would thwart the purpose of the exception since requiring an express lock-up would have the result of including most funds intended to be excluded. The interpretation reflected in this footnote would also seemingly have the effect of including all existing funds, even if they have been in existence for more than two years, if their governing documents contain no express preclusion of redemption within the first two years.

Most privately-placed funds are closed-end and their governing documents are silent as to any lock-up since there is no provision for the fund to redeem investors' interests. In a closed-end fund, investors' expectations are that their investment will be illiquid and will not be available for the life of the fund, typically five to ten years. This is due to the nature of the asset classes in which most private funds are formed to invest - private asset classes for which no public market exists.

Real estate funds purchase office buildings, retail malls, apartment complexes and other properties, which cannot be sold quickly. Private equity funds purchase, in transactions negotiated directly with the issuer, equity securities that have not been registered with the SEC and cannot be resold without an available exemption from registration. Resales of restricted securities are generally in private transactions, unless the issuer has gone public through an initial public offering of securities. Funds that invest in other private asset classes, such as commercial mortgage loans, private debt securities and mezzanine debt, face similar restrictions, legal or practical, on the liquidity of their investments.

As a result, these investments are typically "buy and hold" investments, where the fund manager intends to hold them for a number of years or until (in the case of private debt securities and commercial mortgages) they mature in accordance with their terms (commonly five years or more) or are voluntarily prepaid. Investors are fully aware of this, and typically invest in such funds in order to achieve an asset allocation that permits them to diversify risk and obtain investment characteristics not found in investments that are traded on stock exchanges and in other public markets. Like the investments made by the funds themselves, investors intend to hold fund interests for the life of the fund. Indeed, they represent that they are purchasing their fund interests for investment purposes only and not with any intent to resell, and make other representations that reinforce their understanding that they are investing for the life of the fund.

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[2] This comment relates to unregistered investment companies that invest in private asset classes such as real estate, private equity and private debt. It does not relate to hedge funds that invest in publicly-traded securities and expressly provide for redemption of investors' interests.

Because the investments are illiquid, it would not be practicable for investors to be able to require the fund to redeem their interests. To effect redemptions, a fund might have to sell assets in a fire sale mode, which would be against the interests of both an investor who wants out and the other investors. Thus, private closed-end funds do not normally have any provision at all for redemption of investors, and accordingly do not prohibit redemption.

Another factor is that private closed-end funds typically have an investment period of up to five years. In a $250 million fund set up to invest in a private asset class, investors do not invest $250 million at the outset. Rather, they agree collectively to invest up to that amount by making capital contributions as requested by the fund manager to fund investment opportunities as they arise. It normally would not be possible for the fund manager to invest the full $250 million immediately in the targeted asset class. It usually takes several years for the manager to source and close all the fund's investments. A right of redemption during the investment period would be inconsistent with the purpose and method of operation of a private closed-end fund.[3]

Over the last twenty years, PIM has sponsored dozens of closed-end private funds structured as limited partnerships and limited liability companies, and we do not believe that any has afforded investors redemption of their interests. It would be burdensome and would not serve the purposes of the proposed rule if most funds intended to be excepted were in fact included merely because the fund documents, which do not provide for redemption, are silent about prohibiting it. We believe that there are thousands of existing private funds that would be affected by footnote 16 in the proposing release.

We therefore recommend that the release accompanying the final rule make clear that the wording of the rule means what it says - that it would apply to an unregistered investment company that "permits an owner to redeem his or her ownership interest" within two years of purchase, and that the redeemability element does not depend on an express lock-up provision or prohibition of redemption in the fund documents.

2. Scope of Proposed Rule -- Institutional Funds

We recommend that FinCEN consider an additional exception to the proposed rule, in Section 103.132(a)(6)(ii), for unregistered investment companies in which the minimum investment required is at least $5 million and in which the only investors are institutional investors. We suggest that "institutional investors" be defined to include at a minimum the following:

- "Qualified purchasers" as defined in Section 2(a)(51)(A)(iv) of the Investment Company Act of 1940 (the "1940 Act") (persons acting for their own account or other "qualified purchasers" as defined in Section 2(a)(51)(A)(i) through (iii), that own and invest on a discretionary basis at least $25 million in assets);
- Pension and other employee benefit plans described in Section 3(c)(11) of the 1940 Act;
- Sovereign investors such as foreign national governments, financial institutions and agencies;

[3] This multi-year investment period, coupled with no right of redemption, illiquidity of fund investments and long fund life, makes private closed-end funds exceedingly inconvenient as vehicles for money laundering.

- Pension and other employee benefit plans established by foreign national governments, political subdivisions and municipalities and agencies;
- Pension and other employee benefit plans established by international organizations designated by Executive Order pursuant to Section 1 of the International Organizations Immunities Act (22 U.S.C. 288); and
- "Qualified institutional buyers" as defined in Rule 144A(a)(1) under the Securities Act of 1933.

The basis for this recommendation is that such funds do not pose meaningful risks of being used for money laundering or financing terrorist activities.

PIM's investment management client base, other than mutual funds and brokerage wrap fee programs, is almost exclusively institutional. The primary focus of our marketing to prospective new clients is large U.S. pension plans for public employees and their counterparts abroad, large U.S. pension plans for corporate employees, pension plans of international organizations (e.g. the United Nations), insurance companies, and foundations and endowments. The private funds that are managed by PIM and are marketed to such investors require minimum investments of $5 million or more. The nature of these well-known and reputable investors, as well as the investment minimum, make it unlikely that any funds invested are derived from an improper source or could be structured in transactions designed to evade Bank Secrecy Act reporting requirements.

3. Notification Requirement - Private Funds Advised by a Registered Investment Adviser

The proposed rule, in Section 103.132(d), imposes a notification requirement upon covered unregistered investment companies. We recommend that there be an exception to this notification requirement for any unregistered investment company which is advised by an investment adviser who is registered with the SEC under the Investment Advisers Act of 1940 (the "Advisers Act"), and which is required to be reported on the adviser's Form ADV under the Advisers Act.

The proposing release indicates that the notification requirement is premised on FinCEN's concern that, absent self-reporting by funds, FinCEN or other Federal functional regulators will otherwise have no means of identifying and locating unregistered investment companies and assuring, through examination or enforcement, that covered unregistered investment companies are in compliance.

The very rationale proposed suggests the basis for an exemption for any unregistered investment company that is in fact known to a Federal functional regulator. The SEC requires that every registered investment adviser disclose, in Part IA of its Form ADV filed with the SEC under the Advisers Act, initially upon registration and with annual updates thereafter, certain information about each investment-related limited partnership or limited liability company of which the investment adviser or a related person is the general partner or manager.

As a result, each registered investment adviser already is effectively required to provide information to the SEC (which is publicly available) concerning most if not all unregistered investment companies that the adviser or its related persons advise.[4] Thus, for any unregistered investment company advised by a registered investment adviser, which is organized as a related limited partnership or limited liability company, the proposed additional notification requirement would be duplicative and burdensome.

Like other large investment managers, PIM's registered investment advisers disclose in their Form ADV the existence of numerous private funds that are advised by PIM or its affiliates.

4. Scope of Proposed Rule - Offshore Retail Funds

In addition to sponsoring and advising private funds and U.S. mutual funds, PIM also advises retail funds that are domiciled and registered in offshore jurisdictions and are sold to retail investors outside the United States. We recommend that FinCEN consider an additional exception to the proposed rule, in Section 103.132(a)(6)(ii), for unregistered investment companies that are either domiciled and registered in foreign countries that are Financial Action Task Force (FATF-GAFI) members, or have their shareholder servicing and administrative activities performed in such countries, and hence are subject to meaningful AML regulation in such countries.

We base this final comment on our belief that extraterritorial application of U.S. AML laws may not be appropriate when an FATF-compliant local regulatory regime exists. In such a case, local activities are already required to comply with local laws (including laws relating to privacy and protection of customer information), and to superimpose U.S. requirements creates extra burdens and potential inconsistencies. Imposing dual regulation also may send a message to the local jurisdiction that the United States deems its AML regulatory efforts insufficient or ineffective.

We appreciate the opportunity to comment on the proposed rule. If you have any questions or would like any further information, please call the undersigned at 973-367-3949.

Very truly yours,

John L. Bronson

[4] In our experience, U.S. private funds are generally structured as limited partnerships or limited liability companies. Under this recommendation, if an unregistered investment company were structured in some other manner (e.g. a private REIT organized as a business trust), a notification would be required under Section 103.132(d) notwithstanding that it was advised by a registered investment adviser.