Subject: File Number S7-30-04-Draft #2

To The Securities and Exchange Commission

I am writing in response to Release No. IA 2266 pursuant to which you have solicited comments regarding a requirement that would cause all hedge fund managers to register with the Commission under the Advisers Act.

<u>Summary</u>

I am opposed to the adoption of the proposals because the case for the Proposals which you have made in the Release is not persuasive; the risk that you will further fail in the execution of your current responsibilities is enhanced if the Proposals are adopted; the organizational structure through which you conduct your current inspections is dysfunctional and neither adequate nor deserving of greater responsibilities or burdens and the distinction which you attempt to draw between "hedge" funds and other privately offered products such as venture capital funds and other private equity funds is so hyper-technical and attenuated that you risk negatively impacting these funds , which for now are innocent bystanders.

Your Release attempts to set forth the usual "parade of horribles", but a jaundiced summary is: "After 60+ years of regulating and inspecting the investment company industry, we failed to discover that a few hedge funds, many with the acquiescence of some mutual fund managers, were stealing from mutual fund shareholders. Somehow, we also have discovered that a few other hedge fund managers have committed fraud in other ways. If we can make all hedge fund managers register under the Advisers Act, we will know where to find them, we can inspect them and the rules under the Advisers Act will force them to be good citizens. Of course, we have the ability to prosecute the managers who have committed fraud and of course we have the authority to protect less affluent citizens from predatory sales practices ("Retailization") through our oversight of the NASD, but it is a lot more exciting to propose new rules, expand our jurisdiction and justify an increase in our budget than it is to simply enforce the laws and rules that exist today".

The failure of your inspectors to discover the "after hours" mutual fund trading abuses when they were inspecting the sites where the abuses were occurring does not leave one sanguine that this group will be more perspicacious when inspecting firms which are implementing complicated investment strategies. There are two risks. The simple risk is that the inspectors will look for 60 years and find nothing, even if something "bad" is happening. The far more serious risk is that they will look, find a strategy which they don't understand and tie up endless hours of investment staff time explaining and defending, perhaps ultimately before an Administrative Law Judge or a Federal District Court Judge, a complicated but perfectly legitimate investment strategy. This result not only is costly to the firm involved, it is a waste of the Commission's resources and it will have a "chilling" effect on investment innovation. In addition, resources that should be used to inspect investment companies will be diverted to inspecting hedge funds and that creates a risk that small investors, who truly are in need of protection, are being left with diminished protection!

A word about OCI. It has never been logical to have the inspectors segregated in a different bureaucratic "silo". It is probable that this organizational weakness permitted the after hours trading to go unnoticed by your inspectors. When the inspectors "on the ground" are organizationally cut off from the substantive review and supervision of DIM, the risks of this kind of gap are enhanced geometrically. Even if OCI were to be place back under the jurisdiction of DIM, I am not persuaded that the Proposals should be adopted, but so long as OCI remains outside of DIM, I strongly believe that they should not be adopted!

Tinkering with the Private Adviser Exemption is an exceedingly bad idea. And tinkering with it in the proposed way is especially problematic. Determining whether a “private equity fund” is or is not a “hedge fund” would, under the Proposals, become a metaphysical exercise, not unlike trying to determine the “number of angels dancing on the head of a pin”. Relative certainty of private status would give way to a series of “tests”, each of which can be finessed in the design phase of a new product. Thus, an otherwise covered “hedge fund” would not be covered if certain features-all unrelated to the portfolio characteristics and construction of the new fund-were designed to avoid being covered. So, it would not be a “hedge fund”. Conversely, a Venture Capital Fund would be a Hedge Fund if it made certain “errors” in its capital structure. This Jurisdictional nexus seems tenuous indeed.

<u>Conclusion</u>
A Wall Street Journal editorial on July 13, 2004 entitled, "The SEC's Expanding Empire" addresses the Proposals. I call your attention the final line of that editorial, "A bureaucracy that failed to monitor the markets for which it already has responsibility hardly deserves a larger empire to rule". I concur completely and urge you to abandon these Proposals.

Very truly yours,
Arnold D. Scott