September 15, 2004

Via electronic mail

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File Number S7-30-04: Registration Under the Advisers Act of Certain Hedge Fund Advisers

Dear Mr. Katz;

I am writing you in response to the call for comments regarding the recent SEC proposals for oversight of hedge funds.

I do not believe that requiring "hedge fund" advisors to register with the SEC is the most prudent method for achieving the goals of the above proposed rule. It is unfortunate that the SEC's only response to the questionable perception of "hedge funds" running amok is to increase regulation rather than enforce the rules and regulations already on the books.

The SEC's attempt to single out "hedge funds" and their advisors for increased regulation, and its rationalization for needing additional regulation falls short logically for several reasons.

"Hedge Funds" should not be so narrowly defined or singled out from other alternative investments.

What the media and public commonly refer to as a "hedge fund" is simply a private investment pool, and one of several *alternative investments* that seek returns uncorrelated with standard stock and bond investments. These alternative investments include *real estate*, *private equity, leveraged-buyout, venture capital, managed futures, managed Forex,* and *absolute-return* funds. Technically, there is no such thing as a "hedge fund". To attempt to single out certain advisors of alternative investment funds based on amount of assets-under-management (AUM) or the lock-up duration of investors' capital. Instead of singling out a certain type of alternative investment—that just happens to be in the news a lot lately—the SEC should seek to register all alternative investment advisors, with the caveat that many alternative investment advisors are already registered with the CFTC. This would also prevent funds the SEC deems "hedge funds" from simply changing their structure so that they get classified as some other non-"hedge fund" type—like changing the capital lock-up period to two years or more. If anything, the SEC should be looking to regulate funds and advisors with longer lock-ups since there is more time to for things to go awry with investors' capital.

The SEC would be duplicating the regulation of the CFTC and state agencies for most "hedge funds", and the increased regulation would <u>not</u> prevent fraud.

If an investment pool or advisor makes even one trade in a futures contract or other derivative regulated by the CFTC, that fund or advisor is required to register with the CFTC. I would venture to guess that the vast majority of so-called "hedge funds" trade futures, swaps, currencies and other derivatives in order to achieve their non-correlation to stocks and bonds. Therefore, the SEC would be increasing regulation in a place where sufficient regulation already exists. Also, since "hedge funds" and other alternative investments make private offerings rather than public securities, again the vast majority are required to register with state agencies in whichever states they offer to investors. As numerous other commentators and the dissenting commissioners have already stated, "hedge funds" and their advisors are already subjected to state corporate laws, most likely CFTC regulations, and state and federal fraud and consumer laws. As the recent mutual fund scandals have shown, the myriad of regulations for that industry did not prevent fraud, misappropriation or unethical behavior. And yet they themselves are being subjected to even more regulation in recent months. Likewise, the brokerage industry is regulated to the hilt, yet there is no shortage of fraud and securities law violations in that industry. Additional rules and regulations will not hinder those that are intent on committing unlawful acts. Rather, the additional rules and regulations will hurt those that are already law-abiding and will increase their burden of keeping up with those laws and regulations. A correlative example would be gun control. Chicago has some of the strictest gun-control laws in the country, yet is consistently at the top of crime occurrence lists. Their regulations have not hindered criminals intent on getting and using guns, but have rather hamstrung citizens who are already law-abiding from choosing to protect their homes.

The "retailization" of "hedge-funds" is a myth, and could be prevented by simply strengthening the *accredited investor* and *qualified purchaser* rules.

The simple fact is that "hedge funds" are not intended for the so-called retail investor, and it would not be a wise economic decision for an advisor to admit more retail investors (a certain number of non-accredited investors are allowed under certain rules, but an advisor cannot charge them incentive fees.). If the SEC is concerned about more and more people able to get into "hedge funds", and there are certainly more newly affluent people, then perhaps they should look at increasing the income levels for AI's and QP's to ensure they are truly sophisticated enough to invest in hedge funds. Furthermore, the SEC's attempt to increase regulation on "hedge fund" advisors just because a few pensions decided to invest in them is aimed at the wrong party. The SEC should rather focus on those pension and other public fund advisors who are doing the due diligence and making the decision to invest in alternative investments. But even in those instances, the SEC would be encroaching on an area already significantly regulated by ERISA and the Department of Labor. Conversely, I have no problem with the SEC seeking to register and regulate "hedge fund-of funds" (HFOF) since their very intention is to cater to smaller investors. In those instances, they are acting not unlike a regular mutual fund, and so the SEC would be well within its mandate to regulate them. But let's say a mutual fund advisor decides to invest in a stock from Slovakia. Although the SEC should well regulate the mutual fund advisor, they should not try to regulate every underlying investment the advisor makes since the SEC has no business regulating a purely Slovakian stock. The same could be said for the approach the SEC <u>should</u> take with HFOF's. The HFOF advisor is making the representation that they have researched and packaged certain investments that they claim are acceptable for the average investor, and that HFOF, or retailized, advisor should be the focus of the SEC. *If* a "hedge fund" advisor wished to attract more retail investors whether directly or through pension funds, it should be up to that advisor and the investor(s) whether the advisor registers with the SEC. And that is the case in the industry already. Those advisors that have already registered with the SEC because they had become so large or were seeking pension and public investments did so at the request of their clients—not because the SEC was forcing the added burden on them. The decision to register was because it made sense to them from a cost-benefit perspective.

The costs of registration and increased regulation outweigh the benefits.
I do not believe the SEC fully grasps the cost and inconvenience increased regulation will cause to small and medium "hedge fund" advisors. As stated above, "hedge fund" advisors that are already registered did so because the cost-benefit analysis was favorable to their size, business model, goals, and marketing strategy. Having worked in the institutional investment world for many years, I know that having a compliance department or even one compliance person is no cheap matter. And I don't know any compliance officers who would work for the peanuts the SEC claims it would cost. If a small or medium-sized advisor is forced to increase their expenses because of regulation, they will either be forced out of business or will simply pass on the expense to investors in the form of higher fees. As others have stated, some advisors will simply move offshore in order to avoid the burden and cost. If the SEC is intent on increasing the costs of an advisor, then perhaps they would be so kind as to allow greater benefit from required registration. For instance, if this registration effort is to protect the average investor, then the SEC should allow advisors to actively market to those investors—or allow any active marketing for that matter. Not only would these increased regulatory costs stifle the entrepreneurial aspect of many alternative investment advisors, but it works against the very basics of capitalism.

The SEC already has adequate sources of information on "hedge fund" advisors and their funds.
As other commentators have more eloquently put it, the SEC already has more then enough resources for gathering information from "hedge fund" advisors and their funds. As we have learned from September 11th, it is prudent for federal agencies to communicate better with each other and share more information. Rather than silo-ing itself and requiring the same information already provided to state agencies, the CFTC, prime brokers and exchanges, the SEC can make use of more then enough information already in existence to learn about any particular "hedge fund" advisor or fund. The SEC could also improve existing filings, like Form D, to glean more information about the history of an advisor and their business practices, without imposing the burdens of formal registration.

Conclusion
The bottom line is that in any market, increasing the regulatory burden stifles innovation, entrepeneurism, weighs down law-abiding participants, and pushes further into the shadows less

scrupulous participants. As much can be said about increasing the regulation of so-called “hedge fund” investment pools. With that being said, the SEC should rather consider the following alternatives to the proposed Rule if they are intent on working against a free market:

1. Rather then attempt to regulate a slippery definition of “hedge fund”, regulate the entire alternative investment industry in conjunction with the CFTC;

2. If a “hedge fund” fits the criteria of required registration, allow them to pursue the same marketing and advertising practices as a registered mutual fund;

3. Tighten the rules or raise the hurdles of the *accredited investor and qualified purchaser* rules to disallow any “retail” investors, exempting only defined family of the advisor;

4. Significantly raise the proposed hurdles for requiring registration to be more reflective of the composition of the industry, and making the cost-benefit impact more reasonable;

5. Changing existing forms and filings to gather more information without formally requiring registration.

I would like to thank the SEC for the opportunity to comment on the Proposed Rule, and commend the SEC’s intent of further protecting investors. However, I believe the SEC needs to take a stronger and more well-thought-out look at finding more cost-effective ways of ensuring the SEC can access pertinent information about the hedge fund industry and enacting measures designed to deter and detect fraud and prevent retailization. This is imperative to minimize the costs that full registration and compliance will have on existing hedge fund advisers and those looking to enter the industry.

Kind regards,

Jeffrey R. Neufeld