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Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 5th Street, N.W.
Washington, D.C. 20549-0609

RE: Release No. IA-2266 (File No. S7-30-04): Proposed Registration under the Advisers Act of Certain Hedge Fund Advisers

Dear Mr. Katz:

Thank you for the opportunity to comment on the Commission's proposal (the "Proposed Rule")[1] to require hedge fund advisers to register under the Investment Advisers Act of 1940 (the "Act"), instead of operating free of registration under section 203(b)(3) of the Act. The International Swaps and Derivatives Association, Inc. ("ISDA") believes that the Proposed Rule represents a significant and unwarranted departure from current law, raises serious policy and practical concerns and will not accomplish the Commission's stated goals. ISDA urges the Commission to withdraw the Proposed Rule.

ISDA is the global trade association representing participants in the privately negotiated derivatives industry, a business covering swaps and options across all asset classes (interest rate, currency, commodity and energy, credit and equity).[2] ISDA was chartered in 1985, and today numbers over 600 member institutions from 46 countries on six continents. These members include most of the world's major institutions who deal in, as well as leading end-users of, privately negotiated derivatives. The membership includes associated service providers and consultants.

Since its inception, ISDA has pioneered efforts to identify and reduce the sources of risk in the derivatives and risk management business. Among its most notable accomplishments are: developing the ISDA Master Agreement; publishing a wide range of related documentation materials and instruments covering a variety of transaction types; producing legal opinions on the enforceability of netting and collateral arrangements (available only to ISDA members); securing recognition of the risk-reducing effects of netting in determining capital requirements; promoting sound risk management practices, and advancing the understanding and treatment of derivatives and risk management from public policy and

[1] Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg 45172 (proposed July 28, 2004) (to be codified at 17 C.F.R. 275,203(b)(3)-2) [hereinafter, PROPOSED RULE].
[2] Please see our website at http://www.isda.org.

regulatory capital perspectives. Included in our membership are hedge funds; many of our members act as counterparties to hedge funds in a variety of transactions.

Hedge funds are an important source of liquidity in the privately negotiated derivatives industry (as in other markets)[3] and are important participants in the innovation that has characterized the privately negotiated derivatives industry in the United States. The entrepreneurial spirit of the hedge fund industry, combined with the myriad strategic directions hedge funds may pursue, provide the privately negotiated derivatives industry with participants who engage in a wide range of transactions, thereby increasing liquidity, stability and efficient pricing in that industry. ISDA is concerned that the Proposed Rule will inhibit the development of hedge funds, both by the costs it will impose (without countervailing benefits) on what are often small organizations and by the uncertainty it will create regarding the future direction of hedge fund regulation. This will negatively affect the privately negotiated derivatives industry.

I. Effect of the Proposed Rule on the Privately Negotiated Derivatives Industry

Privately negotiated derivatives are powerful tools that enable American businesses and other end users to manage the interest rate, currency, commodity, credit and other related risks that are inherent in their activities. In this way, users of privately negotiated derivatives are able to lower their cost of capital, manage their credit exposures, and increase their competitiveness both here and abroad by focusing on their core areas of expertise.[4] The United States has been a leader in the development of derivatives and American businesses were among the earliest to benefit from these risk management tools.

Hedge funds are an important component of the privately negotiated derivatives industry because they act as counterparties in a wide range of transactions in which traditional market players are uninterested.[5] Hedge funds act as sources of liquidity,[6] as risk takers and absorbers of shock,[7] and as

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[3] *See* PRESIDENT'S WORKING GROUP ON FINANCIAL MARKETS, *Hedge Funds, Leverage, and the Lessons of Long-Term Capital Management*, at 2, A-5 (April 1999) [hereinafter, PWG REPORT]. *See also* SECURITIES AND EXCHANGE COMMISSION, *Implications of the Growth of Hedge Funds: Staff Report to the United States Securities and Exchange Commission*, at 4 (September 2003) [hereinafter, SEC STAFF REPORT]. *See also*, PROPOSED RULE, *supra* note 1, at 45178.

[4] "Over the past several years, the U.S. economy has proven remarkably resilient in the face of a series of severe shocks . . . . The use of a growing array of derivatives and the related application of more-sophisticated methods for measuring and managing risk are key factors underpinning the enhanced resilience of our largest financial intermediaries . . . . When [concentrations of risk] exceed the risk appetites of intermediaries, derivatives can be employed to transfer the underlying risks to other entities." Alan Greenspan, *Remarks on Corporate Governances at the 2003 Conference on Bank Structure and Competition*, Chicago, Illinois (May 8, 2003).

[5] Hedge funds are important participants in the derivatives industry. Appendix D of the 1999 PWG Report indicated that, "Most bank exposures with hedge funds arise from counterparty trading and derivatives activities." At that time, approximately $1 trillion in total notional value of derivatives contracts at money center banks were with hedge funds. PWG REPORT, *supra* note 3, at D-1. The PWG Report also notes that, "in general, hedge funds are more active users of derivatives and of short positions than are mutual funds or many other classes of asset managers. In this respect, the trading activities of hedge funds are similar to those undertaken by the proprietary trading areas of large commercial and investment banks." *Id.* at 3. According to VAN Hedge Fund Advisers International, as of the first quarter of 2003, 44 percent of hedge funds used derivatives for purposes other than hedging. This is up from 28% in the first quarter of 1999. *See* Van Hedge Fund Advisers International, LLC, *Characteristics of a Typical Hedge Fund*, available at http://www.hedgefund.com/abouthfs/attributes/Characteristics/characteristics.htm (last visited Sep. 7, 2004).

[6] *See* sources cited *supra* note 3. This liquidity, in turn, creates more stable and efficient markets, thereby reducing the amount of risk in the economy as a whole.

[7] "[I]t's so important that [hedge funds] are left free to supply the extent of liquidity that they are in fact supplying to our financial markets . . . [because they are] instrumental in enabling us to absorb the shocks which have been so extraordinary in recent years. And one of the most flexible parts of our system is financial, and our ability to

innovators. In addition, through active trading and research, hedge funds push the market towards efficient pricing.[8] Efficient markets help not only the system as a whole, but also have a direct benefit for individual investors, for example, by lowering interest rates or the costs of hedging against particular risks.

To the extent the Proposed Rule adversely affects hedge funds, those adverse effects will also take a toll on the derivatives industry. In particular, ISDA is concerned that:

- Mandatory registration will reduce the number of new entrants into the hedge fund industry, thereby decreasing the innovative and entrepreneurial spirit that contributes greatly to the derivatives industry;
- Mandatory registration may force hedge funds offshore, thereby adding legal and political risk to derivatives transactions and imposing additional administrative costs not contemplated by the proposing release; and
- The prospect of any additional regulatory requirements will reinforce each of the negative consequences listed above.

To the extent that any of the foregoing concerns are realized, the privately negotiated derivatives industry will be adversely affected. In the absence of countervailing benefits, ISDA urges the Commission to withdraw the Proposed Rule and so avoid the risks it would create.

II. Inappropriateness of the Proposed Rule – A Departure from Fundamental Principles

In the American free enterprise system, the norm is freedom from regulation in the absence of a compelling need for regulation. Hedge fund advisers have previously not been required to register with the SEC because there has not been a compelling need. To force their registration in the absence of compelling need is a departure from a fundamental principle at the intersection of American law and commerce.

According to the President's Working Group on Financial Markets (the "PWG"):

> *[I]n our market-based economy, market discipline of risk taking is the rule and government regulation is the exception*. Generally, government regulation becomes

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absorb financial shocks. If you start to inhibit the number of types of unregulated participants in the financial market from taking the types of risks and supplying the liquidity, I am fearful that we will remove some of the flexibility we have in our overall system. . . ." *Renomination of Alan Greenspan as Chairman of the Federal Reserve Board of Governors: Hearing Before the Senate Banking, Housing and Urban Affairs Committee* (testimony of Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve) (June 15, 2004).

[8] "[M]any of the things which [hedge funds] do . . . tend to refine the pricing system in the United States and elsewhere. And it is that really exceptionally and increasingly sophisticated pricing system which is one of the reasons why the use of capital in this country is so efficient . . . there is an economic value here which we should not merely dismiss . . . I do think it is important to remember that [hedge funds] . . . by what they do, they do make a contribution to this country." *Hearing Before the Senate Banking, Housing and Urban Affairs Committee* (testimony of Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve) (October 1, 1998), *cited in* PROPOSED RULE, *supra* note 1, at note 65. *See also The Federal Reserve's Second Monetary Policy Report to Congress for 2004: Hearing Before the Senate Banking, Housing and Urban Affairs Committee* (testimony of Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve) (July 20, 2004) (stating, "Hedge funds taking positions in volume tend to eliminate inefficiencies by aligning markets and providing liquidity to markets.").

> necessary because of market failure . . . . Government regulation of markets is largely achieved by regulating financial intermediaries that have access to the federal safety net, that play a central dealer role, or that raise funds from the general public. *Any resort to government regulation should have a clear purpose and should be carefully evaluated in order to avoid unintended outcomes*.[9]

Although the Commission is a member of the PWG and joined in this PWG statement, the Proposed Rule is at odds with this statement.

First, there has been no market failure that would justify the Proposed Rule.[10] Quite to the contrary, there has been market success, yielding an increase in the number of hedge funds and the size of hedge fund assets, but without any significant mishap in the hedge fund industry in the five years since the PWG's report.[11] The Commission release accompanying the Proposed Rule (the "Release") refers to a number of fraud cases brought by the Commission against hedge fund operators, but it does not indicate that these cases represent either a disproportionate affliction of the hedge fund industry or a problem that would be significantly ameliorated by the Proposed Rule.[12] The Release also refers to hedge funds participating, as favored customers, in the mutual fund market timing scandal.[13] The Commission already has extensive jurisdiction over mutual funds, however, and that would seem sufficient to protect against the risk of similar problems in the future.

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[9] PWG REPORT, *supra* note 3, at 26. Emphasis added. Guidelines issued by the President's Office of Management and Budget to assist agencies implement Executive Order 12866 also make this principle applicable to agency rulemaking. *See infra* notes 10 and 15. It is important to note that the PWG Report affirmatively did not recommend registration of hedge funds. PWG REPORT, *supra* note 3, at 42. Nor did the PWG Report recommend registration of hedge fund advisers, noting that this was not "an appropriate method to monitor hedge fund activity." PWG REPORT, *supra* note 3, at B-16.

[10] A finding of market failure is a typical prerequisite to establishing the economic need for regulatory action, although even market failure, by itself, may not justify regulation. *See* OFFICE OF MANAGEMENT AND BUDGET OF THE EXECUTIVE OFFICE OF THE PRESIDENT, *Economic Analysis of Federal Regulations under Executive Order 12866* (January 11, 1996) (stating, "In order to establish the need for the proposed action, [an agency's] analysis should discuss whether the problem constitutes a significant market failure. If the problem does not constitute a market failure, the analysis should provide an alternative demonstration of compelling public need, such as improving governmental processes or addressing distributional concerns.") *See also,* Jacob J. Lew, Director of the Office of Management and Budget of the Executive Office of the President, *Guidelines to Standardize Measures of Costs and Benefits and the Format of Accounting Statements*, M-00-08 (March 22, 2000) (stating, " To establish a need for the proposed action, you should explain whether the problem arises because of a significant market failure or some other compelling public need. If there is a significant market failure, you should describe the nature of this failure in both qualitative and quantitative terms. Since the existence of a market failure is not sufficient to justify government intervention, you should show that government intervention to correct the market failure is likely to do more economic good than harm. If the problem is not a significant market failure, you should provide an alternative demonstration of compelling public need. Such needs may include the improvement of governmental processes or distributional concerns. ") *See infra* note 11 and discussion of "Retailization" at *infra* p. 8, a Commission concern that also would not justify the Proposed Rule.

[11] Nor has market growth been supported by unqualified investors. "There is no evidence that investors in hedge funds today are less sophisticated than they were in 1999. Indeed, institutional investors have accounted for a growing share of hedge fund investments, and they can and should protect their own interests rather than rely on the limited regulatory protections that would be provided as a result of a registration requirement." *The Federal Reserve's Second Monetary Policy Report to Congress for 2004: Hearing Before the Senate Banking, Housing and Urban Affairs Committee* (written response of Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve, to Chairman Shelby's Questions) (July 20, 2004).

[12] PROPOSED RULE, *supra* note 1, at 45179.

[13] PROPOSED RULE, *supra* note 1, at 45175, 45188.

Second, the Commission proposes to impose regulation not on financial intermediaries that have access to the federal safety net, that play a central dealer role or that raise funds from the general public, but on a diverse array of independent, relatively small organizations that do none of those things. This fact alone raises questions as to the real potential for public benefit from the Proposed Rule and the appropriateness of the burden the Proposed Rule will impose on the regulated parties.

Finally, as discussed in more detail below, the purpose of the Proposed Rule is unclear—including in its references to potential greater regulation.[14] This raises concerns about the unintended outcomes to which the PWG referred.

III. Lack of Benefits of the Proposed Rule

The rulemaking process requires an agency to set forth its view of both the benefits and costs of rules it wishes to promulgate.[15] Examination of the benefits listed by the Commission in the Release[16] shows these benefits to be speculative.

First, the Commission promises benefits to hedge fund investors (while conceding that "these benefits are difficult to quantify"), most importantly by deterring fraud and curtailing losses.[17] The Commission attempts to validate this promise by reference to 46 fraud cases it has pursued against hedge funds over the past five years. This key promise is shattered, however, by the fact that of these 46 cases, eight (8) were brought against hedge funds that were already voluntarily registered with the Commission and involved frauds that were consummated *without being discovered by the Commission*, despite registration of those involved. Of the remaining 38 cases, 20 were brought against hedge funds too small to require registration under the Proposed Rule.[18] A further seven of the cases involved parties that either were or should have been registered with the Commission under a variety of other regulations. Thus, the Proposed Rule would extend Commission registration to only a small portion of those hedge funds accused by the Commission of fraud and the Commission can offer no evidence that registration will actually diminish the incidence of fraud.

The Commission also promises that the Proposed Rule will bring this purported fraud deterrence to bear on behalf of mutual fund investors, stating that hedge fund registration will deter activity such as that involved in the market timing scandal. As noted above, however, the Commission already has broad regulatory oversight of the mutual fund industry and that should be sufficient to deter activity such as market timing.

The Commission asserts that imposition of the Proposed Rule will provide investors with better information about hedge funds and will foster a "culture of compliance."[19] Yet the Commission makes no

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[14] "Should the existing proposal fail in achieving its goal, pressure will become irresistible to expand SEC's regulatory reach in an endeavor to accomplish what it set out to do." *The Federal Reserve's Second Monetary Policy Report to Congress for 2004: Hearing Before the Senate Banking, Housing and Urban Affairs Committee* (testimony of Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve) (July 20, 2004).

[15] Exec. Order No. 12866, 58 Fed. Reg. 51735 (Oct. 4, 1993), *as amended* by Executive Order No. 13258, 67 Fed. Reg. 9385 (Feb. 28, 2002).

[16] PROPOSED RULE, *supra* note 1, at 45187-45189.

[17] PROPOSED RULE, *supra* note 1, at 45187.

[18] Dissent of Commissioners Cynthia A. Glassman and Paul S. Atkins to Proposing Release No. IA-2266; Proposed Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg 45197 at 45198 n.14 (proposed July 28, 2004) (to be codified at 17 C.F.R. 275,203(b)(3)-2) [hereinafter, DISSENT].

[19] PROPOSED RULE, *supra* note 1, at 45188.

showing (i) that the information it will collect is not available elsewhere[20] or (ii) that the "culture of compliance" needs to be encouraged in an industry that has shown no greater incidence of malfeasance than any other financial industry sector, whether subject to registration requirements or not. Indeed, the General Counsel of the Commodity Futures Trading Commission noted that, "in the last 5 years, less than 3% of all enforcement actions by the CFTC and the SEC (81 out of 3,035) have been against hedge funds and/or their advisers."[21]

The Commission claims that imposing registration will "legitimize a growing and maturing industry."[22] As we have observed above, the Proposed Rule brings no real protections to hedge fund investors. To the extent "legitimization" causes hedge fund investors to be less diligent in their own required investigation of potential hedge fund investments, it will be truly harmful.

In the midst of the Commission's list of purported benefits flowing from the Proposed Rule, the Commission referred to benefits to "regulatory policy." These "benefits" are that registration of previously unregistered hedge fund advisers will allow the Commission to collect data to "frame appropriate regulatory policies."[23] Asserting registration jurisdiction over previously unregistered market participants in order to frame regulatory policy for an industry that has not shown any need to be

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[20] *See Regulation of the Hedge Fund Industry: Hearing Before the Senate Banking, Housing and Urban Affairs Committee* (written statement of Adam Cooper, Chairman of the Managed Funds Association), at 10-11 (July 15, 2004) [hereinafter, MFA STATEMENT]. The CFTC has made the following comment in this regard: "It has been said that SEC registration of hedge funds and their advisers is necessary to afford a window for regulators into these investment vehicles in order to combat fraud . . . . [S]uch a window already exists with respect to the segment of the hedge fund industry that is registered with the CFTC. The CFTC has a substantial amount of information available to it regarding these CPOs, commodity pools, and CTAs. This information has proved fully sufficient for the CFTC to bring enforcement actions for fraud on those relatively rare occasions when it occurs. And the CFTC stands ready to continue sharing this information with other regulatory authorities that may be in need of it." *See Regulation of the Hedge Fund Industry: Hearing Before the Senate Banking, Housing and Urban Affairs Committee* (testimony of Patrick J. McCarty, General Counsel of the Commodity Futures Trading Commission), at 11 (July 15, 2004) [hereinafter, CFTC STATEMENT]. In addition, basic information about unregistered hedge funds will be available to the SEC under a proposed Treasury Department anti-money laundering rule, which will require the establishment of compliance programs by 203(b)(3) unregistered investment advisers that have $30 million or more of assets under management. Authority for examining compliance will be delegated to the SEC. Under this proposed rule, unregistered investment advisers must submit a notice to FinCEN stating (a) the investment adviser is an unregistered adviser; (b) the address, e-mail address (if applicable), and telephone number of the unregistered adviser; (c) the name, e-mail address (if applicable), and telephone number of the designated anti-money laundering program compliance officer of the unregistered adviser; (d) the total number of clients of the unregistered adviser; and (e) the total amount of assets under management of the unregistered adviser, as determined under the instructions to SEC Form ADV, Part 1A, as of the end of the adviser's most recent fiscal year. *See*, DEPARTMENT OF TREASURY, *Financial Crimes Enforcement Network; Anti-Money Laundering Programs for Investment Advisers*, RIN 1506-AA28 (to be codified at 31 C.F.R. pt. 103). *See also The Federal Reserve's Second Monetary Policy Report to Congress for 2004: Hearing Before the Senate Banking, Housing and Urban Affairs Committee* (written response of Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve, to Chairman Shelby's Questions) (July 20, 2004) ("If there were a public policy reason to monitor hedge fund activity, the best method of doing so without raising liquidity concerns would be indirectly through oversight of those broker-dealers (so-called prime brokers) that clear, settle, and finance trades for hedge funds.").

[21] CFTC STATEMENT, *supra* note 20, at 1.

[22] PROPOSED RULE, *supra* note 1, at 45189.

[23] PROPOSED RULE, *supra* note 1, at 45188.

regulated, whether under the criteria set forth in the PWG's Report,[24] guidelines laid out in applicable regulations and executive orders[25] or any other reasonable criteria, is inappropriate.

In contrast to the Commission's views, ISDA believes that the benefits posited by the Commission are unconvincing. This is because, as a matter of fact, market discipline appears to be alive and well in the hedge fund industry. This no doubt is in part a result of the fact that hedge fund investors must be sophisticated (as well as wealthy), and are capable of demanding such discipline from the hedge funds themselves. Although the Commission argues that the Act does not distinguish between advisers to sophisticated customers and advisers to the unsophisticated,[26] the purpose of the Act actually was to protect the unsophisticated public, not the experienced, moneyed investor.[27] The Commission acknowledges in the Release that its "concern is and must be the protection of investors."[28] We suggest that, to the extent the Commission seeks to protect investors who do not need the protection it offers, any description of the benefits of such protection will appear strained.

Costs

The Release follows its statement of purported benefits with a less than full accounting of the costs attendant upon registration. The Proposed Rule would extend registration and related compliance formalities to hedge funds with as little as $25,000,000 in assets under management. It is reasonable to assume that the management team (if more than a single person) for that quantity of assets would be small. The imposition of compliance training and compliance formalities on such a small enterprise cannot be anything other than burdensome and a barrier to entry into the hedge fund business.[29]

There is also the risk that the Proposed Rule will force existing mid-size hedge funds—which do not earn fees sufficient to support the burdensome costs of registration—to either grow in order to create economies of scale or shrink in order to fall under the $25 million registration threshold.[30] Because hedge

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[24] *See supra* text accompanying note 9. *See also* PWG REPORT, *supra* note 3, at 29-30, 42.
[25] *See supra* notes 10 and 15.
[26] PROPOSED RULE, *supra* note 1, at 45173.
[27] The Senate Report recommending passage of the Investment Advisers Act and the Investment Company Act stated, "The nature of the functions of investment advisers, their increasing widespread activities, their potential influence on security markets and the dangerous potentialities of stock market tipsters imposing upon unsophisticated investors, convinces this committee that protection of investors requires the regulation of investment advisers on a national scale." S. REP. NO. 1775, at 21 (1940). Similarly, the House Report (Report 2639 at 28) stated, "the essential purpose of [the Investment Advisers Act] is to protect the public from the frauds and misrepresentations of unscrupulous tipsters and touts and to safeguard the honest investment adviser . . . ." H.R. REP. NO. 2639, at 28 (1940). Moreover, in an editorial supporting the legislation that would enact the Investment Advisers Act and the Investment Company Act, the New York Times stated, "Many shocking abuses and scandals on the part of poorly managed companies, with attendant losses to a class of investors who could least afford them, could have been avoided if such regulation had been instituted 10 or 15 years ago . . . . The main justification for the very existence of investment trusts is the service they can perform for small or uninformed investors." Editorial, *Overdue Regulation*, N.Y. TIMES, March 16, 1940, at 8.
[28] PROPOSED RULE, *supra* note 1, at 45178.
[29] "Hedge fund arbitrageurs are required to move flexibly and expeditiously if they are to succeed. If placed under increasing restrictions, many will leave the industry - to the significant detriment of our economy." *The Federal Reserve's Second Monetary Policy Report to Congress for 2004: Hearing Before the Senate Banking, Housing and Urban Affairs Committee* (testimony of Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve) (July 20, 2004).
[30] "The requirement to register when assets reach $25 m is extremely burdensome. The comparison to small money managers that currently register is an absurd comparison. No money manager starts a firm, with all the associated paperwork and lower fees, with the intention of staying small. Many hedge funds, on the other hand, purposely stay small. The rule will have the effect of forcing a fund to stay under $25 m or trying to grow well beyond $50

funds tailor their size to a particular investment strategy, this will not only impose additional unnecessary and uncontemplated costs, but it will also depress the efficiency of the hedge fund marketplace.

Retailization

The Release refers prominently to the issue of "retailization," which may be described as the allegedly increased access by less wealthy (and theoretically less able) investors to hedge funds. Interestingly, the Commission does not include mitigation of retailization among the benefits of the Proposed Rule. This is most striking, given that the Proposed Rule would have the "effect of requiring all direct investors in most hedge funds to . . . have a net worth of $1.5 million or have at least $750,000 of assets under management with the adviser."[31] By thus increasing investor standards, the Proposed Rule would accordingly limit the risk of retailization. Of course, a change in investor standards can be accomplished *without the imposition of registration*, as has been proposed by the Managed Funds Association.[32]

The Release also alleges that the risks of retailization are apparent in the investment by pension funds and other professional investors in hedge funds. Yet these investors are both skilled and subject to their own regulatory requirements and would not seem to require the assistance of the Proposed Rule.[33] Any concerns that may exist about pension fund and similar investors' hedge fund activities should be addressed through the regulatory mechanisms already in place with respect to these investors.

Valuations

According to the Release, the Proposed Rule is also inspired, in part, by "improper valuation of hedge fund assets by hedge fund advisers . . . ."[34] Nonetheless, the Commission admits that its proposal to simply examine hedge funds' valuation procedures[35] would not reduce investment risks, because Commission examination "is not designed to evaluate advisers' investment and trading strategies."[36] Indeed, the SEC 2003 Staff Report found that valuation-based problems derived from "the fact that hedge fund performance results are not required to be reported using a uniform or standardized performance measure."[37] The Managed Funds Association, however, already has established valuation guidelines that should be helpful in alleviating the Commission's concern, without the need for the Proposed Rule—another example of appropriate market discipline.[38]

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m. Any fund in between $25 to $50m, which is a very typically sized hedge fund, will have all the heavy costs of being registered without the fee stream or infrastructure to easily shoulder the burden." Guy Judkowski of Hedgehog Capital, *Comment on SEC File S7-30-04* (July 27, 2004), at http://www.sec.gov/rules/proposed/s73004/gjudkowski072704.htm (last visited Sep. 7, 2004).

[31] PROPOSED RULE, *supra* note 1, at 45180.

[32] *See* MFA STATEMENT, *supra* note 20, at 11.

[33] Pension plans and funds of hedge funds are already regulated either by the Department of Labor and the laws of the states in which they operate or by the Commission, respectively.

[34] PROPOSED RULE, *supra* note 1, at 45179.

[35] "Registered investment advisers are not required to follow any particular valuation methodology, but our examiners consider whether the adviser's procedures for valuing the managed assets are effective, whether the adviser's actual practices in valuing client assets follow the procedures they have established, and how the adviser discloses, mitigates and manages the conflicts of interest that can arise with respect to valuation" PROPOSED RULE, *supra* note 1, at 45179.

[36] PROPOSED RULE, *supra* note 1, at 45179 n.75.

[37] SEC STAFF REPORT, supra note 3, at 51.

[38] *See* MANAGED FUNDS ASSOCIATION, *2003 Sound Practices for Hedge Fund Managers*, at 12-14 (August 5, 2003).

IV. Conclusion

We appreciate the Commission's desire to be vigilant with respect to the growing hedge fund market. We respectfully urge the Commission, however, to recognize that the hedge fund market overall has been functioning at least as well as, if not better than, other markets that are subject to greater degrees of regulation. We hope that the Commission will withdraw the Proposed Rule and so avoid burdening this important and dynamic market with presently unneeded regulatory requirements and the chilling effect of potential additional regulation to follow.

Thank you for the opportunity to comment on the Commission's proposal. We hope you find our comments helpful. Should you have any questions, please do not hesitate to contact Robert G. Pickel at (212) 901-6020.

Yours sincerely,

Robert G. Pickel

Executive Director and CEO
International Swaps and Derivatives Association, Inc.