

February 20, 2007

Dear SEC Commissioner(s) and Staff:

In response to your request for comments regarding S7-25-06, I would like to register my objections to the proposed changes to the definition of an “accredited investor.” As the Principal of a small hedge fund, this issue is critical to the vitality of my business.

At the heart of my objection is my belief that investors should be treated equally and have access to sources of money management that offer them the best chance at a well-funded and enjoyable retirement. I truly believe that hedge funds, and other pooled investment vehicles, help investors achieve this goal.

The proposed change makes implementing modern portfolio theory impossible for almost 99 percent of investors. Proponents of modern portfolio theory, which is the basis of nearly all financial theory taught and explored today, note that expected investment returns can be increased. It is also no secret that, by and large, pooled investment vehicles have historically had low or little correlation to traditional asset classes. In the context of a portfolio, then, pooled investment vehicles can help lower risk and enhance returns.

It seems patently unfair, then, to prohibit investors of impressive means from lowering their portfolio risk and raising their portfolio returns through investment in pooled investment vehicles. It seems even more unfair to withhold this risk from the very people who need it most—those who are building their retirement nest eggs. Why should the implementation of modern portfolio theory be given solely to the one percent of Americans who need it least—those with a net worth, not including their primary residence, of \$2.5 million?

The proposed change discourages competitive practices. It is mildly ironic that an executive branch agency of the United States, the poster child of free market economies, is considering an act that will blatantly discourage competition. With more funds fighting for more investment dollars, competition would usher in more investor-friendly fee regimes, heightened transparency, and all-around better products. For examples of this process, we need to look no further than the evolution of the mutual fund industry in the 1980s and the commodity fund industry of the 1990s.

It should be noted that in Europe, and the majority of the rest of the world, investors in pooled investment vehicles do not have to meet net worth requirements nearly as burdensome as the requirements imposed by the SEC. Enacting the proposed changes further tightens the competitive handcuffs already worn so tightly by U.S.-based pooled investment vehicles.

The proposed change disproportionately impacts small pooled investment vehicles. The proposed changes will make it nearly impossible for small hedge funds to get started. Current rules restrict most funds to 99 investors, which creates a natural demand for super-wealthy investors. The top three quartiles of accredited investors have a disproportionate appeal to funds

because they offer more investment dollars per individual. Large funds, therefore, often have initial purchase minimums of \$1 to \$5 million. A prudent investor who wishes to diversify must have a net worth in the ballpark of \$10 to \$50 million. Meanwhile the bottom quartile of accredited investors, or those just over the current \$1 million threshold, is likely to purchase investments of \$10,000 to \$100,000. While such investors are often not worth the time of large and established funds managing hundreds of millions or billions of dollars, they are the lifeblood of small young funds. They act as angel investors, providing the seed capital for funds to generate the track record necessary to succeed in the long run. Eliminating this body of capital disproportionately impacts small funds and has almost no impact on large funds. Imagine Congress prohibiting the Small Business Administration from making loans to businesses that don't have a 15-year history and \$50 million in annual sales.

While the SEC is considering the proposed changes in order to benefit the average American investor, they are in fact ceding power to large and established pooled investment funds.

While I understand that the SEC must uphold their congressional mandate to protect investors, I feel that proposed rule S7-25-06 does more harm than good, both to the investors of pooled investment vehicles and the managers of pooled investment vehicles.

Cordially,

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Principal
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