



VIA ELECTRONIC DELIVERY AND U.S. POSTAL MAIL

March 2, 2007

Ms. Nancy M. Morris  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-5041

Re: File No. S7-25-06; Release No. 33-8766; IA-2576; Accredited Investors in Certain  
Private Investment Vehicles

Dear Ms. Morris:

VanthedgePoint Group, Inc. ("VanthedgePoint" or "Company") is pleased to submit this comment letter to the Securities and Exchange Commission ("SEC" or "Commission") in connection with the proposed new rules 216 and 509 under the Securities Act of 1933 ("Securities Act"). VanthedgePoint would like to take this opportunity to furnish the Commission with comments to the proposed rules.

VanthedgePoint appreciates the SEC's continuing efforts to improve regulatory oversight of hedge funds to better protect the investing public; however, VanthedgePoint believes the Commission's proposed new rules will not result in the additional investor protections with respect to pooled investment vehicles.

**Background**

VanthedgePoint launched in February 2006 to meet the needs of smaller hedge funds, and is viewed as a leading authority on the "emerging" segment of the hedge fund industry. It now serves 30 hedge funds both in the United States and Europe, and its growth continues to accelerate. The Company operates three wholly owned subsidiaries: VanthedgePoint Securities LLC, a registered broker/dealer, VanthedgePoint Technologies LLC, an operations outsourcing firm, and VanthedgePoint Futures LLC, a registered futures introducing broker. Combined, VanthedgePoint offers a comprehensive brokerage services and operational support platform for start-up and emerging hedge fund managers, which predominantly start as 3(c)(1) Pools. The Company's technology-based platform provides both the operational scalability and the preferred pricing typically possible for only large, multi-billion dollar hedge funds. In addition, its clients enjoy capital introduction support and exclusive access to VanthedgePoint's extensive network of investors seeking opportunities with promising emerging managers, a portion of whom are high net worth individuals who qualify as "accredited investors."

**VANTHEDGEPOINT GROUP, INC.**

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VanthedgePoint decided to address this segment of the hedge fund industry because over half of all hedge funds manage less than \$25 million, and over 85% manage less than \$100 million.<sup>1</sup> These funds often depend on high net worth investors, so called “friends and family,” to launch their businesses. It is this target market that is the sole focus of VanthedgePoint’s growing business, and given the Company’s client base its perspective on the Commission’s proposed new rules is worth noting.

## **Discussion**

In December 2006, the SEC put forth two proposals: the introduction of “Accredited Natural Persons” and Prohibition of Fraud by Advisers. VanthedgePoint wishes to provide the Commission with comments on the former, and has no comments on the latter.

First, the Commission believes that a “revised eligibility standard may benefit those accredited investors who would meet the definition of accredited natural person by increasing the competition among 3(c)(1) Pools for their investment money. Such competition may result in lower fees.” VanthedgePoint believes that decreasing the number of “accredited investors” would reduce competition by forcing many 3(c)(1) Pools to close down due to their inability to attract sufficient capital to maintain operation thereby limiting investor choice. In addition, given the increasing interest among individual investors in hedge funds the investing public needs to see a steady flow of new, innovative strategies. Implementation of the new rule would decrease the number of 3(c)(1) Pools and reduce the number of investors eligible to invest in such vehicles thereby causing a significant slowdown in the number of new hedge funds.

The Commission fails to acknowledge the vast disparity in the distribution of wealth within the United States, and its proposal would help reinforce this disparity by allowing the ultra high net worth investors to invest in hedge funds, while denying other sophisticated investors the same potential benefits for the sole reason that they are slightly less wealthy. The SEC’s contention that these minimums need to be increased since they have remained the same since first imposed in 1982 has merit; however, the exclusion of personal residences effectively raises the minimum qualifications even further than it appears, placing countless sophisticated investors at a disadvantage. Furthermore, the removal of the income test places many sophisticated investors at a severe disadvantage, particularly younger investors with longer time horizons, who, despite having significant income may not have built up a \$2.5 million investment portfolio. For example, a financial services executive with familiarity with hedge funds who earns \$500,000 per year in income and has \$1 million in investments (excluding their personal residence) would be deemed ineligible under the proposed rule. VanthedgePoint recommends that the SEC conduct further research and analysis into the relationship between wealth and investor sophistication, and propose new minimum eligibility criteria for comment.

Second, the SEC contends that fees have risen or are too high among hedge funds, yet it fails to produce evidence to support such a claim. The typical fee structure of hedge funds is a 2% basic fee plus a 20% performance fee; however, over 83% of hedge funds, and virtually all of VanthedgePoint’s clients, charge a base fee of 1.5% or less (59% charge 1.0% or less) plus a 20% performance fee.<sup>2</sup> The growth in the number of hedge funds has increased competition for investors, and forced managers to lower fees to attract capital. The Commission also fails to note the

<sup>1</sup> VanthedgePoint Emerging Hedge Fund Manager Sentiment Survey, January 2007; Strategic Financial Solutions, LLC Database Study 2004 analysis of the twelve leading hedge fund databases found that “nearly 175 funds have surpassed the \$1 billion mark. However, the vast majority of funds continue to manage less than \$25 million.”

<sup>2</sup> Hedge Funds, City Business Series; International Financial Services, London, April 2005, p. 4

growing popularity of Separately Managed Accounts (“SMA”) by investors, which have further driven down fees while providing increased investor protection by limiting manager control over the assets held in the SMA. The consequences of the proposed rule would be fewer choices for investors, which would enable the remaining hedge funds to charge higher fees for reasons discussed later.

The SEC fails to acknowledge that one major reason hedge funds are able to charge what are perceived to be high fees relative to mutual funds and other asset managers is because hedge funds tend to attract the most talented money managers. Many hedge fund managers have an extensive track record, and have historical success in the execution of their investment strategies. Therefore, the Commission is not taking into effect the training, knowledge and expertise of the managers themselves in its assessment of the fees charged by hedge funds. In addition, these individuals largely use strategies that they developed while at larger institutions where their employer was the primary beneficiary of their work. Today, many entrepreneurial-minded money managers seek to start their own hedge funds, typically 3(c)(1) Pools, to gain greater financial benefit from executing a successful investment strategy. In spite of these ideals, several recent high-profile fraudulent hedge funds call into question personal integrity of hedge fund managers, and heighten the importance investors should place on conducting thorough background and due diligence on managers prior to investing. Thus, to provide investors with greater protection, VanthedgePoint suggests that the Commission should consider enforcing higher scrutiny and oversight of the individual managers themselves, or requiring completion of an intensive registration process for the individuals that wish to start a hedge fund similar to the registration required to become a Registered Representative.

In fact, on February 22<sup>nd</sup>, a number of publications reported that “the Canadian Securities Administrators (CSA) is proposing new oversight measures that include hedge fund registration and background checks of HF (hedge fund) managers and sales staff,” which the SEC would be wise to explore further.

Another trend the Commission failed to recognize is that as more institutions seek to deploy capital into hedge funds, both the demand and the minimum investment levels for the largest hedge funds are increasing. This fact allows the largest hedge funds to increase their fees despite not necessarily delivering superior performance to justify such higher fees. Some large hedge funds charge well in excess of the previously discussed hedge fund fee structures because they face capacity issues related to their investment strategy, have significant operational expenses and have built brands around years of successful performance. In particular, capacity limitations cause many successful funds to grow and then close to new investors further reducing the number of hedge funds for investors to choose from. The combination of lower performance and higher minimums has forced individual investors to seek smaller, so called “emerging” hedge funds. It turns out that numerous studies have found that “emerging” hedge funds outperform larger, more established hedge funds.<sup>3</sup> VanthedgePoint believes the rules will place individual investors, even those that will meet the new qualification criteria, at a major disadvantage to institutional investors since they not only may be unable to meet the increasing minimum investment levels required by large hedge funds, but also will have fewer hedge funds to choose from.

Third, the Commission contends that hedge funds employ “complicated investment strategies” that include sophisticated products and transactions, but this assumption is correct only with respect to certain larger hedge funds. One can argue that real estate transactions involve more complex agreements and analysis than equity investments. The fact is that a majority of 3(c)(1) Pools maintain

<sup>3</sup> Size vs. performance in the hedge fund industry, Capco Institute 2004

investment strategies in liquid investment products such as U.S. equities or listed U.S. option that are no more complicated or sophisticated than the majority of mutual funds in existence;<sup>4</sup> nearly half are based on an “equity hedge” strategy.<sup>5</sup>

However, the SEC is correct in that certain large hedge fund do employ complex strategies that not even some of the world’s largest financial institutions are fully equipped to handle, yet they still engage in business with these funds and in some cases even solicit investors on their behalf. In fact, there have been a number of recent articles questioning whether regulated entities, such as banks, brokerages and insurers, fully understand their risk exposure to the large hedge funds with which they do business. It is these regulated firms, and other counterparties like them, that merit the Commission’s attention to improve investor protection. Specifically, with regards to the solicitation of hedge funds, the Commission could further strengthen rules these regulated firms must follow to ensure their Registered Representatives are properly evaluating the suitability of recommending hedge funds to their clients. In addition, the Commission could explore raising the reserve requirements for regulated entities that engage in such complicated strategies to provide greater investor protection given several recent high profile large hedge fund failures. VanthedgePoint believes that increasing oversight between regulated entities that engage in business activities with larger hedge funds, particularly those employing complex strategies and using sophisticated products, would be more appropriate given the existing familiarity the Commission already has with regulated entities. The SEC need not overextend itself by trying to regulate the vast majority of hedge funds, many of which use trading strategies no more complex than that of a typical mutual fund.

The Commission fails to recognize that operational risk is the most common cause for hedge fund failures, accounting for over half of all hedge closures.<sup>6</sup> Increasing the reporting requirements for 3(c)(1) Pools, such as requiring them to demonstrate independent verification of their performance or total assets under management, will do more to benefit and protect investors than simply increasing the minimum qualification requirements to invest in hedge funds. Introducing rules to require independent portfolio valuation and independent annual audits of performance, and requiring clear and bold disclosure of such third parties, would go far further to protect investors than the Commission’s current proposal.

The SEC also indicated that its “proposed rules would not grandfather current accredited investors who would not meet the new accredited natural person standard so that they could make future investments in private investment pools, even those in which they currently are invested.” How can the Commission justify that an investor who already knows the risks associated with a given investment, and invests with full knowledge of such risks, is suddenly ineligible to invest further sums because their personal wealth is now insufficient to qualify them to make such investment decisions? This provision could place the investor at a disadvantage to other investors in the hedge fund. Failure to grandfather investors would also complicate matters for the fund manager from a shareholder record-keeping perspective, thereby increasing their operational burden to maintain compliance with a rule that seems arbitrary. VanthedgePoint believes that it is unreasonable to prohibit investors who have already invested in a specific hedge fund and are familiar with its investment strategy to invest additional amounts, and it recommends that the Commission reconsider this proposed rule.

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<sup>4</sup> *Accredited Investor E-Newsletter*, May 2005

<sup>5</sup> Hedge Fund Research, 2005

<sup>6</sup> CAPCO Research, 2004

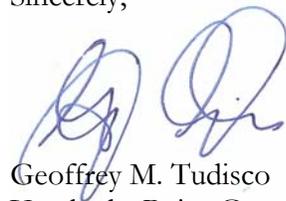
## Conclusion

As a new financial services business that assists start-up and emerging hedge fund businesses to grow and succeed, VanthedgePoint strongly urges the Commission to reconsider its approach to improve investor protection with regard to hedge funds. The proposed increase in the minimum qualifications fails to resolve investor protection issues related to hedge funds other than through exclusionary practices that place countless investors at a competitive disadvantage when investing their money. While VanthedgePoint agrees that the minimum qualifications should be updated to reflect inflation and other economic factors since 1982, it believes the Commission needs to propose minimum qualification criteria that will not stifle innovation and competition. Increasing the minimum qualification while continuing to include primary residence is a more suitable solution, and it allows a large population of high net worth investors to participate in hedge funds. In addition, the Commission should explore other potential avenues to improve investor protection such as requiring registration of individual hedge fund managers, independent portfolio valuation and annual audits of performance.

VanthedgePoint's client base, like its employee-shareowners, consists of entrepreneurial-minded financial industry professionals who want to pursue their own version of the American Dream. In the final analysis, the purpose of any government agency should be to help its citizens achieve such goals with the proper rules and protective measures in place. VanthedgePoint believes the Commission's proposal fails to uphold these ideals, and urges it to carefully weigh these comments when making a determination in how to proceed.

VanthedgePoint welcomes further discussion. If you or your staff has any questions, please feel free to contact Geoffrey M. Tudisco by phone at (212) 514-8639 or via e-mail at [info@vanthedgepoint.com](mailto:info@vanthedgepoint.com).

Sincerely,



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VanthedgePoint Group, Inc.  
*Chief Executive Officer & Founder*