Our firm appreciates the opportunity to submit feedback to the commission regarding proposed rule change S7-25-06. With respect I provide the following feedback and recommendations:

Why Are Pooled Investment Hedge Funds Singled Out as Needing Specific Restriction Over Other High-Risk Investment Options?
Our government's current laws and regulations assume those with less than $1,000,000 in net worth can understand the risks and withstand the loss of potentially all of their invested capital in publicly traded stocks (of which there are countless blow-ups and huge losses, even in large cap US fortune 500s), futures and options (where an individual can expose themselves to lose even more than their original invested capital), penny stocks and startups (where the business model and product potential are unproven, extremely hard to understand, and flat out highly risky) and stock of emerging market foreign companies (which operate in places where the rules of business and government regulation are very different than ours, and that inherently have difficult to understand political risk). Our country's laws and philosophies on individual freedoms in financial matters further allow our citizens, of any financial means, to take risks by concentrating their investments in one or a few number of assets, to gamble their savings away in a casino, and apply their entire net worth, including mortgaging their home, toward their own high-risk business startup. Why does the SEC not find it necessary to "protect" lower net worth citizens from all these other high risk investments, but holds out Hedge Funds as somehow different in risk exposure?

To illustrate the point further, the very same SEC proposal, that presumably is intended to protect the general investing public from hedge fund risk, specifically exempts private equity funds from the new accredited investor regulations. Some very smart and sophisticated financial industry professionals consider venture capital funds to be even more volatile and harder to understand than most hedge funds. This apparently is rationalized by the importance of VC funding in the American economy and the desire not to affect the flow of capital to this important growth engine. Is it not also true that hedge funds have become an important source of capital for business growth in this country, and that the new rules would clearly reduce the capital available to businesses by this source of financing? How can the SEC, on the one hand say that investors need to be protected (restricted) from one risky investment, and then on the other hand immediately say everything but VC Funds? It's hard to understand how the commission can rationalize this contradiction and inconsistency.

It is simply wrong for the government to deny equal access to what many feel are the best investment managers and strategies in the world that are available through hedge fund investments.

The Risks of Investing in Hedge Funds Are Not Hidden from Potential Investors.
As a Fund-of-Hedge Funds manager, I review a very large number of private investment offering documents. Every one I've ever read is laden with risk disclosures and warnings as to the speculative nature of such an investment. Every set of documents

I've seen would scare any "unsophisticated" investor away in short order. In addition, the vast majority of subscription documents require investors to acknowledge they have an understanding of the risks, that they have the ability to evaluate the merits and risks of such an investment, that they are sophisticated in financial and business matters, and that they have the capacity to withstand a loss of some or all of their investment. These investors are becoming equity owners in a limited partnership, they not simply buying a public stock online. The mere effort to join a Partnership, with all the required paperwork and disclosures, gives pause and caution to even the wealthiest investor. As it is, no unsophisticated investor would come close to getting through the subscription process of a private investment if were they not sophisticated. You just can't join a pooled investment hedge fund quickly, easily, accidentally or in an unsuspecting way. The offering documents are designed intentionally to bring awareness to the risks and, frankly, to scare away the unsophisticated, unsuspecting, and risk averse investors, and so it should be. The commission should focus on mandating and standardizing risk disclosures to ensure adequate attention to risk is brought to the potentially unsophisticated or unaware investor, but it should not limit access. Due to the strict rules on advertising, and the secretive, exclusive nature of private offerings that result, you have to be a sophisticated person just to even find out about hedge fund offerings, let alone make an investment in one being unaware of the risks.

Home Equity Exclusion Not Fair or Rational

The SEC proposes excluding the value of one's home in the calculation of net worth, presumably because they feel the value of equity earned in one's home by recent market appreciation is no indicator of sophistication. I assume they would argue the individual did nothing actively to cause this increase in value of the home that would indicate a person is sophisticated, that the rising markets in general were the cause. Why would that argument be any different from someone who takes a gamble in a startup company and profits big from the company's success? Or someone's mutual fund portfolio rising significantly? Or someone who inherits a large amount of money? What is it about being the beneficiary of a general rising market or simple good fortune that makes someone sophisticated? Couldn't it be argued that the rise in value of one's home is the same as the rise in value of one's investment portfolio? How is the rise and fall of the real estate market different from the rise an fall of the other general markets? I believe excluding the equity in one's home in the calculation of net worth is addressing a point-in-time concern. It appears the commission feels the recent run up in value of real estate somehow exaggerates the value of a person's net worth. If the commission were considering these rule changes in the late 1990's would it be considering excluding technology stock investments in the calculation of net worth because they had a recent significant run up in value, and are therefore "exaggerating" the value of one's portfolio? The commission should explain its rationale more clearly on the home equity exclusion in calculating net worth, and explain how a rise in one asset class should be held out differently from another. Is it not true that real estate can fall in value as well as rise? It's happening today as the residential real estate market softens. I would hope the commission rethinks this point-in-time exclusion of home equity.

Choice and Diversification are Good for All Investors, Not just the Already Rich.
The addition of un-correlated investment asset classes to a portfolio is considered a sound investment practice. Many hedge fund strategies are highly uncorrelated with the general stock and bond markets. High net worth individuals and institutions are taking advantage of this fact by diversifying a part of their portfolios into hedge funds. This sound effort to diversify a portfolio should be made available to smaller investors as well.

No one would suggest that all or even a significant proportion of an investor's portfolio should be in hedge funds, or any other single asset class or investment for that matter. But reasonable diversification across all classes is appropriate. Lower net worth individuals should not be disadvantaged (by government regulation) from the wealthy in their opportunities to reduce portfolio correlation to the overall equity markets and increase portfolio diversification.

Those who oppose allowing average investors to have the same choices as the rich for diversification and asset protection, should provide a rational reason why. Lower net worth individuals have the same potential to be smart, educated, and professionally experienced (sophisticated) as the already rich and they would tell you, in no uncertain terms, as much of the feedback to the commission would support, that the proposed rules are the type of government protection they would greatly resent.

Are Hedge Funds Really So Much Different That They Require Special Regulation?
There is no rational justification that hedge funds provide any more risk than the plethora of other high-risk investments and activities that any citizen can already enter into with their money. Nor is there any reason a smaller investor can not understand the strategies and risks of hedge funds, particularly in light of all the other complex, high-risk investment choices to which they already have unrestricted access. If investors can be assumed to understand the complexities and risks involved with penny stocks, futures, currencies, options, venture capital funds, foreign stocks, and real estate, then how can anyone suggest that hedge fund strategies are beyond their understanding? A hedge fund is a business, generally with a straightforward premise. It is no more, and often far less, difficult to understand than the business risks and strategies of publicly traded companies (to say nothing of a bio-tech, high-tech startup or foreign emerging market company) than the risks and concepts of a typical hedge fund.

Why Do Foreign Investors Have More Choices Than US Investors?
As I’m sure the Commission is aware, England has no real net-worth requirements for investing in hedge funds. Investment advisors are required to determine the sophistication of investors and the suitability of a hedge fund investment, regardless of net worth. Europe in general is moving to open up access to hedge funds to all investors under some reasonable regulatory control. The reality is that average net worth investors outside the US have more and better investment choices than do

average investors in the US. How is it that their governments are more committed to individual freedom of choice than the United States?

Let’s Truly Define Sophistication in the Interest of Fairness to All and Stop Seeking the Easy Way Out.
It appears from the outside that by using a simple net worth test, the SEC is seeking the simple way to address a complex issue. In doing so, it creates an unfair playing field for the sophisticated but not-yet-wealthy investor. This simple way sets aside an entire class of investment exclusively for the already rich. The lack of interest or capacity by the commission for developing real, meaningful standards in determining the sophistication of a prospective investor is the real problem here. It’s true that meaningful standards that would be fair to all would require some upfront work and ongoing maintenance by the commission. But in the interest of fairness to all smart and sophisticated Americans, this effort must be undertaken. We should not just accept that it would be hard to create such standards and then fall back on the easy way out which is to simply limit investment to those that can supposedly afford to lose it. We should consider using the best of the European regulations as a foundation for fair governance in hedge fund oversight.

Suggestions for What to Do.
It is my strong feeling that the focus of any new regulations should be to make sure that true sophistication of the investor can be reasonably assessed in a manner that does not make the option the exclusive domain of the already rich. In addition, the focus should be on ensuring that potential investors are made fully aware of the risks of investing in hedge funds, but not to prevent them from taking risks. It is acknowledged that doing this would require a new approach and some up front work by the Commission. It is in the interest of fairness and free access to all citizens, as well as to retaining an important source of capital formation, that the commission expend the effort necessary, now, to improve the basic structure of these rules so they do not unfairly prevent access to an entire class of investment that heretofore have been the exclusive domain of the already rich.

With that I make the following recommendations for consideration in any proposed rule changes:

> **1. Provide Additional Methods for Determining Sophistication.**
> I propose that the “net worth only” method of qualifying as an Accredited Investor be considered just one way of becoming Accredited. Any investor that meets the net-worth-only standard would not need to do anything else for qualification and can invest freely in hedge funds, as it is today. This should not be the only way to determine an investor’s level of sophistication however.
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> Other ways should be introduced by the commission in the new rules that will allow individuals with lower net worth to qualify as sophisticated (Accredited) and to have

access to hedge fund investments. I propose additional rules be adopted that state if an individual has at least $750,000 in total net worth AND satisfies one of the following other criteria, they should also be considered sophisticated and therefore Accredited.

a. By Exam
   Come up with an accredited investor's exam or adopt one of the existing exams as an Accredited Investor exam. Individuals who pass the exam would be considered Accredited and would be allowed to make their own decisions on investing in hedge funds. No advisor would be required.

b. By Qualified Third-Party Advisor
   Any individual who used an investment advisor or broker that 1) had passed an appropriate exam demonstrating competency in hedge funds or 2) had a sufficient number of years experience in the industry, could invest in hedge funds. The individual seeking to invest would provide a written acknowledgement, signed by the advisor, acknowledging the determination that the investor is sophisticated and that an understanding of the risks exists.

c. By Educational Background
   Any person who has earned one of the following degrees:
   1. MBA
   2. Masters in Finance
   3. Masters in Accounting
   4. Masters in Economics

d. By Work Certification/Profession
   1. Any Attorney
   2. Any Certified Public Accountant
   3. Any State or Federal Investment Advisor Representative
   4. Any Licensed Broker
   5. Any Officer or Board Member of a company with $5 million or more in revenue

2. Standardized Risk Disclosures.
The commission could develop mandated risk disclosure language that would satisfy the commission that all potential investors have been informed of the risks associated with a hedge fund investment prior to the investment being made.

3. Limitation on Investment Amount.
While not a proponent myself of this suggestion, if the Commission still thought it necessary to provide additional protections, it could adopt an additional rule which provides that any investor determined to be Accredited, but that does not yet meet the net-worth-only test, could invest no more than 20% of their total net worth in private investment hedge funds.

Grandfathering.
If the commission moves forward with increasing the net-worth-only test without providing alternatives methods for determining sophistication, which I strongly believe would be a mistake, than a very clear grandfathering rule should be specifically incorporated into the new rules.

If there were no grandfathering clause, a person who satisfies the Accredited Investor rule today (and is considered sophisticated today), who has made investments in private hedge fund offerings, would instantly no longer be considered sophisticated and prevented not only from making new investments in funds, but also in making additional contributions even to an investment they have already made. How is this fair? These people played by the rules and then, in an instant, would have this investment opportunity taken away from them. They had already done their due diligence and evaluated the risks, why should they all of sudden be considered unsophisticated and prevented access?

I am requesting that the commission incorporate two specific grandfathering provisions if a net-worth test remains the only method for determining sophistication:

1. Existing Accredited Investors that have an existing investment in a private offering hedge fund at the time the rule changes should be allowed to add capital to that same investment into perpetuity.

2. As a Fund-of-Funds Manager, our fund satisfies the current Accredited Investor rule because we are an entity in which all of the equity owners are Accredited Investors [Regulation D § 230.501 (a)(8)]. This rule provides our partnership Accredited Investors status which qualifies us as an entity to make investments hedge funds.

   If the rule change were to go into affect as proposed without a specific grandfathering provision, any entity that qualifies today under Regulation D § 230.501 (a)(8), that has just one individual that does not meet the new Accredited Investor standard, would immediately cease to be considered an Accredited Investor as an entity. This could result in all kinds of very serious adverse consequences for those entities.

   Any rule changes therefore should specifically modify Regulation D § 230.501 (a)(8) to say something like the following:

   Any entity in which all of the equity owners met the definition of accredited investor that was in effect at the time of their initial purchase of equity interests in the entity. For purposes of satisfying this rule only, any investor who met an earlier standard, that does not meet the then current accredited investor standard, will still be considered accredited if they have maintained continuous equity ownership in the entity from the time of making their original investment in which they met the accredited investor standard in affect at that time.

Small Business Impacts.

The commission requested feedback on the impact of the proposed rule changes on small businesses. Increasing the net worth requirement alone, by definition, would clearly have a major affect on small business hedge funds (funds with under $5,000,000 in assets). If the commission is genuinely concerned about the affects on existing small businesses, and the ability of small business hedge funds to form, the feedback provided in this letter, and from the other rule change feedback provided to the commission, must be given careful and serious consideration. If not, it is likely that small business private investment hedge funds will have limited or no ability to form if the new rules are adopted as proposed, and some may possibly be forced to shut down if the rules are adopted as currently proposed. The playing field then, for all intents and purposes, would be closed to small businesses.