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March 3, 2007

Nancy M. Morris
Secretary
Securities & Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. S7-25-06 -- Proposed Rule: Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles

Dear Ms. Morris:

In a speech she gave at the National Economists Club on July 6, 2006 (http://www.sec.gov/news/speech/2006/spch070606cag.htm) former Commissioner Cynthia A. Glassman, an economist, offered a valuable critique of the Commission's rulemaking process. Her advice can be summed up as follows: "Focus on what we are trying to accomplish and what the best way is to accomplish it." Her bottom line is that the Commission should use substantive economic analysis before it proposes a rule. There is scant evidence that the Commission did any serious economic analysis before it proposed two rules that apply to hedge funds. While the proposed rules are less disruptive than the rule we challenged in federal court that would have required hedge fund advisors to register with the Commission, both are flawed at best.

The first proposed rule would explicitly bar an advisor to a hedge fund from defrauding the fund's investors. The Commission states that it is concerned that Goldstein v. SEC "created some uncertainty regarding the application of sections 206(1) and 206(2) of the Advisers Act in certain cases where investors in a pool are defrauded by an investment adviser." However, as the Commission notes, section 206(4) already makes it illegal for an investment adviser "to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative." Therefore, it is hard to understand why the Commission thinks there is any question about its authority to bring an enforcement action if "false or misleading statements [are] made, for example, to existing investors in account statements as well as to prospective investors in private placement memoranda, offering circulars, or responses to requests for proposals." Consequently, the proposed rule, while benign, is unnecessary.

The second rule proposes a massive increase in the minimum wealth an individual would need before that person could invest in a hedge fund. The Commission's asserted reason for the rule is as follows:

> *Many individual investors today may be eligible to make investments in privately offered investment pools as accredited investors that previously may not have*

qualified as such for those investments. Moreover, private pools have become increasingly complex and involve risks not generally associated with many other issuers of securities. Not only do private pools often use complicated investment strategies, but there is minimal information available about them in the public domain. Accordingly, investors may not have access to the kind of information provided through our system of securities registration and therefore may find it difficult to appreciate the unique risks of these pools, including those with respect to undisclosed conflicts of interest, complex fee structures and the higher risk that may accompany such pools' anticipated returns.

This conclusory assessment suggests that the Commission does not have a good understanding of the hedge fund industry or why it has grown so rapidly in recent years. In short, there is no basis for making these broad assertions. The Commission should first conduct a survey of the hedge fund industry. While there are, of course, risky hedge funds (since "hedge fund" is really a misnomer for almost any private investment fund), the industry is too diverse to make generalizations. Many hedge funds, such as the so-called "market neutral" funds, are less risky than the vast majority of "long only" mutual funds which are highly correlated to stock market movements. Our flagship hedge fund, Opportunity Partners L.P., which is closed to new investors, is not market neutral but it is risk averse. It has produced positive returns in each of the fourteen years since its inception. There is no good reason to prevent any investor from investing in a low risk hedge fund like ours.

More important, the rule is fatally flawed from a legal standpoint because private equity funds are excluded, not because they are less risky than hedge funds but because of "the benefit that venture capital funds play in the capital formation of small businesses." The relative importance of venture capital funds vis-à-vis hedge funds is irrelevant and cannot serve as a legitimate basis to exclude venture capital funds from the rule. In fact, venture capital funds are generally more risky than hedge funds. First, venture capital funds do not hedge. They have less transparency than hedge funds and their assets are priced with more subjectivity. Finally, they offer abundant opportunities for fraud and self-dealing due to the close relationship between the fund's manager and its portfolio companies. In sum, if investor protection is the sole objective of the proposed rule (as it should be) then excluding venture capital funds unquestionably renders the rule arbitrary and capricious.

However, we do not intend to challenge the rule because, like most established hedge funds, we do not expect it to have a material effect on our business. Nevertheless, it is apparent from the many passionate and well-reasoned comment letters that investors have submitted to the Commission that it will adversely affect a significant number of persons that would like to invest in hedge funds. The Commission cannot deny that many of these investors seem fully capable of understanding "the unique risks" of investing in a hedge fund. Therefore, it would be contrary to the Commission's mission to adopt a rule that prevents them from investing in a hedge fund if they so choose.

There is an easy way to accommodate knowledgeable investors that wish to invest in a hedge fund while protecting those that "find it difficult to appreciate the unique risks" of hedge funds. The Commission has broad authority to exempt any person from its rules. Why not allow a blanket exemption for an investor to opt out of the rule if that investor first submits a letter to the Commission stating in substance the following?

> I understand that the Commission believes that many investors do not adequately understand the risks inherent in hedge funds and has adopted a rule that would prevent me from investing in a hedge fund because I have insufficient wealth. Nevertheless, I have performed due diligence on XYZ Partners L.P. and I would like to make an investment in it. I have not been unduly influenced by anyone to make this investment and I am willing to accept the risks of making it. I will not hold the Commission responsible for any losses I may incur as a result of investing in XYZ Partners L.P.

Such an exemption is consistent with the philosophy underlying the federal securities laws, i.e., that all investors should be able to make informed decisions about their investments. Without it, the rule makes the decision not to invest in any hedge fund for them even if that decision is contrary to what they would choose.

Very truly yours,

Phillip Goldstein
Principal