National Advisors Trust

February 21, 2007

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

Re: File No. S7-25-06: Proposed Rules re: Prohibition of Fraud by Advisers to Certain Pooled Interest Vehicles, Accredited Investors in Certain Private Interest Vehicles

Dear Ms. Morris:

On behalf of National Advisors Trust Company, FSB I am pleased to present certain views on the proposals ("the Proposals") set forth December 27, 2006.

Background

National Advisors Trust Company acts as custodian, fund accountant, or administrator to approximately 10 pooled investment funds, involving 6 independent registered investment advisors located in several states. In such capacity, the trust company provides certain structural checks and balances that relate to the objectives of the Commission. National Advisors Trust Company is a federally chartered savings bank with a national trust charter. We are owned by 120 independent registered investment advisors and our fiduciary services are provided primarily to the clients of our owner-advisors. We currently hold in excess of $4 billion for such clients in retirement plans, individual trusts, custody accounts, and pooled funds. We are regulated by the OTS and the FDIC. We opened for business in 2001. As of this date, we have not requested that our investment powers be activated.

Rules re Prohibition of Fraud by Advisers

We have no comments on the anti-fraud proposals.

Accredited Natural Persons

National Advisors Trust believes that the new "accredited natural person" definition (the "Definition") is unnecessarily restrictive and will have limited utility for the Commission's objectives. Moreover, it will produce a number of predictably negative effects, plus the potential for significant unintended consequences. We respectfully ask that the Commission consider the following observations:

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A. The lack of a "grandfathering" provision for current fund investors creates a burden on existing investors with little or no apparent benefit. There is no proposed grandfathering of current investors in hedge or pooled funds who would not qualify under the new Definition. The Proposal suggests that an existing "old rule accredited" person may remain in a fund, but not add capital. We would point out that there is no evidence that current investors would gain any meaningful protection from not being able to add capital to a fund with which they already are familiar. On the other hand, eliminating the possibility for making incremental capital additions over time would certainly limit an investor's flexibility going forward. If a new Definition is adopted, we recommend that current investors be grandfathered for additional capital.

B. The venture capital exemption is inconsistent with the stated objective of "strengthening protections for investors." The Definition exempts venture capital ("VC") funds. Most disclosure documents would suggest that the risks of investing in VC funds (for example, extended illiquidity and investments in companies without operating histories) exceed the risks of investing in the "average" hedge or pooled fund. The Proposal suggests that the capital formation function of VC is important, with the implication that such benefits trump investor protection concerns. Our intent for this comment is not to suggest the elimination of the VC exemption; rather to illustrate an inconsistency of method and purpose. As discussed below, there are alternative methods of achieving the "strengthening protections" objective that do not create such inconsistencies.

C. The Proposals will create competitive dynamics that are contrary to free market principles. One certain effect of the new Definition will be to limit the formation of new hedge or pooled funds. Few such funds begin operations with large capital infusions and large numbers of persons meeting the new Definition. Conversely, the new Definition would seem to have much less effect on large existing funds, except to perhaps limit marginal capital contributions due to the lack of a grandfathering clause (discussed above). This dynamic will almost certainly hurt competition and entrench current funds and managers. We would suggest that there may be other, unknown at this time, unintended consequences of increased barriers to entry (including some related to the VC exemption).

Interestingly, the Proposal makes the argument that reducing the investor pool will increase competition and lower fees and suggests that this anticipated benefit will offset the other investor burdens. The apparent logic is that, while limiting new fund formation (supply), further limiting the number of potential purchasers (demand) will drive fees (prices) down. We would contend that this notion is highly speculative. Over the last 25 years, the supply of hedge funds has risen from perhaps 200 in 1982 to numbers that are reported in the 10,000 range today. Just viewing the numbers, that expansion of funds (supply) greatly exceeds the increase in numbers of accredited investors (demand). We are unaware of any evidence that such increased competition for investors has lowered fees (in fact, some report that fees have risen in recent years), so there are clearly other factors at work other than numbers of investors and funds. Accordingly, by limiting the supply of hedge or pooled funds, we believe that fees are just as likely to rise as fall.

D. There is no evidence provided for the Proposal's assertion that hedge or pooled funds "have become increasingly complex and involve risks not generally associated with many other issuers of securities" and "not only do private pools often use complicated investment strategies, but there is minimal information available about them in the public domain." We suspect that this assertion is based on information relating to the largest, most visible hedge and pooled funds – those least likely to be impacted by the Definition. The pooled funds that National Advisors Trust administers are domestic funds which would be affected by the Definition, and virtually all are utilizing investment strategies similar to

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those of 20 years ago. In fact, we would contend that the major risks in the pooled funds we serve are the same ones that have existed for decades: excess leverage; lack of diversification; illiquid securities; unpredictable markets, poor management, and, of course, fraud.

Additionally, it is our observation that information provided to hedge or pooled fund investors is, in many ways, superior to that provided to mutual fund investors. The funds that National Advisors Trust administers provide monthly or quarterly valuations and periodic narrative reports that discuss investment themes. It is our belief that similar information from mutual fund issuers is less frequent. In addition, the quality of disclosure in the average pooled fund offering materials appears to be superior to that of a mutual fund prospectus – including those materials that must be specially requested (and, we suspect, most investors never see) such as a mutual fund's "statement of additional information."

As for a lack of hedge or pooled fund information in the public domain, that is most likely a product of the private offering rules themselves.

E. The Proposal does not provide adequate reasoning for why the pool of potential investors in hedge funds should be shrunk by 80%. The Proposal's census figures suggest that the investor pool will decrease from 8.5% of households to 1.3% by application of the proposed Definition. The Proposal estimates that 1.9% of households were qualified in 1982. While the Proposal asserts that hedge and pooled funds have grown more complex, it does not provide substantiation for that assertion, nor does it address the likelihood that investors have, in general, grown more, not less, sophisticated in the last 25 years. Given the much greater public access to information about securities, including complex securities and strategies, via the Internet, we believe that most observers would agree that investors are much more well-informed about investments than they were in 1982. Given our contention above regarding fund complexity, a reasonable threshold test of this sort would be expected to result in a qualified population somewhere between the 1.9% number from 1982 and the current estimated 8.5%, not something completely below that range.

F. The $2.5 million investments test is arbitrary and unrelated to the existing qualification standard. The proposed "accredited natural person" standard would be "investments" of $2.5 million, excluding non-investment real estate and the value of businesses under $50 million in size. According to the Proposal's figures, $1 million in 1982 is equivalent to $1.9 mil now. Why increase the threshold to $2.5 million and also eliminate residential real estate and small business interests?

According to a 1983 Federal Reserve survey "Financial Characteristics of High-Income Families[2][2]," the mean value of a personal residence for those surveyed was 15% of net worth; plus the mean value of non-public business interests was 14% (or 33%, depending on management and non-management definitions). By applying the lower, more conservative, business interest value, one could estimate that, in 1983, a family worth $1,000,000 at that time had a $150K house and a $140K business interest. Therefore, it would follow that they had some $710K in "investments." Accordingly, the proper math to achieve "investments" equivalency today would be 1.9 times $710K, or $1.35 million.

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[2][2] Federal Reserve Bulletin, vol. 72 (March 1986), pp. 163-77: **Financial Characteristics of High Income Families by** Robert B. Avery and Gregory E. Elliehausen

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G. There are alternative methods of strengthening investor protection that do not create such a negative impact. Twenty years ago, there was no domestic third-party administration industry serving US hedge or pooled funds. Today, our polls of attorneys who form hedge and pooled funds suggest that most new fund formations include an independent administrator, and virtually all such funds are audited. One simple way to advance investor protection is to require a bold disclosure on the first page of an offering memorandum stating if the fund is independently administered and if it is audited.

Recommendations

Based on the observations above, National Advisors Trust respectfully suggests that the Commission consider the following recommendations:

1. Delay the imposition of the new accredited threshold until further objective study can be done. If the purpose is "strengthening investor protections," it would be interesting to see more quantitative analysis of the risks: Where is money being lost by investors? What types of funds are involved? What are the profiles of investors in non-problematic hedge and pooled funds? What stronger protections can be put in place without freezing out 80% of the current qualified households?
2. If an adjustment for inflation is deemed more expedient than further analysis, using the arithmetic set forth above, the Definition should either be $1.4 million in "investments" or $2 million in net worth.
3. If any higher threshold is imposed, there should be a provision for grandfathering additional investments by existing accredited investors.

National Advisors Trust Company appreciates the opportunity to comment to the Commission on this issue and would welcome further discussion. If you or your staff have questions or seek amplification of our views, please feel free to contact me by phone at (913) 234-8234 or by e-mail at mbaker@nationaladvisorstrust.com.

Sincerely yours,

Michael C. Baker
Chief Executive Officer

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