February 23, 2007

Dear Sirs:

I strongly oppose your proposed rule raising the minimum net worth required for investors to invest in hedge funds.

My company, Benchmark Funds, Inc. (B.F.I.), started a small hedge fund in 2000. Last year was the first year BFI, as manager, was in the black, with all prior earnings being used to pay consultants to assist in finding managers.

On the other hand, the hedge fund investors have enjoyed consistent positive returns from the beginning and are about 30% ahead of where they would have been had they invested in the S&P500.

Your rule, if implemented, will destroy my fund. All of the investors meet the current definition of an accredited investor but only one would meet your new definition. Besides destroying my business, which I have worked extremely hard to create and which is just now becoming profitable, you would prohibit my investors from continuing with an investment that they like and which has been profitable for them.

B.F.I. is a Registered Investment Advisor regulated by the state of Arizona. B.F.I. is required to have two audits each year by a qualified and independent CPA firm, both of which are submitted to the Securities Commission for review. The company is also audited by the Commission on a regular basis to make certain that all of the RIA rules and regulations have been properly followed.

With all of the fraud going on in publicly traded companies costing investors billions of dollars each year, rampant sale of unregistered securities by persons without securities licenses, etc., etc., it seems like a gross misapplication of your limited resources and a gross mistake in setting your priorities to target and destroy funds like the one being run successfully by B.F.I.

If you are going to destroy my business for no good reason, are you willing to pay me for my loss? It seems that at some point you should be financially responsible to hedge fund operators for the damages you cause by making decisions that are clearly incorrect.

Your proposed rule also makes no sense when viewed from the perspective of the investors. You are using a wealth test to define what investors shall be deemed to be “sophisticated” and “knowledgeable” when there is not necessarily any correlation between them.

The above can be demonstrated by this rather extreme example, but it makes the point:

A 21 year old buys a lottery ticket and wins $22, 500,000 after taxes. He proceeds, over a 6 month period, to lose $20,000,000 investing in venture capital, penny stocks and Enron leaving him with $2,500,000. According to your proposed wealth test rule, this 21 year old is a "sophisticated" and "knowledgeable" investor who is eligible to invest in "risky" hedge funds. In contrast, an individual who has carefully invested his savings over a 10 year period by investing in numerous investments including hedge funds and creates a $1,000,000 net worth would be, according to your proposed wealth test, $1, 500,000 shy of being "sophisticated" and "knowledgeable" enough to continue to invest hedge funds.

Underlying your proposal is the premise that hedge funds are riskier than investments available to the general public. In fact, generally speaking, the opposite is the case. Your wealth test would prohibit small investors from participating in hedge funds but yet it would allow anyone to invest in the stock market that lost 50% in an "allowable" S&P 500 index mutual fund during 2000-2002. On the other hand, hedge funds in general performed substantially better profiting in fact during this period. So, the SEC's actions would allow an "unsophisticated" investor to invest in the extremely volatile S&P index fund but would prohibit him from potentially mitigating his loss through diversification into hedge funds that might actually lower his overall investment volatility and possibly made him money instead of losing 50% which is still down 6% six years hence (NASDAQ is over 50% down after six years)! Thus, by prohibiting hedge fund investments for the small retail investor via its wealth test, the SEC would have acted contrary to its supposed goal of protecting the small investor from "risky" investments. The clear message being sent by the SEC through its exclusionary wealth test is that it is a shill for Wall Street's established stock and bond firms by preventing competition from investment alternatives such as hedge funds, all at the expense of the small retail investor.

Back to BFI's hedge fund, if my investors lose money by being forced to invest elsewhere, are you ready to compensate them for their losses? Just as with the hedge funds themselves, it seems that you should be financially responsible for losses you cause investors because of an arbitrary rule adopted by the SEC that has no factual basis.

You first proposed to regulate hedge fund operators. After having this regulation held by the courts to be illegal and unlawful, it appears that you now would like to do an end run around that decision by essentially destroying most hedge funds. Your thinking appears to be "If we can't regulate them, then we'll put them out of business instead." The fact is that a majority of hedge fund managers are regulated as Registered Investment Advisers with either the SEC or the states. If you want to adopt another arbitrary rule, why not impose the wealth test only on funds that are not regulated? That would also appear to be illegal, but of course that has not stopped the SEC before.