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March 8, 2007

VIA E-MAIL

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

Re: File Number S7-25-06: Accredited Investors in Certain Private Investment Vehicles

Dear Ms. Morris:

We thank you for the opportunity to comment on the proposed rule and rule amendments (the "Proposed Rules") contained in SEC Release No. IA-2576 (the "Proposing Release") that would revise the definition of "accredited investor" as it relates to natural persons investing in private investment funds.

Our law firm has been representing advisers to private investment funds for over 30 years and currently represents over 250 such advisers, both registered and unregistered, large and small, domestic and foreign.

We understand the rationale behind an increase in the qualification standards for a natural person accredited investor, but do not agree with the proposal put forth by the Securities and Exchange Commission (the "SEC"). According to the Proposing Release, when Regulation D was adopted in 1982, the percentage of U.S. households that met the accredited investor standard was approximately 1.87%. If the changes to the accredited investor standard under the Proposed Rules become effective, the percentage of U.S. households that would meet the new standard would be approximately 1.3%, approximately 30% lower than that in 1982. We think it to be fairly obvious that investors today have substantially more information, knowledge, resources and financial sophistication regarding private investment vehicles (especially hedge funds) than investors did in 1982. We wonder why the SEC would propose a standard that would result in substantially fewer people (on a percentage basis) being able to invest in such vehicles in 2007 than were permitted to do so in 1982.

Discrimination Against Hedge Funds

The proposed increase in the qualification standard proposed by the SEC distinguishes between hedge fund investments and other private placement investments in a way that we believe discriminates against hedge fund investments. The Proposing Release does not provide any factual basis for a finding that persons investing in hedge funds need more protection than persons investing in any other private placement activity. In particular, the SEC has proposed that hedge funds be treated differently than venture capital funds on the theory that investment in venture capital funds promotes small business capital formation, and therefore should be encouraged. There is no support provided for a finding that venture capital funds are either more beneficial to the economy than hedge funds, or less risky than hedge funds.

Hedge funds play an important role in our economy today as supported by statements by the SEC, Congress and the Treasury Department. They provide market liquidity, counterparties for transactions and a mechanism for capital to be allocated among dynamic enterprises. Allowing hedge funds to grow will allow for growth in other industries, through investments both public and private. If the SEC cannot point to factual evidence that certain private investment vehicles, such as hedge funds, are more risky than those not covered by the Proposed Rules, the new category of accredited natural person should apply to all such vehicles. To us, it seems that venture capital funds, internet start-up companies, biotech start-up companies, and other start-up or private business ventures generally carry greater risks than hedge funds, including a higher failure rate and less liquidity.

After being studied on numerous occasions over the past decade, there have been consistent findings that there is a significant portion of hedge fund activity that is good for the investment marketplace. Various studies have found that even allowing for "survivor bias" and other factors, hedge funds have produced solid returns for investors with <u>lower</u> volatility than mutual funds and the markets generally. Hedge funds provide consumers – purchasers of investment advisory and investment management services, in this case – with alternative investment vehicles and strategies that might not otherwise be available. In the absence of a finding that there is a basis for disfavoring hedge funds, as to the need for investor protection, we believe that it is inappropriate and improper to impose a higher standard (more difficult test to satisfy) with respect to hedge fund investments. As described below, the result of doing so is likely to produce a number of adverse consequences, including reduced access by investors to investment options (for those that do not meet the new standard), and fewer investment options in the future.

Rather than protecting investors, we believe that the restrictive proposal published by the SEC has the potential to harm investors by restricting their investment choices. Hedge funds have been shown to provide a valuable alternative to investing in mutual funds or individual stocks and bonds. The fact that many sophisticated high net worth investors, foundations, endowments, institutional investors, and professional investment advisors invest in and through hedge funds, is some indication that those who study investment returns think that hedge fund investments may be valuable. By adopting the Proposed Rules, the SEC would be effectively foreclosing that option for many investors who do not meet the new standards.

In addition, the proposal may make it more difficult for new hedge funds to be formed, since start-up hedge funds may no longer be able to attract sufficient capital from investors to make launching the fund economically viable. This results in managers with access to large institutional clients having a significant advantage over entrepreneurs looking to start their own hedge fund. Accordingly, the result of the Proposed Rules would be anti-competitive, and would potentially reduce the amount of new investment talent that enters the marketplace.

Registered Investment Advisers

The Proposed Rules may have been formulated by the SEC in response to the recent court determination that its rule requiring increased registration of hedge fund investment advisors was held invalid. We would not be surprised if the SEC were to believe that investors would benefit from increased SEC review and regulation of hedge fund advisors, as a means to deter and prevent fraud and improper conduct. Moreover, the fact that the SEC published the Proposing Release suggests that it also may believe that the Regulation D accredited investor standard should be reviewed in the context of hedge funds, without an overall review for private placements generally.

We strongly disagree with the notion that hedge fund investments should be disfavored as opposed to other private placement investment options. However, if the SEC believes that it must go forward with stricter tests for hedge fund investing, in light of the foregoing, we believe it would be more consistent with the views previously expressed by the SEC (and more consistent with the goals of promoting capital formation as well as facilitating investor options while providing investor protection) to limit the applicability of the new accredited investor standard to those hedge fund managers that manage in excess of $25 million but do not register with the SEC as an investment adviser in reliance on Section 203(b)(3) of the Investment Advisers Act. In that way, the SEC would be incentivizing investment advisors that wanted to market to less wealthy individuals to register, while allowing those that were going to market to investors that could meet higher financial standards to continue to service those investors in an unregistered capacity, if they so chose.

Even in that case, we believe the appropriate target percentage for persons that should be able to qualify under the more stringent standards should be higher than the 1.3% that the Proposed Rules would result in. As noted above, there is much more information available today than in 1982 concerning investment options and there is generally a higher degree of wealth in the United States today (even after adjusting for asset inflation). All this suggests that a greater percentage of the population today versus 1982 should qualify to participate in private placement investments as accredited investors.

Other Alternative Solutions

The SEC is concerned that as a result of inflation, over 8.5% of U.S. households currently satisfy the accredited investor standard and that many of these people may not have the financial sophistication to be investing in these types of private investment vehicles. In response to such concern, we believe that there are several alternate solutions which would impose standards which are sufficiently formidable to prevent financially unsophisticated investors from obtaining access to these types of vehicles, but would not unduly restrict such access to only the "super rich."

For example, we agree with the SEC's proposal to subtract the value of an investor's home in calculating net worth. Some people may satisfy the net worth portion of the accredited investor standard based primarily upon the current market value of their residence. In general, the value of one's home is not indicative of his or her level of financial sophistication. We believe that a significant portion of the growth in the accredited investor class may be traced to rising home values. Accordingly, removing the value of one's residence from such calculation would help to address the SEC's concern without completely overhauling the accredited investor standard.

If that were deemed insufficient, another practical solution would be to increase the net worth test to $1,500,000 (based upon the "qualified client" standard) in order to account for inflation. If you do not take the value of an investor's home into account, this would be a very significant increase from the current standard and should help to alleviate some of the concerns of the SEC. In the past, state blue sky laws frequently had a suitability standard that excluded personal residences and furnishings.

We believe that the amount necessary to meet the net worth test should not be subject to an automatic adjustment for inflation every five years. Adjustments should be evaluated periodically after careful thought and consideration rather than done mechanically. Among other things that should be considered is whether, as a result of increased wealth, financial sophistication and access to information, an upward adjustment is really necessary for investor protection. An automatic inflation adjustment would also cause uncertainty for investors who are seeking to formulate and implement a medium or long-term financial plan.

If the SEC wants to create a secondary filter for natural person accredited investors, the filter should still have alternative net worth and income tests. Merely having a net worth test unduly discriminates against younger individuals who earn significant amounts of money and are financially sophisticated.

We believe that a standard of $275,000 (individual income) or $400,000 (joint income) could be an appropriate amount for such purpose (i.e., as an alternative to the proposed new net worth standard). These numbers achieve the goal of taking inflation into account while still resulting in a percentage of households being eligible to qualify under the new accredited investor standard higher than that in 1982 but substantially lower than the current 8.7%.

Asset Test

We believe that filtering access to hedge fund investments by the amount of someone's prior investment activity is not an accurate way to measure one's financial sophistication. The fact that someone may have investments in index funds, money market funds, treasury bills, mutual funds, or, for that matter, individual stocks and bonds, is not an indication that the person is financially sophisticated.

If the SEC deems it necessary to amend the accredited investor definition to include a standard based on amounts of investment assets, we believe that the amount proposed as the standard for investments is simply much too high, as is evident by the dramatic decrease in the number of people that would qualify as accredited investors under such new standard. We propose that the amount should be no more than $1,000,000. Another alternative would be to limit the amount an individual investor may invest in hedge funds to a certain percentage of their net worth (excluding their personal residence).

Existing Investors

Another significant concern we have regarding the SEC's proposal is that investors will not be "grandfathered" into the investment vehicles in which they currently invest. An investor who has been invested in a hedge fund for several years certainly has a level of financial sophistication and knowledge with respect to that fund and certainly ought to be allowed to make additional investments into such fund. Why does the SEC make a distinction between this fact pattern and that of an accredited investor who is invested in a hedge fund where the investment manager or general partner would have been required to register as an investment adviser under the SEC's "private fund" rules? In the case of managers who registered as investment advisers under the rules which were ultimately struck down, the accredited investor was grandfathered into the fund and did not need to meet the higher standard of a "qualified client" that new investors were required to meet in order to make additional investments.

Knowledgeable Employees

We also feel very strongly that employees of a private investment vehicle should not be subject to the new accredited natural person standard. If such employees were not able to invest in private investment vehicles as a result of this proposal it would undermine the proposition that the SEC is concerned about the financial sophistication of an investor. Who is more sophisticated with respect to investing in hedge funds than their employees? Who has better knowledge of the risks associated with such investments? The idea that such employees should have exemptions from certain qualification standards is evident by the inclusion of such an exemption in both the "qualified client" standard and the "qualified purchaser" standard. We don't see why the accredited investor standard should be different. (In this regard, the current "executive officer" standard in the "accredited investor" definition is outdated. Currently, "knowledgeable employees" who may be highly sophisticated junior traders, analysts or accountants are permitted to invest under the 3(c)(7) rules but may be shut out of their funds anyway because they don't have an executive officer title and do not yet have sufficient wealth. This problem would become much more acute if the new asset test is adopted.)

We acknowledge that there is merit to reviewing the accredited investor standards in Regulation D, given that the standards were set over twenty years ago. As a result of inflation and price increases for homes, there is no denying that a greater percentage of people can satisfy the accredited investor standards today than could at the time the standards were initially adopted. That is not necessarily a bad thing, however. There is nothing to say that the standards that were originally adopted set the bar at precisely the right level. At the time Regulation D was adopted, there had been much less experience with private placements as a means to facilitate capital formation and achieve investor goals. Moreover, given the explosion of information easily available to people today from a variety of sources, the general increase in wealth among the population as a whole in the United States, and the generally higher level of educational achievement, it may be reasonable to conclude that a greater percentage of the population today, as opposed to when Regulation D was initially adopted, ought to be able to qualify for investing in private placements.

In any case, we believe that the Proposed Rules represent an extreme response to the problem, if one exists. The SEC should raise the standards only to the minimum extent needed to satisfy the goal of investor protection.

Please do not hesitate to contact Stephen M. Schultz (sschultz@kkwc.com), Martin D. Sklar (msklar@kkwc.com), Eric S. Wagner (ewagner@kkwc.com) or Sharon M. Tomao (stomao@kkwc.com) if you have any questions regarding our proposal.

Very truly yours,

KLEINBERG, KAPLAN, WOLFF & COHEN, P.C.