The Commonwealth of Massachusetts
Secretary of the Commonwealth
State House, Boston, Massachusetts 02133

William Francis Galvin
Secretary of the Commonwealth

March 9, 2007

Nancy M. Morris, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

Re: Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles
Release No. 33-8766; IA-2576 – File No S7-25-06

Dear Ms. Morris:

The Massachusetts Securities Division (the "Division") is pleased to have this opportunity to comment in support of the U.S. Securities and Exchange Commission's (the "Commission") proposal to amend anti-fraud rules to prohibit advisers to pooled investment vehicles from making false or misleading statements or otherwise defrauding investors or prospective investors in such vehicles. The Division also supports the Commission's proposal to upgrade the definition of accredited investor as it relates to natural persons; the proposal would apply only to the offer and sale of interests in certain privately offered investment pools specified in the rules, primarily hedge funds.

ANTIFRAUD PROVISIONS OF THE ADVISERS ACT

Scope of the Rule

Anti-Fraud Rule 206(4)-8.

The Division is in full agreement with the Commission's proposal to adopt an anti-fraud provision that is tailored to hedge funds and other pooled investment vehicles. The Division is also in accord with the Commission's desire to adopt an antifraud rule to protect the underlying investors in these vehicles.

To the extent the Goldstein decision[1] created uncertainty about the Commission's authority to bring enforcement actions against advisers who commit fraud against the underlying investors in hedge funds and other pooled vehicles, the Commission is using its rulemaking powers appropriately and wisely to resolve any such uncertainty. We believe, along with the Commission, that the rule is well supported by the language of Section 206(4) of the Investment Advisers Act of 1940 (the "Act").

The Division agrees with the Commission's application of the fraud rule to both investors and prospective investors in pooled vehicles. This is consistent with the language and policy of the antifraud sections of the Act.

The Division is in accord with the Commission's approach that this anti-fraud rule should apply to all advisers of pooled vehicles whether or not such advisers are registered, or required to be registered, under the Act. State and federal regulators have seen instances of fraud by unregistered advisers, so it is crucial that the Commission be able to bring fraud actions against advisers, whatever their registration status. Moreover, we are in accord with the Commission's intention that this provision should reach advisers that are subject to state registration; it is healthy to have many cops on the beat to guard against fraud by advisers who manage smaller pools of assets.

The proposal also appropriately applies to all types of pooled vehicles. This will protect investors in investment companies as well as investors in vehicles that are excluded from the definition of Investment Company pursuant to Section 3(c) (1) or 3(c) (7) of the Investment Company Act of 1940.

Similarly, we agree with the antifraud rule's applicability to all advisers, regardless of the investment strategy they employ or the structure of the pooled vehicles they manage. Such vehicles include: hedge funds, private equity funds, venture funds and other privately offered pools that invest in securities, as well as public investment companies. Investors in all of these vehicles should be protected against fraud.

Prohibition on False or Misleading Statements

It is appropriate that proposed rule 206(4)-8(a)(1) prohibits advisers to pooled investment vehicles from making any materially false or misleading statements to investors, regardless of whether the vehicle is offering, selling, or redeeming securities.

The proposed rule is wide ranging; this is appropriate because fraud and misrepresentation can take a multiplicity of forms. Adviser fraud can include misrepresentations of the experience and credentials of the adviser, pool performance, valuation of accounts, and misrepresentation of practices like the allocation of investment opportunities.

Prohibition of Other Frauds

[1] Goldstein v. Securities and Exchange Commission, 451 F.3d 873 (D.C. Cir. 2006)

It is appropriate that the new antifraud rule will reach fraudulent, deceptive, or manipulative acts, practices or courses of business with respect to any investor or prospective investor in a pooled investment vehicle. It is simply common sense that the antifraud provision should extend to fraudulent conduct that may not involve statements. This will permit the Commission to be confident that it can reach forms of fraudulent conduct like conversion or misappropriation of funds.

No Fiduciary Duty Created

The Commission states that the porposed rule will not create a fiduciary duty to investors or prospective investors in a pooled investment vehicle that is not otherwise imposed by law. The Division urges that the advisers of pooled investment vehicles should stand in a fiduciary relationship to both the pools they advise and the underlying investors. We urge the Commission to undertake consideration of rules to reinforce the fiduciary duties that investment advisers properly have to their customers, and make it clear that such duties extend to dealings with the investors in pooled investment vehicles.

AMENDMENTS TO THE PRIVATE OFFERING RULES UNDER THE SECURITIES ACT OF 1933

Offer and Sale of Securities Issued by Private Investment Pools

Accredited Natural Person Definition.

The Massachusetts Securities Division strongly supports the Commission's proposal to add to Regulation D a definition of "Accredited Natural Person," that would apply to investors in hedge funds. The term accredited natural person would mean any natural person who meets the net worth or income test specified in Rule 501(a) of Regulation D or Rule 215, as applicable, and who owns at least $2.5 million in investments, as defined in the proposed rules. The term "investments" would exclude the person's personal residence, place of business, and real estate held in connection with a trade or business.

The Division fully supports the traditional doctrine that the essence of a non-public offering is one that is directed to those "who are shown to be able to fend for themselves"[2] in the financial marketplace. The availability of the private placement exemption turns on the knowledge of the offerees and is limited to situations in which the offerees have access to the kind of information afforded by registration under the Securities Act.

The Division notes that establishing net worth and income benchmarks to qualify investors is in some ways a surrogate for determining whether they in fact have sufficient knowledge and experience in financial and business matters to evaluate the merits of a prospective investment. It is clear, however, that net worth and income are meaningful indications of whether investors are able to bear the economic risk of the investment, and whether they can appropriately be sold an illiquid investment. The Division also notes in

[2] SEC v. Ralston Purina Co., 346 U.S. 119, 125 (1953)

this regard that investor net worth and income are essential facts in determining whether a sale of a security will be appropriate under industry suitability[3] and "know your customer"[4] rules.

Periodically Updating the Qualified Accredited Investor Standard is Appropriate

The Division agrees with the Commission's proposal to adjust the amount of investments under the definition of Accredited Natural Person at regular intervals to reflect any changes in the value of the Personal Consumption Expenditure Chain-Type Index, as published by the Department of Commerce. In order for the definition of Accredited Natural Person to continue to provide meaningful protection to investors, the definition must reflect the impact of inflation and price changes. To omit such an adjustment would eventually doom the definition to obsolescence, particularly in the face of price inflation.

The Division suggests that it may be appropriate to adjust the standard more frequently than every five years.

The Risks of Hedge Funds Warrant High Standards for Investor Qualification

It is appropriate for the protection of investors to have a heightened level of investor qualification for hedge funds. We share the Commission's view that hedge funds present unique risks, including those of undisclosed conflicts of interest and complex fee structures. Some hedge funds use high leverage. Others pursue exotic investment strategies, which make it difficult for even sophisticated investment professionals to evaluate the risks taken on by the funds.

Hedge funds are notoriously opaque. As the Commission has noted, there is minimal information available about them in the public domain. Moreover, many funds treat even their investment strategies as proprietary information, asserting that this level of secrecy will help them reap profit opportunities ahead of other investors. These factors make hedge funds very different from, and riskier than, registered securities. Hedge funds are among the riskiest privately sold investments; therefore, the standards for individuals to invest in hedge funds should reflect this.

The Accredited Investor Definition No Longer Serves to Protect Investors

Pursuant to Rule 501(a), individuals are accredited investors if they have either a net worth exceeding $1,000,000 or an annual income exceeding $200,000. As the Commission notes, these standards were established in 1982, and they have been severely eroded by inflation since then. These standards no longer assure that such investors will have the ability to fend for themselves in connection with private offerings.

Due to inflation and the growth of the value of real estate, many individual investors who are representative of the general public, and who would benefit from the protections

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[3] NASD Conduct Rule 2310, Recommendations to Customers (Suitability)
[4] New York Stock Exchange Rule 405, Diligence as to Accounts

afforded by the registration of public securities offerings, now meet the 1982 definition of accredited investor. This is a bad result from the viewpoint of policy and real-world investor protection –many unsophisticated investors are now qualified under Regulation D to be sold complex and risky private placements.

We note that many of the investments that have traditionally been sold pursuant to Rule 506 of Regulation D, besides hedge funds, involve very high levels of risk. These investments include: an array of aggressive tax shelters, real estate syndications, and oil and gas programs. On top of the risks of these investments, investors are also subject to the risks of holding illiquid securities, for which there is little information available even in specialized business publications.

An update of the accredited investor standard for individuals is long overdue. We urge the Commission, at a minimum, to update the 1982 accredited investor standard for individuals to reflect both the impact of inflation and the growth in the value of assets (particularly homes and retirement assets) held by ordinary middle class investors.

Please contact me, or Bryan J. Lantagne, Director of the Massachusetts Securities Division, at (617) 727-3548, if you have questions about these comments or if I can assist in any way.

Sincerely,

William F. Galvin
Secretary of the Commonwealth
Commonwealth of Massachusetts