March 9, 2007

Via e-mail only, to rule-comments@sec.gov

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

Re: File Number S7-25-06

Dear Ms. Morris:

Clarium Capital Management LLC ("Clarium") respectfully submits this comment letter to the Securities and Exchange Commission (the "SEC" or the "Commission") regarding the Commission's proposed rules for the modification of the "accredited investor" requirement for certain pooled investments, the exclusion of "knowledgeable employees" from the proposed accreditation requirement, and related commentary contained in Release Nos 33-8766; IA-2576 (the "Proposing Release"). Clarium is a hedge fund manager based in San Francisco with approximately $1.9 billion under management.[1]

I. Executive Summary

We appreciate the opportunity to comment on the Proposing Release. We offer these comments in the context of the Commission's goals of investor protection, maintenance of fair and efficient markets, and capital formation.[2] We believe that certain of the proposed rules contained in the Proposing Release may not, in their current form, promote those goals efficiently. A summary of our analysis follows:

a) The data do not show that hedge funds are "riskier" than publicly tradable assets; hedge funds also provide extensive disclosures to their prospective investors.

While the perceived riskiness of hedge funds has been a subject of considerable media attention, there is little economic reason to describe hedge funds as "riskier" than securities in which non-accredited investors can invest. The reasons for our view:

- Hedge fund volatility is comparable to, and often less than, that of publicly traded securities.
- At the same time, hedge fund returns are generally higher than those of other asset classes, on both a nominal and risk-adjusted basis.
- The market demands, and experience suggests hedge funds generally provide, significant disclosure to qualified investors. In relevant respects, hedge fund disclosures are of comparable quality to those of issuers registered under the Securities Act of 1933 ("Securities Act"), the Securities Exchange Act of 1934 ("Exchange Act"), and the Investment Company Act of 1940 ("Company Act").[3]
- Contrary to generally held opinion, hedge fund strategies are no more difficult for qualified investors to understand than the businesses of publicly traded companies, and hedge fund disclosures are generally easier to comprehend than reports filed under the Exchange and Company Acts.
- Hedge fund portfolios generally present similar or even fewer valuation issues than those of issuers, such as venture capital funds.

1 *While the Proposing Release affects hedge funds generally, its effects and burdens on larger funds like Clarium may be somewhat diminished. Nevertheless, as a formerly small fund and as an entity with a sense of the industry, Clarium respectfully submits these comments to advance the policy discussion.*

2 *15 USC §77(b).*

3 *Securities Act, 15 USC §77a* et seq*; Exchange Act, 15 USC §78a* et seq*; Company Act, 15 USC §80a-1* et seq.

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a) The exclusion of a large number of currently "accredited" investors from the proposed definition may increase market inefficiencies and impede the formation of capital.

Many hedge funds depend on "friends and family" capital for their launch and initial growth phase; a portion of this capital may no longer be accessible under the proposal rules. Thus, tightening the accreditation requirement may reduce the number of new hedge fund launches, privilege larger, more established funds, and decrease competition.

Further, hedge funds of all sizes are also a significant source of liquidity, accounting for an estimated 30% or more of daily trading volume.[4] Reducing assets available to hedge funds will decrease global liquidity, contributing to pricing inefficiencies, with particular risk to the liquidity of smaller capitalization issues.

4 E.g., *Moyer, Liz, Hedge Fund Investors: Caveat Emptor, Forbes.com, Feb. 22, 2007 (last visited March 6, 2007) http://www.forbes.com/2007/02/22/hedge-fund-regulations-biz-cx_lm_0222hedge.html&partner=rss*

b) The absence of explicit grandfathering language may force the involuntary liquidation of investments by currently "accredited" investors.

Ambiguity in the proposed release may force hedge funds to expel investors who cannot meet the new "accredited natural person" standard. Expulsions may result in adverse performance and tax consequences and limitation of economic opportunity, without any underlying change in an investor's actual financial status. This result may unfairly penalize investors qualified under existing law and abridge their freedom of contract.

c) The inclusion of "knowledgeable employees" within the class of "accredited" persons will enhance investor protections by aligning management and investor interests.

Many hedge funds require more senior employees to co-invest substantial portions of their compensation in the funds managed. Co-investment of compensation significantly improves alignment between management and investors. Moreover, knowledgeable employees are uniquely well-placed to evaluate the risks of investing with the entities that employ them and thus require less mandated disclosure than third-party investors.

II. Hedge Funds Are Not Inherently Riskier Than Other Asset Classes And There Is No Coherent Rationale For Imposing Differential Accreditation Requirements.

The enhanced accredited natural person ("ANP") test is premised on the idea that "private pools have become increasingly complex and involve risks not generally associated with many other issuers of securities."[5] The Proposing Release notes that

> [n]ot only do private pools often use complicated investment strategies, but there is minimal information about them in the public domain. Accordingly investors may not have 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.[6]

5 *Proposing Release at 17 (citation omitted). Significantly, the proposed rules are not designed to eliminate the risks of investing in hedge funds. To the extent that the proposed rules are a reaction to the spectacular, though abnormal, failures of hedge funds like Long Term Capital Management, Amaranth, and Bayou, it is noteworthy that they would not by themselves have prevented those failures.*

6 Id.

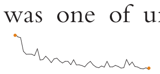
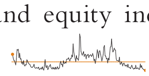
We respectfully disagree with Proposing Release's assessment of hedge funds as uniquely risky and/or opaque; specifically, we question: (i) to what extent hedge funds "involve risks not generally associated with many other issuers of securities"; (ii) whether that concern is relevant; (iii), and, whether the risks peculiar to hedge funds are less transparent than those associated with publicly traded instruments.

a) Hedge Funds Are Not More Economically Risky Than Investments Available To Non-Accredited Investors.

In the economic sense, risk is most often measured by the volatility of a given instrument. The more volatile the instrument, the higher the risk of loss.[7] Because volatility reflects all risks attendant to ownership of a security, and because price volatility is directly tied to an investor's probability of gain or loss, the academic consensus is that volatility is the most appropriate metric for evaluating an asset. Judged by volatility, hedge funds are actually less risky than assets available to non-accredited investors, both on an absolute and a risk-adjusted basis.

With respect to publicly traded equities, the data show that hedge funds are substantially less volatile. Over the past four years, the HFR Global Hedge Fund Index has displayed a standard deviation – the basic unit of volatility – of 0.1833% on a daily basis.[8] By contrast, the S&P 500 Index of publicly traded large capitalization stocks exhibited a 0.7084% daily standard deviation over the same period – almost four times the volatility of the hedge fund universe. The same relationship persists on a monthly basis: the S&P 500 exhibits a monthly volatility of 2.366%, while the HFR index shows a monthly volatility of 1.2505%.[9] Stocks, which are readily available to non-accredited investors, are thus riskier than hedge funds, which are not. It is significant that these volatility figures are absolute calculations not adjusted for the higher returns generated by hedge funds.[10] To the extent that the new ANP test is based on the "higher risk that may accompany such pools' anticipated returns," we believe it should be abandoned.

Because of diversification effects, the volatility of an index tends to be lower than the volatility of a component thereof. A review of some of the largest, most widely held equities in the S&P 500 reveals that individual equity volatility is substantially higher than commonly appreciated.

As Table 1 shows, individual equity volatilities are significant – even among the nation's largest companies, which are disproportionately well-researched and enjoy very diverse shareholder bases. Notably, Table 1 shows marked volatility even though the period measured (2003-2007) was one of relative peace, prosperity, and a stock market rally.[11] And as the sparkline of the VIX (a measure of the volatility of the S&P 500) shows, the period measured was one of unusually low equity volatility.  In more typical periods (1990-2007), volatilities displayed by equities and equity indices are substantially higher.[12] 

By contrast, volatility among large, individual hedge funds over the same period is significantly lower, as seen in Table 2.

Table 1: Volatility of Individual Large Cap Equities (January 2003-January 2007)

	Market Capitalization	Monthly Volatility
Alcoa (AA)	$30 billion	7.9%
AT&T (T)	$233 billion	5.5%
Cisco (CSCO)	$165 billion	7.4%
ExxonMobil (XOM)	$440 billion	5.4%
General Electric (GE)	$372 billion	4.1%
General Motors (GM)	$20 billion	9.9%
3M (MMM)	$56 billion	5.3%
Microsoft (MSFT)	$284 billion	4.7%
Procter & Gamble (PG)	$204 billion	3.7%
Ten Year Treasury Note (UST 10)	N/A	1.8%

Table 2: Volatilities of Large Hedge Funds (January 2003-January 2007)

	Style	Assets Under Management	Monthly Volatility
Hedge Fund A	Distressed	$900 million	1.3%
Hedge Fund B	Fixed Income (non-arbitrage)	$1,400 million	.05%
Hedge Fund C	Fixed income	$800 million	.15%
Hedge Fund D	Global macro	$800 million	2.9%
Hedge Fund E	Value (equity)	$500 million	2.9%
Hedge Fund F	Long/short	$1,000 million	5.2%
Hedge Fund G	Long/short (European focus)	$1,300 million	2.0%
Hedge Fund H	Long/short (value)	$700 million	2.6%
Hedge Fund I	Long/Short (emerging markets)	$600 million	5.7%
Hedge Fund J	Convertible arbitrage	$700 million	1.4%
Hedge Fund K	Multi-strategy	$2,100 million	1.3%

Source: Hedgefund.net[13]

Hedge fund volatility also compares favorably with mutual funds, which represent a significant portion of the nation's investing. For the January 2003-January 2007 period, mutual funds exhibited an aggregate volatility of 1.867%, compared with 1.2505% for hedge funds. And, compared on an individual basis, hedge funds again deliver comparable risk to large mutual funds managed by some of the largest and most qualified advisers, as seen in Table 3.

Judged against two of the most popular and widely held asset classes available to non-accredited investors, hedge funds display comparatively low risk. Even judged against the "safe" ten-year Treasury note, hedge funds exhibit significantly less volatility (1.3% vs. 1.8%).

7 *While volatility can be measured in many ways, we focus here on the volatility of an asset's price, which most directly reflects the possibility of loss (or gain).*

8 *Data are 3/31/2003-2/13/2007. The HFR Global Hedge Fund Index is "designed to be representative of the overall composition of the hedge fund universe" and includes more than 2000 hedge funds. www.hedgefundresearch.com*

9 *Because many hedge funds report returns on a monthly, rather than daily basis, daily volatility exhibited by the HFR Index may be less than actual volatility of the total universe of funds. Nevertheless, as the monthly data make clear, hedge funds are significantly less volatile than equities.*

10 *Calculating risk-adjusted returns shows that hedge funds are even more attractive on a risk-return basis than publicly traded equities.* See infra *Part II.D.*

11 *It is not trivial that Table 1 contains "widows and orphans" stocks like Exxon, General Electric, and AT&T, which are routinely touted as appropriate investments for the risk-averse.*

12 *Interestingly, the decline in equity volatility over the past three years has been matched by a general decline in the volatility of securities world-wide and is coincident with a large increase in the number of hedge funds and the assets they manage. While the decline in volatility is overdetermined, it does suggest that hedge funds are contributing to greater market efficiency.*

13 *Data for January 2007 are estimates. For confidentiality and compliance purposes, the actual names of hedge funds in this table have been deleted and their assets rounded to the nearest $100 million, but can be made available upon request.*

	Style	Assets Under Management	Monthly Volatility
Vanguard Energy Fund	Energy-focused	$9.9 billion	5.0%
Pimco Global Bond Fund	Bonds (multinational)	$900 million	1.0%
Pimco Foreign Bond Fund	Bonds (non-US)	$130 million	.86%
Fidelity Aggressive Growth Fund	Equities	$3.7 billion	3.6%
Goldman Sachs Core Fixed Income	Bonds	$2.2 billion	1.2%
Fidelity Magellan	Equities	$44 billion	4.3%
Fidelity Blue Chip Growth	Equities	$20 billion	2.4%
Fidelity Global Balanced Fund	Equities	$300 million	2.7%
Goldman Sachs Balanced Fund	Equities	$700 million	1.8%
Schwab Core Equity Fund	Equities	$1.5 billion	2.4%

Table 3: Volatilities of Individual Mutual Funds (January 2003-January 2007)

Source: Bloomberg

If the foregoing data seem counterintuitive in light of recent media portrayals, they are entirely consistent with the *raison d'etre* of hedge funds – to provide maximum returns with minimum risk. The first hedge fund, founded by Alfred Winslow Jones, was explicitly based on the idea that taking both long and short positions would minimize risk. In funds making investments in only one direction (a strategy pursued by most mutual funds, ETFs, and non-accredited investors), capital was exposed to two risks: first, the risk that the market would move in the contrary direction and second, the risk that the investment manager would pick investments poorly. Jones realized that he could eliminate market risk by taking both long and short positions in equal size. About half of all hedge funds continue to pursue this long-short strategy. Other hedge funds strive to minimize risk through hedging using derivatives, arbitrage, diversification across asset classes, and many other strategies. Some of these strategies may be "complex," but the essential point is that they are intended to reduce volatility. The general success of such strategies, however straightforward or arcane, is readily reflected in the substantially lower volatility of hedge funds.

Another driver of low volatility in hedge funds is that funds are evaluated based on risk-adjusted returns. Firms will only assume as much risk as is justified by increased returns, providing incentives to self limit risk. Virtually all hedge funds have self-imposed rules limiting risk. While these rules take many forms, risk controls are pre-disclosed to investors, who can then evaluate the risk limits a fund will assume. And because these risk rules are based on large quantities of publicly available data, hedge fund risk controls are statistically robust.[14] Publicly traded companies, by contrast, cannot by their nature offer risk controls of this sort because they cannot quantify business risk.

b) Non-Economic Risks Are Minimized By Transparency.

One of the concerns raised in the Proposing Release is that "private pools have become increasingly complex."[15] While hedge funds vary in complexity, the factors driving that complexity, as well as the "unique risks of [hedge funds]," are comprehensively discussed in the disclosures demanded by the marketplace and routinely provided by hedge funds.[16] Further, neither the Proposing Release nor Staff Study support the idea that private pools are now so complex as to be incomprehensible to investors.

The Proposing Release justifies a tightened accredited investor requirement on the basis that information of the kind normally required to be disclosed by the Securities and Exchange Acts is not publicly available to hedge fund investors. With respect to funds managed by advisers registered under the Investment Advisers Act of 1940 ("Advisers Act"), that justification is partially vitiated by disclosures mandated by the Advisers Act. Registered advisers must complete Form ADV, which contains essential information regarding the adviser, with the SEC making available Form ADV Part I via its website and the adviser being required, under Rule 204-3, to provide the additional disclosures of Form ADV Part II to investors.[17] Form ADV disclosures for hedge fund managers cover precisely the same ground as those for registered mutual fund advisers.

As a matter of business practice, virtually all hedge funds present investors with private placement memoranda ("PPM") that provide extensive information regarding investment program, fees, risk factors, conflicts of information, historical performance data, and other corporate information.[18] In pertinent respects, the disclosures in such PPMs parallel the disclosures found in prospectuses filed under the Securities Act.

14 *Risk controls can fail, as the case of Long Term Capital Management dramatically underscored. But the failure of LTCM encouraged investors to demand more conservative risk metrics, which the industry subsequently adopted. Kurdas, Chidem, "Alternative Approaches to Calculating Value-at-Risk Show Promise," Hedge World Daily News (October 3, 2003). Firms now routinely seek to avoid "fat tail" risk through a variety of controls, such as assuming the perfect downside correlation of their entire investment portfolio (i.e., assuming that large, statistically improbable losses affect every investment at the same time). Moreover, the failure or near-failure of a handful of hedge funds out of thousands may make good reading, but carries no statistically robust implication about the health of the industry.*

15 *Proposing Release at 17 (citing generally to the 2003 Staff Study).*

16 *It is perhaps less relevant that "minimal information [is] available about [hedge funds] in the public domain." Proposing Release at 17. First, in order to qualify for exemption from registration under the Securities Act, hedge funds cannot release much information into the public domain. The absence of information is thus no indication of excessive secrecy. Second, the relevant inquiry is whether qualified prospective investors have adequate access to information prior to investing with a fund. As we discuss in this Part II.B, that access is routinely granted. Third, significant public disclosures would betray investment strategies, substantially circumscribing a fund's ability to create value for its investors.*

17 *Advisers Act Rule 204-3*

18 *See 2003 Staff Study at 63.*

Many – and we believe most – hedge funds provide significant additional disclosures in response to investor demands. Based on our experience, such disclosures go beyond the data required to be furnished under the Exchange or Company Acts. Chief among them are investment presentations which summarize the firm's investment strategy and outlook. Many funds also provide detailed monthly or quarterly market commentaries, discussing their views on economic conditions and trading strategies. By contrast, mutual funds, public companies, and bond issuers usually confine their discussions of economic conditions and trading strategies to brief generalities.

Hedge funds also provide performance data more regularly and more intelligibly than many other issuers, and unlike most other issuers, hedge funds are generally available for open and frank discussion with investors at any time. It is routine for hedge funds to provide monthly reports, and many provide weekly and even daily reports of performance. It has been our experience that these reports contain the following metrics:

- Performance net of fees
- Attribution
- Leverage
- Volatility
- Sharpe ratio
- Sortino ratio

Performance net of fees is paramount for most investors, and this headline number is a regular feature of hedge fund periodic reports.[19] Performance is routinely compared graphically and in tabular form to relevant benchmarks, including hedge fund indices, equity markets, and Treasury yields. Reports also generally feature attribution analyses, describing what portion of profit and loss was attributable to a given strategy or group of instruments. Data concerning leverage is also commonly available, as are estimates of volatility (based on historical data), allowing investors to assess the approximate risk the portfolio is subject to. Finally, hedge fund investors demand – and receive – funds' Sharpe and Sortino ratios, which respectively measure the total volatility adjusted performance of the fund and the downside volatility adjusted performance of the fund.

It is worth noting that the metrics routinely disclosed by hedge funds are of at least equivalent analytical utility to investors as the data disclosed under the Securities, Exchange, and Company Acts. Performance data, including comparative data, presented by the funds is the same as that provided by listed mutual funds.[20] Attribution analyses from hedge funds also mirror attribution analyses by mutual funds. And by providing Sharpe and Sortino ratios, which concisely quantify the risk-adjusted performance of a fund, hedge funds provide a critical piece of disclosure that mutual funds do not. We believe that these metrics, common in the hedge fund industry and highly uncommon elsewhere, significantly simplify the investment process.

The market demands, and is supplied, with additional information during the due diligence process. Because hedge funds typically have dramatically fewer investors than mutual funds and public companies (hundreds as opposed to tens of thousands), they are generally willing to engage in a substantial due diligence process with investors. During this process, which typically lasts several weeks and often involves several meetings at fund offices, investors have ample opportunity to question fund employees regarding all aspects of fund operations.[21] Investors are also typically granted open and regular telephonic access to hedge fund staff – a due diligence luxury simply unavailable to investors in mutual funds and public companies. Funds also typically prepare "due diligence questionnaires" which embody dozens or even hundreds of questions posed by investors, allowing every investor to benefit from the due diligence insights culled from a wide range of other investors, some of whom are enormously familiar with and skilled in placing capital with hedge funds. In this way, all investors are able to enjoy many of the due diligence insights of the largest and most sophisticated investors. Finally, during the due diligence process, hedge funds have an opportunity to assess the prospective investor and can reject investors who, whatever their monetary qualifications, are unsuitable for the fund.

19 *Because funds present returns net of fees, fee structure complexity is of less relevance. Nevertheless, we note that most hedge fund fee structures are quite straightforward – a management fee, an early redemption fee, and an incentive fee coupled with a high water mark. The first two fees are routinely charged by listed mutual funds. The final fee is simply a flat percentage of gains in the portfolio. The only additional complexity is the high water mark calculation, which prevents a fund from collecting a fee unless the value of an investment exceeds its original cost – and that complexity is a benefit to the investor. It is routine for these fees to be summarized on a simple PowerPoint "terms" slide. And some funds – unlike even the lowest cost publicly traded funds – do not charge a management fee at all; investors are only charged when the fund has profited them.*

20 See, e.g., *Pimco Monthly Returns* *http://www.allianzinvestors.com/mutualFunds/profile/PMALA/performance_A.jsp*

21 *2003 Staff Study at n. 206.*

Substantial additional information about hedge funds is commonly available, due to disclosure requirements imposed by other regulatory entities. For example, many hedge funds are registered with the National Futures Association ("NFA") as commodity pool operators and/or commodity trading advisors, with information about firms and their employees available via NFA's "BASIC" system. NFA-registered funds are also subject to various internal control and reporting requirements. When applicable, hedge funds routinely file periodic reports under Section 13 of the Exchange Act, detailing certain of their holdings. Larger hedge funds may also be subject to reporting requirements imposed by exchanges or the US Treasury, though admittedly, not all such data are publicly available.

It is noteworthy that investors who feel they are unable to evaluate the merits of hedge funds on their own may "hire" a professional manager in the form of a "fund of funds." For a fee, fund of funds advisors will aggregate client monies and allocate them to individual hedge funds. These funds of funds provide both significant professional resources and a diversification benefit.

Finally, we note that the Commission and investors have substantial remedies[22] available to them should funds make inadequate disclosures – and this, in conjunction with market demands, helps ensure that hedge funds provide appropriate disclosures.

In sum, a tremendous amount of information is available to investors. Contrary to common perception, hedge funds are not "secretive" or "closed" operations. Instead, they merely limit their considerable disclosure – as they must, under the Securities Act – to a select group of investors.

c) <u>There Is No Coherent Basis For Applying The ANP Test Only To Hedge Funds</u>

Because there is no strong evidence that hedge funds exhibit greater risk or are materially less transparent than either publicly traded securities or investments available to "accredited investors," there is no coherent basis for singling hedge funds out for the more stringent "accredited natural person" test.

To underscore the lack of theoretical coherence, consider that non-accredited investors may purchase shares in publicly traded companies, mutual fund companies, and bonds. These companies are required by the securities laws to provide certain basic information, upon which investors are presumed to be able to make informed decisions.[23] As discussed *supra* Part II.B, hedge funds provide information substantially similar to that required of registered issuers. From a theoretical perspective, investors in hedge funds should be as well informed as buyers of publicly traded securities.

Further, there is no reason to believe that hedge fund strategies are less comprehensible to investors than the businesses of publicly traded equities, the financial health of issuers of sovereign bonds, or the strategies of mutual funds, many of which have begun to embrace "hedge fund-like" strategies.[24] Evaluating a single stock like Alcoa requires an investor to appreciate global supply and demand for aluminum, long-term global interest rates used to discount cash flows, accounting issues ranging from inventory to revenue recognition and compensation expense, and myriad other arcana. But disclosure is presumed to equip investors to understand those risks, and because hedge funds provide comparable disclosure, *see supra* Part II.B, investors should be equally presumed to be able to appreciate the nuances of hedge fund investment.[25]

Indeed, we believe that the relatively large minimum investments required by hedge funds, the generally limited trading strategies employed by hedge funds, and the comprehensive disclosure offered suggest that hedge fund investors will tend to be better informed than the average shareholder of a public company. Many hedge funds impose minimum investments of $100,000 to $1,000,000. Investors can be reasonably expected to spend a significant amount of time analyzing large, unitary investments.

Moreover, the Proposing Release makes an arbitrary distinction among even accredited investors, with venture capital funds exempted from the ANP requirement. The grounds for such distinction

22 *The proposed anti-fraud rules for hedge funds notably embody many of the protections found in the Securities Act pertinent to newly registered securities.* Compare *Proposed Rule 206(4)-8 (making it unlawful for any hedge fund advisor to "[m]ake any untrue statement of a material fact or to omit to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle)* with *Securities Act §11(a) ("In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security…"). Indeed, the proposed anti-fraud rule is even more rigorous than Section 11, insofar as the exculpatory provisions of Section 11 are not recapitulated in the proposed rule. Should Proposed Rule 206(4)-8 be adopted, there is even less reason to heighten the accredited natural person requirement. Nevertheless, as the Commission has traditionally emphasized disclosure over post-facto enforcement, in the choice between adopting the accredited natural person test, Proposing Rule 206(4)-8, or both, we would recommend the adoption of the accredited natural person test. We also believe that the adoption of the entire suite of rules in the Proposed Release would create an unusually strict regulatory regime for an unregistered asset class – a virtually strict liability anti-fraud rule with no scienter component (the validity of which may be susceptible to challenge) and dramatic restrictions on investor suitability.*

23 *SEC Website* http://www.sec.gov/about/whatwedo.shtml#laws *("A primary means of accomplishing these goals is the disclosure of important financial information through the registration of securities. This information enables investors, not the government, to make informed judgments about whether to purchase a company's securities.")*

24 *Campos, Roel, "Remarks Before Mutual Fund Directors Forum First Annual Directors Institute" (February 28, 2007).*

25 *Admittedly, the hedge fund community has not yet embraced sell-side analysis of the sort applied to public company stocks, though significant public equity sell-side research is a relatively recent phenomenon. However, investors who wish to compare the relative merits of hedge funds may readily compare their performance metrics on a number of hedge fund databases.*

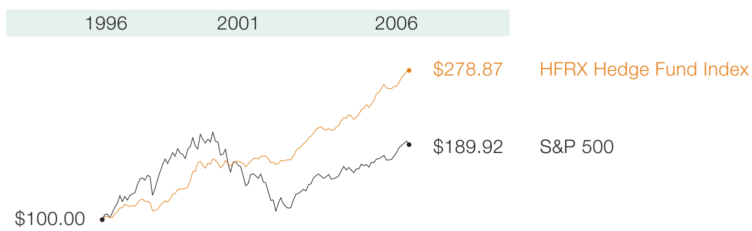
are attenuated. At best, venture capital funds offer equivalent transparency to hedge funds, mutual funds and equity securities. However, the inherent riskiness of venture funds is substantially higher than other asset classes. The typical venture investment has an extremely long horizon, during which venture fund investors have no liquidity. Venture investments are also notoriously difficult to value, given the absence of public markets, meaning that the value of a given investment can only be independently priced during infrequent capital raising rounds. A very large proportion of venture investments expire worthless, exposing investors to a high risk of loss. Finally, conflicts of interest are more likely to be prevalent in venture capital funds than other investment instruments because these funds by there nature do not invest in publicly traded markets, rather, they invest in private companies generally run by few individuals subject to few reporting requirements.

d) Restricting Access to Hedge Funds May Reduce Investor Ability to Diversify And Achieve Attractive, Risk-Adjusted Returns.

The new accredited natural person test will reduce previously accredited investors' abilities to construct efficient portfolios. Hedge funds have significantly outperformed the investment classes – equities, mutual funds, bonds – that are available to non-accredited investors.

Moreover, that outperformance has come without disproportionate risk. Indeed, hedge funds provide notably better risk-adjusted returns than the S&P 500, with the Sharpe ratios for the decade ended February 2007 standing at .05 and .6 for the S&P 500 and HFRX Index, respectively.[26] Moreover, because some hedge funds pursue strategies not commonly pursued by publicly traded securities, they offer a valuable diversification benefit. An ironic result of the new ANP test may be to force previously accredited investors to allocate capital to investments that actually decrease returns and increase risk.

Chart 1: Value of $100 Invested in Equities & Hedge Funds



26 *The period measured – 1997-2007 – encompassed a number of major market events, including the Russian default, the dot-com boom and its collapse (the largest asset bubble deflation recorded), war, and a housing bubble. It is therefore significant that the* risk-adjusted *returns of hedge funds significantly outperformed that of the equity market over the period.*

III. The New Accredited Natural Person Test May Impede Capital Formation, Reduce Liquidity And Impair Competitiveness.

We are aware of no studies indicating the portion of hedge fund assets attributable to investors who are accredited under the old regime, but would not be under the new. For larger funds, where institutional funds are preponderant, the proportion is likely to be small. Smaller funds, however, tend to rely on personal relationships for initial fundraising and their investor base tends to be less affluent. The new ANP test may place younger, smaller funds at a considerable disadvantage. Two implications flow from this: first, it may be more difficult to launch US-based hedge funds in the future; second, because smaller funds tend to focus on less well capitalized instruments, the markets may be deprived of an important source of liquidity.

IV. The Proposed Rules Should Explicitly Grandfather The Hedge Fund Investments Of Currently Accredited Investors.

Should the ANP test be adopted, we urge the Commission to explicitly grandfather the investments of investors who were accredited before the adoption of the ANP test. We believe that in the absence of explicit grandfathering, many funds will expel formerly accredited investors. Such a discontinuous expulsion may subject large numbers of formerly accredited investors to premature realization of gains/loss, adverse tax treatment, and the loss of investment opportunity without any corresponding change in the investor's real economic status. Furthermore, the sudden loss of formerly accredited capital may create significant business difficulties for smaller funds and may result in temporary market disruptions as funds attempt to rebalance their portfolios to cope with the loss of capital.

V. The "Knowledgeable Employee" Exclusion Should Continue To Apply.

Should the accredited natural person rule be enacted, we strongly encourage the Commission to deem as accredited the classes of "knowledgeable employees" enumerated in Rule 3c-5 promulgated under the Company Act.

To promote the alignment of management and investor interests, it is common for hedge funds to require senior employees to reinvest a substantial portion of their compensation into the fund. The accepted industry standard is between 20-30% of gross compensation and it is common for some funds to require contributions of substantially all of an employee's after-tax bonus compensation.

Co-investment by hedge fund employees confers significant advantages, which is reflected in the frequency with which investors ask funds to disclose what percentage of assets were contributed by firm principals.[27] Co-invested capital incents employees to pursue their duties with an extremely high degree of diligence and to maximize returns for investors. Typically long lock-up periods provide a disincentive toward short-term dishonest behavior. And unlike compensation at many publicly traded companies, co-investment by hedge fund employees is of their own, real capital. Each of these is a distinct investor benefit. Finally, co-investment affords employees an additional opportunity to share in the hedge fund's success, and provides an additional incentive for talented employees to migrate to the industry. For obvious reasons, we believe that employees are uniquely well-positioned to evaluate the risks and benefits of investing in the funds which employ them.

27 *The question is sufficiently common that most funds disclose this data as a matter of course. The importance of co-investment can be seen from the converse perspective – many investors request that they be permitted to effect early, unpenalized redemptions should employee investment fall below a specified threshold.*

We are not aware of any study of what portion of hedge fund employees are "knowledgeable employees" consistent in the Rule 3c-5 sense of the term, but not "accredited natural persons." Based on anecdotal evidence and the experience with our own fund, we believe that a substantial fraction of hedge fund employees who are "knowledgeable" would not be ANPs.

VI. Conclusions & Proposals

Hedge funds represent one of the most dynamic sectors in the nation's financial sector, a sector which is itself a major contributor to the American competitiveness. We appreciate that maintaining investor confidence in the industry is a basic necessity for its success. At the same time, we believe – scattered headlines notwithstanding – that the industry has been generally responsible, a fact which has contributed to dynamic growth. For the reasons discussed above, we believe that certain elements of the Proposing Release may diminish the dynamism of the industry, limit capital formation, and may even drive managers into offshore jurisdictions perhaps beyond the Commission's reach, while providing no significant countervailing benefit to investors. Therefore, we respectfully suggest that the new accredited natural person test not be implemented but that, if it is, the Commission explicitly grandfather the extant investments of formerly accredited investors. We also urge that the "knowledgeable employee" exception apply should the Commission heighten the accredited investor standard. Should the Commission wish to address the issues of leverage and concentration risk that have contributed to the well-publicized drawdowns at a few large funds, we respectfully suggest that guidelines be promulgated that address those issues directly. Thank you for the opportunity to comment.

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General Counsel

Alda Leu

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