MANAGED FUNDS ASSOCIATION

March 9, 2007

VIA ELECTRONIC MAIL:
rule-comments@sec.gov

Attention: Nancy M. Morris, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles; S7-25-06

Ladies and Gentlemen:

Managed Funds Association ("MFA") appreciates the opportunity to make this submission of comments to the Securities and Exchange Commission (the "Commission") in response to its proposed rules on "Accredited Investors in Certain Private Investment Vehicles" (the "Accredited Natural Person Proposal") and "Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles" (the "Antifraud Proposal") (together, the "Proposals") in Securities Release No. 8766 (the "Release").[1] We commend the Commission and its staff for addressing these important investor protection issues.

MFA is the only U.S.-based global membership organization dedicated to serving the needs of those professionals throughout the world who specialize in the alternative investment sector of the capital markets, including hedge funds, funds of funds and managed futures funds. MFA has more than 1,300 members, including professionals from a majority of the 50 largest hedge funds, who manage a significant portion of the estimated $1.4 trillion in hedge fund assets.

I. Introduction

Hedge funds inarguably are important and prominent participants in today's global financial marketplace. As recognized by the President's Working Group on Financial Markets ("PWG"), these "private pools of capital bring significant benefits to

[1] Securities Release No. 8766 (Jan. 4, 2006), 72 FR 400.

the financial markets,"[2] and are an "essential part of what keeps our capital markets the most competitive in the world."[3] Some of the important benefits that hedge funds bring to the capital markets include "liquidity, price efficiency and risk distribution."[4] We support the PWG and U.S. agency principals' Statement on Private Pools of Capital and agree that the current regulatory structure is working well. We also agree that "investor protection concerns can be addressed most effectively through a combination of market discipline and regulatory policies that limit direct investment in such pools to more sophisticated investors."[5] Our members have a strong and vested interest in the Commission's current and future rule proposals concerning hedge funds and other alternative investment vehicles, including the Proposals addressed herein.

We commend Chairman Cox as a participant in the PWG on the Statement on Private Pools of Capital. As noted by Under Secretary Steel "private pools of capital—which include venture capital, private equity, and hedge funds—have helped make us the world's leading financial innovator."[6] The creativity, innovation and entrepreneurship that our regulatory system allows private pools of capital, have kept our capital markets the most competitive in the world, and in turn has created new jobs and opportunities, helped new businesses begin and existing businesses expand.[7]

Even today, private pools of capital continue to evolve. The distinctions among hedge funds, private equity funds and venture capital funds are becoming more blurred due to industry innovation and development, and as firms seek to provide investors with greater returns by diversifying their investment strategies. The line between private equity and venture capital has always been hazy, because a venture capital investment is essentially just a private equity investment in an earlier stage company. But beyond that, there has been an even greater blurring of the lines. Today, there are venture capital funds that invest a portion of their capital in hedge funds; venture capital funds that sell their positions to private equity firms; as well as hedge funds serving similar functions to venture capital firms in financing new business entities.[8] The growth and diversity of

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[2] President's Working Group on Financial Markets, *Agreement Among PWG and U.S. Agency Principals on Principles and Guidelines Regarding Private Pools of Capital* (Feb. 22, 2007) ("Statement on Private Pools of Capital"), available at: http://www.treasury.gov/press/releases/reports/principles.pdf.

[3] Remarks of Under Secretary for Domestic Finance Robert K. Steel on Private Pools of Capital, U.S. Department of the Treasury, Treasury Department Cash Room (Feb. 27, 2007) (hereinafter "Remarks of Under Secretary Steel") available at: http://www.treas.gov/press/releases/hp280.htm.

[4] Testimony of the Honorable Randal K. Quarles, Under Secretary for Domestic Finance, U.S. Department of the Treasury, Before the Senate Committee on Banking, Housing and Urban Affairs, page 2 (July 25, 2006). *See also* Remarks of Under Secretary Steel, *supra* note 4 at 8.

[5] *See* Statement on Private Pools of Capital, supra note 2.

[6] Remarks of Under Secretary Steel, *supra* note 4.

[7] *Id.* at 8.

private pools of capital mirror the interests of the increasingly broad range of investors and all their myriad investment objectives.[9] As investors continue to seek to invest in private pools of capital for their diversification benefits and attractive risk-adjusted performance, these investment vehicles continue to diversify their investment strategies to meet the demands of investors. We believe it is important that the U.S. regulatory framework continue to encourage and reward private pools of capital for creativity, innovation and entrepreneurship.

II. MFA Comments and Recommendations on the Proposals

We support the goals and objectives behind the Proposals. We have long advocated raising the Accredited Investor standard, and we have always supported protecting investors from fraud. We have some concerns, however, with the Proposals, as drafted, and we respectfully submit our comments and recommendations below.

A. Accredited Natural Person Proposal

In 2003 we submitted a White Paper to the Commission on increasing financial eligibility standards for investors in hedge funds.[10] In that paper, we suggested amending the definition of Accredited Investor to increase the standards of financial eligibility for natural persons investing in pooled investment vehicles to a net worth threshold of $2 million or annual income threshold of $400,000, and annual joint income threshold of $500,000. We applaud the Commission for revisiting this potential means of investor protection in the Release, but we believe the Commission can accomplish its goals in a more simplified manner than creating a new standard as outlined in the Accredited Natural Person Proposal. Namely, we recommend the Commission simply raise the financial eligibility standard for natural persons in the existing definition of "accredited investor" ("Accredited Investor"), which has not changed since first adopted in 1982. Consequently, we provide the following comments and recommendations on the Accredited Natural Person Proposal.

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[8] *See* Pui-Wing Tam, *Venture Capitalists Must Work To Pull Profits From Investments,* WALL ST. J. ONLINE, Jan. 31, 2007; Jonathan Shieber, *VCs Take Stock of Hedge Fund Interest,* VENTURE WIRE, Feb. 28, 2007; Stephen Heuser, *Start-Ups Turning to Hedge Funds,* THE BOSTON GLOBE, May 29, 2006; *Venture Capital: Hedge Funds Get Active in Financing Start-Ups*, WALL ST. J. ONLINE, Apr. 24, 2006; *Private Equity Cozies Up Further to Hedge Funds*, WALL ST. J. ONLINE, Aug. 1, 2005.

[9] Remarks of Under Secretary Steel, *supra* note 3 at 2.

[10] *White Paper on Increasing Financial Eligibility Standards for Investors in Hedge Funds,* Managed Funds Association, July 7, 2003, *available at:* http://www.mfainfo.org/images/PDF/WhitePaperInvestorEligibilityFinal.pdf.

1. *The Accredited Natural Person Proposal is overly complicated and potentially confusing.*

While we are in support of increasing investor protection, we are concerned that the Accredited Natural Person Proposal is overly complicated. We believe it would be confusing to investors to have yet another federal financial sophistication standard and an additional set of definitions that is inconsistent with existing regulations.

We believe federal financial sophistication standards should be as uniform and logically consistent as possible to prevent investor confusion as well as to enhance investor and manager compliance. Financial sophistication standards under current federal regulations include: *Accredited Investor, qualified client, qualified purchaser, qualified institutional buyer, qualified eligible person* and *eligible contract participant.*[11] The creation of another financial standard, *i.e., Accredited Natural Person*, could further confuse and unnecessarily increase administrative costs borne by investors.

We also believe that any term or definition adopted under a new financial standard should be consistent with existing regulations to avoid investor confusion. For example, it could be confusing for investors and managers to have the term "joint property" defined differently under the Accredited Natural Person Proposal than under other financial sophistication standards, such as, Accredited Investor, qualified client and qualified purchaser.

Recommendation

We recommend that the Commission, rather than create a new financial sophistication standard, amend the Accredited Investor definition by adjusting for inflation the net worth and income thresholds. We believe this would be the simplest yet most effective solution to investor protection concerns.

The regulatory structure in place has led to the success of the U.S. markets and we believe it is working well.[12] We agree with the Commission that it is time to reconsider whether the current financial standard for natural persons is an appropriate threshold for investing in private pools of capital. We believe, however, that the Accredited Investor rule has been successful in limiting private pools of capital and other more risky investments to sophisticated investors. Thus, we believe the Commission should amend the Accredited Investor rule solely by adjusting it for inflation.

We recommend the Commission amend the Accredited Investor definition by adjusting for inflation the $1 million net worth, the $200,000 annual income, and the

[11] *See* Attachment 1, Chart Summarizing Sophisticated Investor Standards.

[12] We concur with Under Secretary Steel that we must be vigilant in maintaining this competitive edge and continually assess current conditions and areas for change. *See* Remarks of Under Secretary Steel, *supra* note 3.

$300,000 annual joint income thresholds. The Commission's Office of Economic Analysis estimated that these numbers, adjusted for inflation, would have been approximately $1.9 million (net worth), $388,000 (individual income) and $582,000 (joint income) as of July 1, 2006.[13]

2. *No Logical or Statutory Justification Exists for Differentiating Among 3(c)(1) Funds.*

We are concerned that the Commission's Accredited Natural Person Proposal discriminates unnecessarily against hedge funds. We do not believe that hedge funds are riskier than other types of private pools of capital, such as private equity funds or venture capital funds. Through the Accredited Natural Person Proposal, the Commission would essentially be promoting funds relying on the exclusion from the definition of investment company under section 3(c)(1) of the Investment Company Act of 1940[14] (the "Company Act") ("3(c)(1) Funds") as riskier than others. We do not believe that it is in the government's interest to advise that investing in a hedge fund is riskier than investing in a private equity fund or venture capital fund.[15] We believe it would be poor public policy to allow a person to participate in illiquid investments such as venture capital, real estate, collectable and other privately offered investments while denying that person an opportunity, for example, to invest in an established hedge fund with quarterly redemptions.

In particular, we believe it is inappropriate to treat venture capital funds differently than hedge funds and private equity funds.[16] The traditional distinctions among hedge funds, private equity funds and venture capital funds have been in their

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[13] 72 FR 406.

[14] A private fund relying on an exclusion from the definition of investment company provided by sections 3(c)(1) – (14) of the Company Act are hereinafter referred to as a "3(c)(x) Fund" with (x) representing the corresponding numerical subsection of section 3(c).

[15] We do not understand the Commission's rationale for seeking to treat 3(c)(1) Funds differently from other private placement offerings that rely on Regulation D ("Reg D") under the Securities Act of 1933.

Private placement investments are characterized by the nature of their offering and are not distinguished by the nature or level of risk of their business investments. We are not aware, nor has the Commission shown, that 3(c)(1) Funds are riskier or less beneficial to the economy than other private placement investments. We believe that private placement investments are by their nature potentially more illiquid and risky than other investments, and in general more appropriate for sophisticated investors.

[16] We note that with respect to the Commission's proposed definition for "venture capital fund," we do not believe the proposed definition would achieve the Commission's intention of carving out venture capital funds from the Accredited Natural Person Proposal. Nor do we believe that the Commission's suggestion of imposing a two (or more) year lock-up would address the underlying concern of limiting "risky" investing to financially sophisticated investors. The problem with defining "venture capital fund" as a "business development company" under the Investment Advisers Act of 1940 ("Advisers Act") is that the term business development company is narrowly constructed, when in fact, the true reach of venture capital investing is far broader.

business strategies, and not the level of risk of their investments. Moreover, the distinctions among these entities are rapidly becoming less clear as firms meet the demands of their investors in diversifying their investment strategies. The Commission has not shown that hedge funds are riskier than private equity or venture capital funds, or even less beneficial to the markets or the U.S. economy as a whole. We believe that there is no logical justification for regulatory discrimination against certain 3(c)(1) Funds.

Finally, we respectfully request that the Commission carefully reconsider whether it has statutory authority to treat venture capital funds differently than other 3(c)(1) Funds. The Company Act provides an exemption from the definition of an investment company under section 3(c)(1) for any issuer with not more than 100 beneficial owners. The statute is silent on the nature or business strategy of the issuer. We believe that it would be arbitrary and capricious for the Commission to treat venture capital funds differently from other 3(c)(1) Funds.

Recommendation

We strongly urge the Commission to treat similarly situated 3(c)(1) funds (i.e., hedge funds, private equity funds, and venture capital funds) in a similar manner. As the Accredited Natural Person Proposal might inadvertently limit the level of innovation and development in the private fund sector, we recommend that the Commission not draw artificial distinctions among investment strategies, nor adopt rules that are overly prescriptive in providing how a hedge fund, venture capital fund, or any other type of fund or business, must operate.

3. *The Accredited Natural Person Proposal overly restricts employee participation in funds.*

As an important matter of public policy, we believe employees of private investment funds or their investment advisers (collectively "Fund Employees") should be able to invest in 3(c)(1) and 3(c)(7) Funds both directly and through deferred compensation and other similar arrangements.[17] One of the best ways to protect investors is to have fund principals' and employees' interests aligned with the interests of investors, through their own investments in the fund.

All "knowledgeable employees" ought to be deemed to be Accredited Investors for the purpose of investing in a private investment fund as to which they are knowledgeable employees. Further, permitting a broader category of Fund Employees to invest in their employer's funds would represent a simple, yet highly meaningful policy change, which would significantly enhance investor protection. Such a policy would significantly reduce and even eliminate many potential conflicts of interest in areas such as personal investments by Fund Employees. Just as a person would find it imprudent to

[17] We are aware that the current narrow interpretations of who qualifies as a "knowledgeable employee" come largely from the American Bar Association letter (American Bar Association, SEC No-Action Letter, (Apr. 22, 1999)), but the Commission has yet to provide clear guidance on the matter.

invest in a start-up company where the company founders and key players did not have a financial interest and/or personal investment at risk, 3(c)(1) and 3(c)(7) Fund investors would find more security in investing in a fund where its employees have aligned interests in the fund's performance. From our experience, prospective investors are keen to learn that Fund Employees are invested in their employer's funds. Further, investors have a strong interest in a fund's ability to attract and retain talented Fund Employees. Allowing Fund Employees to invest in private investment funds managed by their employer is an important retention tool and employee benefit that can help a fund's attract and retain talented employees, such as the best risk and portfolio managers. Such an employee benefit would be akin to a start-up company's ability to offer employees stock or investment opportunities to help attract and retain talented employees who, in turn, help spawn innovation and development.

We believe many non-executive Fund Employees become quite familiar with the risk/return and other characteristics of investments managed by their employers from many vantage points and possess a sophisticated and knowledgeable understanding of the investment objectives, risks and operations of their employer's funds. Such Fund Employees include: (i) "front office" staff, who have marketing or investor relations responsibilities that include providing information concerning potential investments and strategies to clients and prospective investors; (ii) research analysts involved in the investigation and/or analysis of prospective fund investments; (iii) legal counsel providing advisory or other legal services relevant to the fund; (iv) traders who participate in making and implementing trading decisions for the fund; (v) series 7-registered representatives of broker-dealers providing services to the fund or the affiliated management person; (vi) financial, compliance, operations and accounting officers of the fund who have management responsibilities for compliance, accounting and auding functions of funds or their management affiliates.

Recommendation

We recommend that the Commission, in the interest of protecting investors, allow "knowledgeable employees" and certain Fund Employees to invest in their employer's 3(c)(1) and 3(c)(7) Funds both directly and through deferred compensation and other similar arrangements. To achieve that, we recommend that the Commission broaden the scope of the definition of "Knowledgeable Employee" under the Company Act to include employees involved in the operation of the fund or its investment process (other than an employee performing solely clerical, secretarial or administrative functions), such as, marketing and investor relations professional; research analysts; attorneys; traders; brokers and traders of a fund affiliate; and financial, compliance, operational and accounting officers.

4. *The grandfathering provision in the Accredited Natural Person Proposal would create unreasonable and costly burdens for certain investors already invested in 3(c)(1) Funds.*

The grandfathering provisions as drafted in the Accredited Natural Person Proposal would create unreasonable and costly burdens for certain investors already invested in 3(c)(1) Funds, who would be ineligible under the Accredited Natural Person Proposal.

Investors spend a substantial amount of time and money performing due diligence on a fund before investing. We believe it would be unfair to investors who have already performed extensive due diligence and committed capital to a fund to be required to dispose of their interests in a fund or to be restricted from making further investments in the fund.

The grandfathering treatment as contemplated in the Accredited Natural Person Proposal is inconsistent with the treatment the Commission has extended to grandfathered 3(c)(7) Fund investors. When a 3(c)(1) Fund converts into a 3(c)(7) Fund, the Commission allows the grandfathered fund to preserve its arrangements with its non-qualified purchasers and does not limit additional purchases by these purchasers of the grandfathered fund's securities.[18]

Recommendation

We recommend that the Commission allow existing 3(c)(1) Fund investors who would not meet an inflation adjusted Accredited Investor standard or the Accredited Natural Person Proposal to maintain their investments in a 3(c)(1) Fund**.** We also recommend that the Commission provide a grandfather provision to allow existing 3(c)(1) Fund investors who would not meet a new financial sophistication threshold to make future investments in the same 3(c)(1) Fund.

5. *The Accredited Natural Person Proposal would create an unreasonable barrier to entry and other costs and consequences.*

The Accredited Natural Person Proposal creates a new barrier above and beyond the original barrier as contemplated by Regulation D ("Reg D") under the Securities Act of 1933 by virtue of shifting to an investment standard from a net worth standard, and increasing the threshold to such a high investment minimum. While we are in favor of raising the financial standard for investing in private pools of capital, we note that this must be balanced with the concern that too high a threshold would unreasonably raise the barrier to entry and strongly limit competition, innovation and development in this sector. The U.S. has been leading the race in innovation and development in the financial sector through private investment vehicles. Many of today's large and successful funds have roots as small start-up funds with investments primarily from friends and family.

We are concerned that the Accredited Natural Person Proposal would create unintended consequences and inappropriate outcomes. One such consequence is that the

[18] 68 FR 17520 at note 82.

inflation adjustment provision would eventually make it more difficult for a natural person to invest in a 3(c)(1) Fund than a 3(c)(7) Fund. Reg D imposes a $1 million net worth financial standard for natural persons investing in a private placement. The Company Act imposes no financial standard for natural persons investing in a 3(c)(1) Fund and a $5 million "investments" financial standard for natural persons investing in a 3(c)(7) Fund. Under the Accredited Natural Person Proposal, the net worth standard for a natural person to invest in a 3(c)(1) Fund will eventually exceed the $5 million "investments" standard for a natural person to invest in a 3(c)(7) Fund. This outcome seems contrary to the original intent of the Company Act.[19]

Also, we would like to raise for the Commission to consider that the Accredited Natural Person Proposal would create a discrepancy between an investor's ability to invest in a 3(c)(1) Fund and a registered private placement offering of a hedge fund. A registered private placement offering of a hedge fund is registered under the Company Act and thus, not subject to the beneficial ownership limit of section 3(c)(1) of the Company Act. In order to invest in a registered private placement offering, an investor must meet the Accredited Investor standard. The Accredited Natural Person Proposal addresses the ability of a natural person to invest in a 3(c)(1) Fund, but not a registered hedge fund.

Recommendation

We recommend that the Commission fully study the Accredited Natural Person Proposal or any other proposed rule's potential impact on competition in order to assess the right balance between investor protection and competition before adopting such rule.

B. Antifraud Proposal

As we noted above, we have always believed investors deserve protection from fraud at any level. We therefore commend the Commission for addressing this issue in the Release. We fully support the Commission's view that it needs to be able to protect investors from fraud committed by their advisers. At the Commission's December 13, 2006 Open Meeting regarding the Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles, a few Commissioners stated that the purpose of the Antifraud Proposal was to clarify some of the uncertainties caused by the Goldstein decision. The Commission stated that the Antifraud Proposal is meant to eliminate any uncertainty caused by Goldstein regarding the application of sections 206(1) and 206(2) of the Advisers Act to cases where an investment adviser defrauds investors in a pooled investment vehicle.

We agree with the Commission and believe that a new antifraud rule should be narrowly tailored to remedy any uncertainty caused by Goldstein and enable the

[19] Another consequence of the inflation provision is that eventually the financial standard for investment in a 3(c)(1) Fund will be millions of dollars greater than the financial standard to engage in other private placements. We do not believe that this is an appropriate outcome or sound public policy.

Commission to protect investors. However, we are concerned that the Antifraud Proposal sweeps far more broadly than its stated purpose, is not narrowly tailored to restore the pre-Goldstein status quo and, as drafted, is likely to have significant adverse, unintended consequences. We are concerned that proposed rule 206(4)-8 goes beyond the scope of section 206(1) and 206(2) of the Advisers Act, would create uncertainty as to the standard of care required, and would cause pooled investment vehicles to limit the amount of information they provide to investors. We provide the following comments and recommendations.

(1) The Antifraud Proposal creates uncertainty as to the standard of care.

The Release states that the rule would not create a new fiduciary duty or alter any duty or obligation an adviser has to investors. The Release explains that the wording of subsection 206(4)-8(a)(1) is similar to other Commission antifraud laws and rules, such as rule 10b-5; but unlike violations of rule 10b-5, the Commission would not need to demonstrate that an adviser violating rule 206(4)-8 acted with scienter.

First, we believe that it is inapposite and fraught with the potential for adverse impacts to adopt wording from a different rule that requires a finding of scienter in order for a violation to have occurred, into a rule that is intended to require a finding of only simple negligence.

Second, we believe that the Antifraud Proposal, would in fact, create uncertainty as to the standard of care required. The Release states that the standard of care required under the Antifraud Proposal is negligence. The wording of proposed subsection 206(4)-8(a)(1), however, is drawn from rule 10b-5, which courts have interpreted as require a finding of scienter in order for a violation to have occurred. We believe the language of the Antifraud Proposal is inconsistent with the Commission's statements on the proposed rule and the guidance provided by the Release. The inconsistency creates uncertainty as to what a court of law would hold is the appropriate standard of care under the Antifraud Proposal.

(2) The Antifraud Proposal would have a chilling effect on the amount of information funds provide to investors.

We are concerned that the proposed language in 206(4)-8(a)(1) is overly broad and would have a chilling effect on the amount of information funds provide to investors. Proposed rule 206(4)-8(a)(1) would hold a person liable for any untrue statement, even if the person was unaware that the statement was untrue at the time. We are concerned that the Antifraud Proposal would cause funds to be sparing and constrained in disclosing information, rather than encourage more transparency and dialogue with investors. The Antifraud Proposal greatly enhances a fund's risk of fraud liability as any inadvertent untrue statement made by an employee could make it vulnerable, under the Antifraud Proposal, to potential prosecution. We are concerned that the proposed rule would cause

funds to limit daily, weekly or monthly communications with investors.[20] We believe this disserves investor interests rather than enhancing them.

Many private investment vehicle documents are by their nature incomplete information by themselves. It is commonly understood that the private placement memorandum is the only document that binds all previously provided information. We are concerned that with adoption of the Antifraud Proposal, funds will be reluctant to distribute information other than the private placement memorandum. As a result, investors may be unable to obtain the specific information responsive to their individual concerns, but, instead, will receive a forest of material from the fund in an effort to protect against liability.

For example, we are concerned about how the Antifraud Proposal would apply in the case of a fund responding to a prospective investor's request for proposal ("RFP"s). Generally, RFPs are intended to provide a prospective investor with preliminary information that is later integrated into a private placement memorandum.[21] The response to the RFP by itself, however, may not provide complete information. Under rule 10b-5, an issuer knows that all information must be provided to an investor in order for the information provided not to be misleading by the time of the purchase or sale of a security. Since the Antifraud Proposal would apply regardless of whether the pool is offering, selling or redeeming securities and to both prospective investors and existing investors, we are concerned that a fund would be found to violate the rule by providing a prospective investor, even one who never invests, during the due diligence process, an RFP.

We are deeply concerned that the Antifraud Proposal would have a chilling effect on the amount of information funds would provide to investors. We believe this would have a negative impact on transparency and investors' ability to obtain information outside of the formal private placement memorandum.

* * *

[20] Prospective hedge fund investors have access to and receive a great deal of fund information, including the private placement memorandum (or operating memorandum), limited partnership agreement and subscription agreement. A hedge fund investor, depending upon his contract with a fund, also may receive fund information through a due diligence questionnaire or request for proposal (prior to becoming an investor), daily, weekly, monthly or quarterly investor letters, a fund's password protected website, and in some cases, quarterly or annual audited financial statements.

[21] A private placement memorandum typically provides information on: investment strategy; risk factors; information on the general partner or investment manager; management fees and incentive compensation; other fees and expenses; provisions on key personnel of the fund manager; synopsis of the limited partnership agreement or other organization documents; conflicts of interest; side letters; investment, withdrawal, and transfer procedures; valuation; brokerage; tax issues; and ERISA issues. *See* THOMAS P. LEMKE ET AL., HEDGE FUNDS AND OTHER PRIVATE FUNDS: REGULATION AND COMPLIANCE 123 (2006-2007 ed.).

Recommendation

We recommend that the Commission adopt a rule that is narrowly tailored to remove any uncertainty caused by Goldstein v. SEC[22] regarding the application of sections 206(1) and 206(2) of the Advisers Act to cases where an investment adviser defrauds investors in a pooled investment vehicle. We recommend the Commission adopt language from section 206(1) rather than the proposed language in rule 206(4)-8(a)(1). We believe that this would be the clearest and most direct way for the Commission to reestablish any uncertainty caused by Goldstein, without broadening the scope of the antifraud rule or creating any uncertainty as to the standard of care required in a prospective rule.

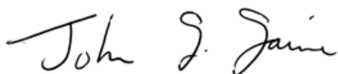
We recommend that the Commission replace the proposed language in subsection 206(4)-8(a)(1) with the following:

> "(1) Employ any device, scheme, or artifice to defraud any investor in the pooled investment vehicle."

V. Conclusion

MFA appreciates the opportunity to comment on the Commission's Proposals. We support the Commission's efforts toward protecting investors and creating a better investment environment for both investors and private pools of capital alike. We are not opposed to any and all regulation, however, we want to ensure that any regulation promulgated by the Commission is both effective and the least intrusive and burdensome as possible. We look forward to working with the Commission and the PWG as the hedge fund industry continues to thrive and prosper. We would be pleased to meet with Commissioners or Staff to discuss our comments.

Respectfully submitted,



John G. Gaine
President

Attachment 1: "Sophisticated Investor" Standards Chart

CC: The Hon. Christopher Cox, Chairman
The Hon. Paul S. Atkins Commissioner
The Hon. Roel C. Campos
The Hon. Annette L. Nazareth

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

The Hon. Kathleen L. Casey
Andrew Donohue, Director
Division of Investment Management
Douglas Scheidt, Associate Director
Division of Investment Management
Robert Plaze, Associate Director
Division of Investment Management
John White, Director
Division of Corporation Finance
Brian G. Cartwright, General Counsel

MFA Comments to SEC on File S7-25-06
March 9, 2007
Attachment 1

Chart Summarizing "Sophisticated Investor" Standards Under Securities and Commodities Legislation and Regulation			
Body of Law & Regulatory Agencies	***Citation & Name of Standard***	***Purpose of Rule/Exemption And Common Use***	***Qualifications to Meet Standard***
Investment Company Act of 1940 ("Company Act") • ***Securities and Exchange Commission ("SEC")***	Section 3(c)(1) private investment funds	3(c)(1) funds are exempted from registration under the Company Act and generally may be sold to "accredited investors" and up to 35 "sophisticated investors" for a maximum total of 99 investors. Note: this structure is commonly used by fund managers in the "start up" phase (e.g. friends and family).	See "Accredited Investor" definition below.
Securities Act of 1933 ("Securities Act") • ***SEC***	Accredited Investors (See Securities Act Rules - Regulation D)	Generally, persons may issue securities to accredited investors, as defined in Regulation D, without having to register the securities with the SEC. Accredited investors are permitted to invest in private funds exempt from registration under section 3(c)(1) of the Company Act (See "Company Act" below)	Accredited Investors generally include: (a) Individuals alone, or together with their spouse, who have over $1,000,000 net worth; or (b) Individuals with income of over $200,000 or $300,000 with their spouse for the past two years and expect to achieve the same income in the current year; and (c) Entities[1] with at least $5,000,000 in assets. Under Regulation D[2] a private fund may accept up to 35 non-accredited investors, however Regulation D, Rule 502(b) requires private funds offered to non-accredited investors to have certain financial statements.

[1] The term "entities" includes charitable organizations, partnerships, corporations, certain employee benefit plans and trusts (so long as such trust was not formed for the purpose of acquiring the securities offered).

[2] Under the Securities Act, any offer to sell securities must either be registered with the SEC or meet an exemption. Regulation D (or Reg D) provides three exemptions from the registration requirements, allowing some companies to offer and sell their securities without having to register the securities with the SEC.

Chart Summarizing "Sophisticated Investor" Standards Under Securities and Commodities Legislation and Regulation			
Body of Law & Regulatory Agencies	***Citation & Name of Standard***	***Purpose of Rule/Exemption And Common Use***	***Qualifications to Meet Standard***
Company Act • ***SEC***	Section 3(c)(7) private investment funds	3(c)(7) funds are exempt from registration under the Company Act and may allow investments by up to 499 "qualified purchasers". (See definition below). This is the most common structure used by today's hedge fund managers. Note: there is no prescribed limit to the number of qualified purchasers in a 3(c)(7) fund, however the limit of less than 500 investors is proscribed to prevent the offering to be deemed a public offering.	See "Qualified Purchaser" definition below. In addition, certain "knowledgeable employees"[3] are permitted to invest in a 3(c)7 funds regardless of whether they qualify under the definition of qualified purchaser.
Company Act • ***SEC***	Qualified Purchaser (See Section 2(a)(51) of the Company Act)	Generally, qualified purchasers are permitted to invest in private funds exempt from registration pursuant to Section 3(c)(7) of the Company Act.	Qualified Purchasers generally include: (a) natural persons with over $5 million in "Investments" (See Section 2(a)(1) of the Company Act for definition of "Investments") (b) Entities[4] with at least $25 million in "Investments" or (c) Certain Qualified Institutional Buyers[5] (See Securities Act above)

[3] The term "knowledgeable employee" includes an executive officer of a private fund or the fund's manager, or an employee that "participates in investment activities" in connection with the operations of the fund or its manager, if the employee has performed services of this type for at least 12 months. Knowledgeable employees may invest in 3(c)(1) and/or 3(c)(7) funds without being counted towards the 100 limit for a 3(c)(1) fund or be a "qualified purchaser" for a 3(c)(7) fund.

[4] Defined as any person, acting for its own account or the accounts of other qualified purchasers.

[5] According to Rule 2a51-1(g) of the Rules and Regulations promulgated under the Company Act, "any prospective qualified purchaser who is, or who a relying person reasonably believes is a qualified institutional buyer ("QIB") as defined in paragraph (a) of Rule 144A of the Securities Act, acting for its own account, the account of a QIB, or for the account of a qualified purchaser shall be deemed a qualified purchaser provided: (i) the dealer described in Rule 144A shall own and invest on a discretionary basis at least $25 million in securities of issuers that are not affiliated persons of the dealer, and (ii) if a state employee benefit plan, ERISA plan or trust composed of ERISA investors or state employees, such plan will not be deemed to be acting for its own account if investment decisions with respect to the plan are made by the beneficiaries of the plan, except with respect to investment decisions made solely by the fiduciary, trustee or sponsor of such plan.

Chart Summarizing "Sophisticated Investor" Standards Under Securities and Commodities Legislation and Regulation			
Body of Law & Regulatory Agencies	***Citation & Name of Standard***	***Purpose of Rule/Exemption And Common Use***	***Qualifications to Meet Standard***
U.S. Investment Advisors Act of 1940 ("Advisers Act") • ***SEC***	Qualified Clients (See Section 205-3(d)(1) of the Advisers Act.	Generally, registered investment advisers may only charge performance fees on investors who qualify as qualified clients. As a result, investors in 3(c)1 and 3(c)7 funds managed by registered investment advisers who charge performance fees must qualify as qualified clients.	Qualified Clients generally include: (a) a person or company with at least $750,000 under management of the adviser immediately after entering into the contract; (b) a person, alone or with their spouse, or a company, whom the investment adviser reasonably believes prior to entering into the contract has a net worth in excess of $1,500,000; (c) a qualified purchaser (See Company Act above).
Securities Act • ***SEC***	Qualified Institutional Buyers (See Rule 144A of the Securities Act)	Qualified Institutional Buyers are permitted to re-sell certain restricted securities to other qualified institutional buyers without having to register the securities. Qualified institutional buyers may also invest in private investment companies exempt from registration pursuant to Section 3(c)(7) of the Company Act. Because QIBs qualify as qualified purchasers, generally, major investment institutions use their QIB status to invest in 3(c)7 funds.	Qualified Institutional Buyers ("QIBs")generally include *any of the following that owns and invests at least $100 million in securities*: (a) certain insurance companies; (b) certain state plans and "benefit plan investors; (c) banks and savings and loans; (d) certain charitable organizations; (e) registered investment companies; or (f) registered investment advisers. QIBs also include registered broker dealers owning and investing at least $10 million in securities of non-affiliates.

Chart Summarizing "Sophisticated Investor" Standards Under Securities and Commodities Legislation and Regulation			
Body of Law & Regulatory Agencies	***Citation & Name of Standard***	***Purpose of Rule/Exemption And Common Use***	***Qualifications to Meet Standard***
Commodity Exchange Act • ***Commodities Futures Trading Commission*** • ***National Futures Association ("NFA")***	Qualified Eligible Persons (See Commodities Futures Trading Commission ("CFTC") Rule 4.7)	Qualified eligible persons may invest in commodity pools without requiring the commodity pool operator to deliver detailed disclosers and certain reporting to the investor. Generally, commodity pool operators registered as such with the CFTC often require investors in their private funds that trade futures (i.e. pool participants) to qualify as qualified eligible persons in order to avoid significant disclosure requirements.	Qualified Eligible Persons generally include: (1) certain registered commodities and securities professionals (e.g., futures commissions merchants, registered broker-dealers); (2) "accredited investors" (See "Securities Act") who have a securities portfolio of at least $2 million or have $200,000 on deposit as commodities margin premium; (3) non-U.S. persons; (4) "qualified purchasers" (See "Company Act" above); or (5) "knowledgeable employees" (See Footnote 3).
Commodity Exchange Act • ***Commodities Futures Trading Commission*** • ***National Futures Association ("NFA")***	Eligible Contract Participants (See Section 1(a)(12) of the Commodity Exchange Act)	Persons or entities designated as "eligible contract participants" may invest in certain over-the-counter and derivatives transactions without being subject to certain CFTC restrictions. Generally, eligible contract participants include highly sophisticated investors managing significant assets. Persons or entities designated as eligible contract participants may trade futures extensively.	Eligible Contract Participants generally include: (a) individuals with $10 million or more in total assets; (b) corporations, partnerships, trusts or other entity with $10 million in total assets or $1 million net worth; (c) registered investment companies; (d) financial institutions; (e) certain state regulated and other insurance companies; (f) certain registered commodity pool operators and commodity trading advisors with more than $5 million in total assets; (g) certain ERISA plans with more than $5 million in total assets; (h) broker-dealer (other than an individual) registered under the Commodity Exchange Act; (i) a futures commission merchant subject to regulation under the Commodity Exchange Act; or (j) a floor broker or floor trader subject to regulation under the Commodity Exchange Act.

Chart Summarizing "Sophisticated Investor" Standards Under Securities and Commodities Legislation and Regulation			
Body of Law & Regulatory Agencies	***Citation & Name of Standard***	***Purpose of Rule/Exemption And Common Use***	***Qualifications to Meet Standard***
Commodity Exchange Act • ***Commodities Futures Trading Commission*** ***National Futures Association ("NFA")***	Rule 4.13(a)(3) Exemption from Registration With the NFA For Certain Commodity Pool Operators ("CPO")[6].	Individuals or organizations otherwise required to register as CPOs may be exempt from registration with the NFA and associated disclosure requirements where all investors in the private fund/pool are accredited investors and futures trading is limited within the parameters set forth in 4.13(a)(3). Generally, investment managers of private funds will seek to claim the 4.13(a)(3) exemption with respect to 3(c)1 private funds managed by such investment manager so long as futures trading for the private fund is sufficiently limited.	To qualify for the 4.13(a)(3) exemption, investors in the pool must be limited to the following: (1) accredited investors (see above); (2) Trusts that are not accredited investors but that were formed by an accredited investor for the benefit of a family member; (3) Knowledgeable employees (See Fn2); or (4) Qualified Eligible Persons (see above). AND The pool operator must at all times limit its futures activity to one or the other futures trading limits: (1) The aggregate initial margin and premiums required to establish commodity interest positions, determined at the time the most recent position was established, does not exceed five percent (5%) of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into; or (2) The aggregate net notional value of the pool's commodity interest positions, determined at the time the most recent position was established, does not exceed one hundred percent (100%) of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into.
Commodity Exchange Act • ***Commodities Futures Trading Commission***	Rule 4.13(a)(4) Exemption from Registration With the NFA For Certain Commodity Pool Operators ("CPO").	CPOs may be exempt form registration with the NFA and associated disclosure requirements where investors in the pool meet	To qualify for the 4.13(a)(4) exemption, investors in the pool must be limited to the following: Natural person investors must qualify as:

[6] A CPO is an individual or organization which operates or solicits funds for a commodity pool; that is, an enterprise in which funds contributed by a number of persons are combined for the purpose of trading futures contracts or commodity options, or to invest in another commodity pool.

Chart Summarizing "Sophisticated Investor" Standards Under Securities and Commodities Legislation and Regulation			
Body of Law & Regulatory Agencies	***Citation & Name of Standard***	***Purpose of Rule/Exemption And Common Use***	***Qualifications to Meet Standard***
National Futures Association ("NFA")		certain eligibility requirements. Generally, investment managers of private funds will seek to claim the 4.13(a)(4) exemption wit respect to 3(c)(7) private funds managed by such investment manager. A private fund operator that is exempt from registration under Rule 4.13(a)(4) is not subject to any futures trading restrictions (i.e., a fund operator's ability to trade in futures is unlimited).	(1) qualified purchasers (see above); (2) non-U.S. persons; or (3) certain industry participants (e.g., registered broker dealers and registered futures commission merchants) Entity (or "Non-natural") investors must qualify as: (1) qualified eligible persons (as defined in Rule 4.7) (see "qualified eligible persons" above); or (2) accredited investors as defined in Rule 501(1), (2), (3), (7) and (8). This includes banks, private business development companies, certain charitable organizations, trusts with in excess of $5,000,000 in assets and entities solely owned by accredited investors, respectively.