MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

April 24, 2008

Via Hand Delivery

The Honorable Christopher Cox
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Meeting with Managed Funds Association

Dear Mr. Chairman:

On behalf of Managed Funds Association ("MFA"),[1] I appreciate the opportunity to meet with you on April 24, 2008, to continue MFA's ongoing dialogue with the U.S. Securities and Exchange Commission regarding various issues affecting the alternative investment industry. Below is a brief discussion of issues facing our industry on which we hope to work with the SEC and its staff going forward.

Hedge Fund Transparency

Policy makers, regulators, investors and members of the media have described hedge funds as "secretive," "unknown" and "predatory investors." MFA believes that these misperceptions of our industry are largely the result of the industry's interpretation of the SEC's private placement rules and staff guidance issued under those rules. Industry participants, based on the advice of legal experts in this field, have generally interpreted the SEC's rules and staff guidance on those rules as precluding a wide range of public communications, including communications that are not intended to be offers to sell or solicitations to purchase an interest in hedge funds. MFA believes that rulemaking by the SEC with respect to hedge fund offerings would promote greater transparency of the industry, without raising investor protection concerns. Further, increased transparency of the alternative investment industry would be of great benefit to hedge fund investors, regulators, policy makers and the U.S. capital markets. One specific benefit of increased transparency would be that more information (and more reliable information) about the industry would be publicly available to regulators, policy makers and others as they consider market stability and systemic risk issues.

[1] MFA is the voice of the global alternative investment industry. Our members include professionals in hedge funds, funds of funds and managed futures funds. Established in 1991, MFA is the primary source of information for policymakers and the media and the leading advocate for sound business practices and industry growth. MFA members represent the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $2 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

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A. The Private Offering Exemption and the Prohibition on General Solicitation and Advertising

As you know, hedge funds generally rely on the safe harbor for private offerings found in Regulation D under the Securities Act of 1933. Rule 502(c) of Regulation D precludes an issuer from offering or selling its securities by any form of general solicitation or general advertising. This prohibition has created great uncertainty and interpretive issues regarding what activities constitute a general solicitation or general advertising. As a result, hedge fund managers, with guidance from outside counsel, often take a conservative, narrow approach and do not provide information about their business and trading strategies to the public out of concern for violating the prohibition.

In addressing this topic, we want to make clear that MFA is not in any way seeking to broaden or expand the existing categories of potential investors to whom hedge funds may be offered or sold. We strongly support the limitation on offers and sales of hedge funds only to sophisticated investors. MFA does believe, however, that there is a meaningful distinction between a hedge fund manager providing information generally and engaging in advertising and solicitation efforts to sell a hedge fund's securities, and we believe this distinction should be made clear in the rules applicable to hedge fund offerings. Because hedge funds can offer and sell their securities only to sophisticated persons, who must also generally be accredited investors or qualified purchasers, we believe a more flexible approach to the prohibition in Rule 502(c), as applied to hedge funds, is appropriate. We recommend that the SEC modify its rules on private offerings of hedge funds by focusing on the limitations on offers and sales solely, rather than other communications by hedge funds or their managers.

The simplest manner of achieving this result would be for the Commission to amend Rule 502(c) by removing the prohibition on general solicitation and advertising for offerings by hedge funds that rely on either Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act of 1940. Under this approach, hedge funds would still face the same limitations on offers and sales of their securities (i.e., only to sophisticated investors). Alternatively, the SEC could amend Rule 502(c) by clarifying what types of information could be communicated publicly without being deemed a general solicitation or general advertising with respect to a hedge fund offering.[2]

We believe that amending the private offering rules in either of the manners described above would promote the transparency of the hedge fund industry, without raising investor protection concerns. The SEC and its staff have acknowledged such a flexible approach in two instances with respect to 3(c)(7) funds. First, in its 1992 report "*Protecting Investors: A Half Century of Investment Company Regulation*," the Division of Investment Management's recommendation to Congress regarding the addition of Section 3(c)(7) to the Investment Company Act did not include a prohibition on 3(c)(7) funds engaging in public offerings. Second, in its September 2003 report entitled "*Implications of the Growth of Hedge Funds, Staff*

[2] We note that either of these approaches may also require rulemaking under Section 203(b)(3) under the Investment Advisers Act of 1940 to clarify that hedge fund managers can provide this type of information without being deemed to be holding themselves out to the public as an investment adviser.

Report to the United States Securities and Exchange Commission," the staff recommended that the Commission consider eliminating the general solicitation prohibition for 3(c)(7) funds, noting that eliminating the restriction for these funds did not seem to raise investor protection concerns. Although the staff has recognized the lack of investor protection concerns with respect to 3(c)(7) funds, we believe that an increase in the accredited investor threshold (discussed below) would alleviate investor protection concerns with respect to 3(c)(1) funds as well.

As mentioned above, we believe that the increased transparency either of these approaches would permit would be of great benefit to hedge fund investors, regulators, policy makers and the U.S. capital markets. Regulators, policy makers and other market participants would be better able to identify misinformation and misperceptions about the industry if they had greater access to information from industry participants. One specific benefit of increased transparency would be that more information (and more reliable information) about the industry would be publicly available to regulators, policy makers and others as they consider market stability and systemic risk issues.

B. Advisers Act restrictions on marketing materials

MFA requests that the Commission engage in rulemaking under the Investment Advisers Act of 1940 to allow hedge fund managers greater flexibility in the type of information that they can provide to existing or potential investors in advertising materials. We believe a more flexible approach would permit greater transparency from hedge fund managers to investors and potential investors. Since a hedge fund manager's advertisements are provided only to sophisticated investors, the Commission's investor protection concerns with respect to advertising materials of investment advisers are minimized. We recognize that advertisements of all investment advisers (whether registered or not), including hedge fund managers, are subject to Section 206 of the Advisers Act and the rules thereunder, which prohibit managers from distributing advertisements that contain any untrue statement of material fact or are otherwise false or misleading.

In addition to the general prohibitions under Section 206 of the Advisers Act and the rules thereunder, advertising materials of investment advisers are subject to a number of specific limitations or prohibitions. SEC and staff guidance under Rule 206(4)-1 under the Advisers Act, for example, places limitations on the ability of hedge fund managers (along with other investment advisers) to discuss past specific investment decisions made by the manager.[3] Moreover, advertisements that contain performance information must follow specific guidance set forth in the *Clover Capital* no-action letter.[4] We note that the types of information discussed in the staff guidance is information that potential investors in hedge funds frequently desire to have, but, consistent with staff guidance, managers often provide only upon unsolicited request by a potential investor.[5]

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[3] See Franklin Mgmt., Inc., SEC No-Action Letter, 1998 WL 853257 (pub. avail. Dec. 10, 1998).

[4] See Clover Capital Mgmt., Inc., SEC No-Action Letter, 1986 WL 67379 (pub. avail. Oct. 28, 1986).

[5] See Investment Counsel Association of America, Inc., SEC No-Action Letter, 2004 WL 892243 (pub. avail. Mar. 1, 2004).

In light of the sophisticated nature of hedge fund investors, we recommend that the Commission adopt a rule under the Advisers Act to permit hedge fund managers to send advertising materials to investors or prospective investors without being required to comply with the specific limitations set out in SEC and staff guidance applicable to advertising material of investment advisers generally. Advertising materials of hedge fund managers would still, of course, be subject to the general antifraud provisions of the Advisers Act. This approach would balance investor protection concerns with increased transparency to investors and prospective investors.

Issuance of Final Rules regarding Accredited Investors

MFA urges the Commission to finalize its proposed rules that would amend the definition of "accredited investor." In December 2006, the Commission proposed a new accredited investor category, "accredited natural person," that would apply solely to private offerings made by certain 3(c)(1) funds in reliance on Rule 506 of Regulation D (the "December 2006 Proposal").[6] In August 2007, the SEC issued a second rule proposal that would revise Regulation D by, among other things, amending the accredited investor definition, as well as adding a new category of investor called the "large accredited investor"(the "August 2007 Proposal").[7] In the August 2007 Proposal, the Commission indicated that it was soliciting further comment on the proposed definition of accredited natural person, and that it may act on the December 2006 and August 2007 Proposals concurrently.

MFA submitted comments on both proposals[8] as each would have a significant impact on hedge funds. Among other comments, we recommended that instead of creating new categories of accredited investors, which could be confusing (particularly in light of the multitude of accreditation standards in the federal securities laws), the SEC should adopt a more simplified approach. This approach would be to adjust the income and net worth thresholds in Regulation D to account for inflation since the thresholds were adopted in 1982, with respect to offerings of 3(c)(1) funds. As noted in the August 2007 Proposal, this approach would raise the net worth threshold from $1 million to approximately $1.9 million and would raise the individual and joint income thresholds from $200,000 and $300,000 to approximately $388,000 and $582,000, respectively. We believe this approach would provide greater clarity than adopting the multiple categories proposed, while addressing the Commission's investor protection concerns.

Implementation of Mutual Recognition

MFA strongly supports the Commission's initiatives on mutual recognition of comparable foreign regulatory regimes and urges the Commission to work expeditiously with

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[6] Securities Release No. 8766 (Jan. 4, 2006), 72 Fed. Reg. 400.

[7] Securities Release No. 33-8828 (Aug. 10, 2007), 72 Fed. Reg. 45116.

[8] See Letter from John Gaine, MFA President, to Nancy M. Morris, SEC (Mar. 9, 2007) (available at http://www.sec.gov/comments/s7-25-06/s72506-567.pdf); Letter from John Gaine, MFA President, to Nancy M. Morris, SEC (Oct. 19, 2007) (available at http://www.sec.gov/comments/s7-18-07/s71807-56.pdf).

foreign regulatory counterparts to increase efficiencies and reduce regulatory barriers between high-quality markets. The regulatory overlap between U.S. and foreign capital markets impedes cross-border investment, increases costs for U.S. investors and raises regulatory burdens for market participants without additional meaningful investor protections. We believe that mutual recognition will benefit U.S. investors by lowering transaction costs, improving access to global capital markets, broadening available investment choices, enhancing transparency, and heightening competition for their order flow. Mutual recognition will also benefit U.S. financial services businesses, as the reciprocal recognition by foreign regulators will lessen regulatory compliance costs and increase the competitiveness of U.S. businesses around the globe.

We applaud the Commission's mutual recognition talks with Australia, and we urge the Commission to begin similar engagements with our European and Canadian regulatory counterparts as soon as practicable. Finally, in considering a mutual recognition framework, we note that some classes of sophisticated investors and eligible broker-dealers are already active internationally and recommend the Commission consider an expedited timeframe for issues that affect these market participants. We would be happy to provide further recommendations for a mutual recognition framework for you and your staff's consideration.

SEC-Alternative Investment Industry Communications

MFA is committed to serving as a resource to the Commission and its staff with respect to the alternative investment industry. MFA welcomes the opportunity to continue its active dialogue with the Commission and its staff, particularly with respect to industry best practice issues and initiatives, including MFA's *Sound Practices for Hedge Fund Managers*. We understand that the SEC regularly evaluates the manner in which information is communicated and disseminated to regulated entities on a variety of issues. We appreciate the significant efforts made by the staff to engage in mutually constructive dialogue with MFA and its members as part of a shared effort to improve communications between the agency and the alternative investment industry. We particularly want to note and thank the SEC staff for recent meetings with MFA, including those on December 11, 2007 (meeting with NYRO OCIE staff) and April 8, 2008 (MFA – SEC Dialogue in New York). We believe that these meetings yielded positive results, and we look forward to the expansion of our cooperative activities. To that end, we offer several suggestions for outreach by the SEC, which we believe can help further the dialogue between the SEC and the alternative investment industry: (1) continue to engage actively in discussions with MFA and other trade associations to discuss industry-wide issues; (2) hold chief compliance officer seminars and roundtables tailored to the hedge fund industry; and (3) engage in ongoing discussions with a core group of advisers to discuss SEC priorities and areas of concern or interest, as well as areas of concern or interest to industry participants. If there are other ways in which MFA can be of assistance in furthering open dialogue between the SEC and the alternative investment industry, please do not hesitate to contact us.

Improved Regulation of Public Commodity Pools

MFA urges the SEC to continue its work with the Commodity Futures Trading Commission under the framework of the agencies' recently signed Memorandum of Understanding to reduce overlapping regulation and improve the public offering disclosure

requirements of public commodity pools. Public commodity pools are regulated by the SEC, CFTC, National Futures Association, the Financial Industry Regulatory Authority and the states. The start-up and ongoing costs of complying with the various regulatory regimes have placed significant burdens on public commodity pools, especially as additional layers of regulation are added from time to time by each regime (i.e., Section 404 of Sarbanes-Oxley). As a consequence, the number of public commodity pool offerings continues to decrease and investors find that they have fewer opportunities to diversify their investment portfolio through exposure to the futures market via a pooled investment vehicle.

By working with the CFTC to reduce overlapping regulation and improve public offering disclosure requirements for public commodity pools, we believe that the regulatory agencies will reduce unnecessary regulatory burdens for public commodity pools without sacrificing investor protection, provide investors with more meaningful disclosures and greater investment options, and improve the overall competitiveness of the U.S. futures markets.

Impact of FINRA Rule 2810 on Public Commodity Pools

MFA requests that the Commission urge FINRA to amend Rule 2810, Direct Participation Programs ("DPP"), by implementing an annual cap on trail commissions in place of a lifetime cap on offering proceeds (which FINRA interprets as including trail commissions). Rule 2810 places a lifetime cap on the underwriting compensation from a DPP, which includes public commodity pools. In 2004, FINRA changed its interpretation of "offering proceeds" to include trail commissions in the calculation of the lifetime 10% cap on fees from offering proceeds. We are concerned that FINRA's new interpretation of Rule 2810 is severely affecting the public managed futures industry and the overall competitiveness of the U.S. futures markets.

Commodity pools (also known as managed futures funds) are complex derivative products that are not tied to the direction of securities markets as are securities and securities-based products. In order for brokers to adequately educate and continually advise and inform their clients regarding the performance and continued suitability of these products, a high degree of ongoing customer service is necessary. Brokers are entitled to receive reasonable compensation for these ongoing services, and cannot reasonably be expected to continue providing services free of charge. A lifetime cap on fees that includes trail commissions is likely to cause brokers to cease offering public commodity pool products to their customers as they would be required to provide ongoing services in the future with respect to those products, without being entitled to receive compensation for those services (once the lifetime cap is met). We are concerned that this is the likely result of FINRA's 2004 reinterpretation of the term "offering proceeds" to include trail commissions, which, in turn, will severely limit the sale and viability of public commodity pools as an alternative investment product and asset class for retail investors. Our initial data shows that the average number of registrations for new offerings and offerings of additional units has decreased by almost 50% since 2004. We urge the Commission to request that FINRA reconsider its position on Rule 2810.

Conclusion

MFA appreciates the opportunity to present these issues and suggestions for your consideration. We hope to continue to serve as a resource for the Commission and its staff as it considers initiatives that affect the alternative investment industry.

Please do not hesitate to contact me with any questions, or if MFA can be service to you, the Commission, or its staff. I can be reached at (202) 367-1140.

Respectfully submitted,

Richard H. Baker
President and Chief Executive Officer