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November 21, 2007

Karen Fong
Office of Legislation and Policy
Department of Corporations
1515 K Street, Suite 200
Sacramento, California 95814-4052

Re: Proposed Revisions to Regulations Under the California Corporate Securities Law Relating to the Registration of Investment Advisers

Dear Ms. Fong:

The Coalition of Private Investment Companies ("CPIC") [1] and Managed Funds Association[2] ("MFA" and, together with CPIC, the "Associations") appreciate the opportunity to comment on the proposal by the Commissioner of the California Department of Corporations ("the Department") to amend § 260.204.9 of the California Code of Regulations ("C.C.R."),[3] which presently provides certain investment advisers with an exemption from registration with the State of California ("California" or the "State").

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[1] CPIC is a membership organization of 20 private investment companies and other associate members with more than $70 billion under management. Its members are diverse in size and in the investment strategies they pursue. CPIC was established in 2006 as a means for fund managers to engage with policy-makers, the media and the public on a proactive basis in the context of the private investment fund industry's growing significance to the United States and world economies.

[2] MFA has served for many years as a voice for the global alternative investment industry. Its members include professionals in hedge funds, funds of funds and managed futures funds. Established in 1991, MFA is a significant source of information for policymakers and the media and a leading advocate for sound business practices and industry growth. MFA's members include the majority of the largest hedge fund groups in the world who manage a substantial portion of the almost $2 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York. More information about MFA is available on its website at www.managedfunds.org.

[3] 10 C.C.R. § 260.204.9.

Many of the Associations' members have been engaged in the fund management business for several decades. Collectively, our members have investors that reside in each of the states, and a number of our members maintain small offices or places of business in California. We are well aware that the growth of our industry has attracted attention. As managers of private investment companies, or "hedge funds," our members share the Department's concerns with respect to investor protection. Nonetheless, as set forth below, we urge the Department to withdraw, or otherwise defer action on, the proposal.

Executive Summary.

The California investment adviser registration rules currently contain the same exemption for private investment fund managers that is found in the Securities and Exchange Commission's ("SEC") rules and the Investment Advisers Act of 1940 ("Advisers Act"). The proposed rule change would amend this exemption to require registration of hedge fund managers and other investment advisers that have a place of business in California. The proposal is similar to the SEC's now-abandoned 2004 rule changes that briefly imposed investment adviser registration requirements on hedge fund managers.[4] While the proposal notes that the SEC's 2004 rule changes were struck down by a federal court, it fails to note that rather than seek an appeal, the SEC chose to allow hedge fund managers to de-register, and pursued other initiatives to address issues that involve hedge funds. These and other federal initiatives address policy issues regarding hedge funds in a different and more targeted manner than the California registration proposal. In fact, the California proposal would put the state at odds with the current federal approach to hedge funds, and conflict with the policy choices made by Congress in 1996 when it adopted amendments to the Advisers Act as part of the National Securities Markets Improvement Act ("NSMIA"), which generally seeks to focus state regulatory efforts on smaller investment advisers. This is a particularly unfortunate issue on which to be out of alignment with the federal approach, as it creates a significant incentive for private fund managers simply to close their California offices and move them permanently to another state because of the compliance costs associated with registration in the State. In addition, it will stifle the growth of the alternative investment industry in California as new and growing advisers would forego opening offices in the State. The proposal makes no attempt to quantify the economic impact upon the State in terms of lost jobs, office rents, support services, and tax revenues that would follow from the movement of hedge fund managers' offices out of California. The closure or relocation of the California offices of private fund managers would have a ripple effect throughout the financial services industry in the State. Moreover, since the proposal relies upon the location of the adviser's place of business as the basis for regulation, or the residency of the adviser's clients,[5] and not the residency of fund investors, we question whether it would serve a significant California investor protection purpose.

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[4] *Registration Under the Advisers Act of Certain Hedge Fund Advisers*, Rel. No. IA-2333 (Dec. 2, 2004) 69 F.R. 72054 (Dec. 10, 2004).

[5] Rule 222-2 under the Advisers Act states that, for purposes of determining the number of clients an adviser has with respect to the de minimis standard set out in the Advisers Act, Rule 203(b)(3)-1 under the Act applies, without giving regard to paragraph (b)(6) of § 203 of the Act. Under § 203, the fund, and not its investors, would be the adviser's client.

The Current California and Federal Exemptions from Registration.

Under § 25230 of California's Corporate Securities Law of 1968 ("CSL"), investment advisers[6] must register as such with the State unless they are otherwise exempt from registration. CSL § 25202 provides that an adviser is not subject to registration if the adviser does not have a place of business in California and had fewer than six clients who were California residents in the preceding 12-month period. In addition, C.C.R. § 260.204.9 currently provides an exemption from state registration for any investment adviser that

(1) does not hold itself out to the public as an investment adviser;
(2) has fewer than 15 clients;
(3) is exempt from registration under § 203(b)(3) of the Advisers Act and
(4) either:
    (i) has assets under management … of not less than $25,000,000 or
    (ii) only advises venture capital companies (as defined in the rule).

On the federal level, the Investment Advisers Supervision Coordination Act ("Advisers Coordination Act"), which was enacted as part of NSMIA, allocated the regulation of smaller investment advisers, in general, to the states, while the regulation of larger advisers was left to the SEC. Pursuant to that Act, the states may not require registration of persons that are registered as investment advisers with the SEC or who are not registered with the SEC because they are excepted from the definition of an "investment adviser."[7] On the other hand, investment advisers with less than $25 million under management are not generally permitted to register with the SEC if they are regulated or required to be regulated by the state in which they maintain their principal office and place of business.[8] A distinction based on a dollar threshold makes sense, as advisers with relatively small amounts of assets under management are not likely to influence national markets and are less likely to have offices or clients in multiple states. Thus, it is appropriate for these smaller advisers to have state regulators as their primary regulators. With respect to advisers who have relatively large amounts of assets under management and therefore are more likely to have an ability to influence national markets or have offices or clients in multiple states, the level and scope of regulation should be determined at the Federal level.

Section 203(b)(3) of the Advisers Act provides an exemption from registration with the SEC for investment advisers that have had fewer than 15 clients in the preceding 12-month period and who do not hold themselves out to the public as investment advisers or act as advisers to registered investment companies. These limitations reflect an investor protection/public interest determination that advisers with a limited number of clients should not be subject to registration requirements. Moreover, funds advised by such "private advisers" may offer their

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[6] § 25009 of the CSL defines an "investment adviser," in relevant part, as "any person who, for compensation, engages in the business of advising others... as to the advisability of investing in, purchasing or selling securities... ."

[7] Advisers Act § 203A(b).

[8] Advisers Act § 203A(a)(1). The general prohibition does not apply to certain investment advisers with less than $25 million under management, such as advisers to registered investment companies, pension fund advisers, and advisers subject to registration in 30 or more states (Advisers Act § 203A(a)(1); Advisers Act Rule 203A-2; 17 C.F.R. § 275.203A-2).

securities only through private offerings, generally pursuant to Regulation D under the Securities Act of 1933,[9] which limits such offerings to accredited investors. Current C.C.R. § 260.204.9, therefore, is consistent with Federal law and its underlying policy by, similarly, providing an exemption for advisers who have fewer than 15 clients and do not hold themselves out to the public as investment advisers -- and who have not less than $25 million under management, the asset amount determined to mark the appropriate federal and state general areas of concern under the Advisers Coordination Act. Consistent with this federal/state policy, the current regulation acknowledges that the fact that such advisers are exempt from federal registration should not be a basis for state regulation.

The Proposed Revisions.

The Department proposes to revise C.C.R. § 260.204.9 so that only advisers to venture capital companies, as defined in the Rule, would be exempt from state registration. Thus, even advisers that are exempt from registration with the SEC under § 203(b)(3) of the Advisers Act and with assets under management of greater than $25 million would be required to register in California if they have either a place of business in California or six or more clients who reside in the State. According to the *Initial Statement Of Reasons* for the proposed rule change ("*Initial Statement"*),[10] "the [current] rule exempted advisers with assets under management of not less than $25 million in recognition of the split in jurisdiction between the [SEC] and the states, and deference to the federal policy behind the registration exemption in Section 203(a)(3) of the Advisers Act."[11] Thus, the Department has itself recognized the policy of the Advisers Coordination Act that advisers with greater than $25 million in assets under management should not be subject to state registration requirements.

Notwithstanding this recognition, the proposal would require such advisers to register with California, based on a 2003 report by the staff of the SEC, entitled *Implications of the Growth of Hedge Funds* (the "2003 Staff Report").[12] The *Initial Statement* provides that the proposed amendments are intended to respond to three "industry trends [that] support the need for greater oversight" that the SEC identified in 2004 when it amended its rules for a brief period to require advisers to certain funds to register with the SEC. Specifically, the *Initial Statement* indicates that the proposal is meant to address the growth of the hedge fund industry, an increase in the number of enforcement cases involving fraud by fund advisers, and increased investment in privately-offered pooled investment vehicles by market participants such as pension funds, individuals and by other investors through "funds of funds."[13] The *Initial Statement* fails to

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[9] 17 C.F.R. §§ 230.501 to 230.508.

[10] *Initial Statement Of Reasons For The Amendments Of Rule Changes Under The Corporate Securities Law Of 1968*, Document 41/06 C (available at http://www.corp.ca.gov/pol/rm/4106c.pdf).

[11] *Initial Statement* at 1.

[12] *Initial Statement* at 4, citing *Implications of the Growth of Hedge Funds, Staff Report to the United States Securities and Exchange Commission* (Sep. 29, 2003) (available at http://www.sec.gov/news/studies/hedgefunds0903.pdf).

[13] *Initial Statement* at 2-3, citing *Registration Under the Advisers Act of Certain Hedge Fund Advisers*, Rel. No. IA-2333 (Dec. 2, 2004) 69 F.R. 72054 (Dec. 10, 2004).

address, however, why the federal policy behind the $25 million threshold should be ignored, as it would have to be for the rule to be adopted as proposed.

While the Associations profoundly respect the work of the SEC staff in creating their report in 2003, we would note that the report itself is more than four years old and the information gathered for the report is more than five years old. We also note that the SEC has since taken its efforts in a different direction. Regrettably, there is no evidence in the *Initial Statement* that the Department undertook any effort to obtain for itself current information about practices and procedures of hedge funds located in the state. Nor does the *Initial Statement* discuss any evidence of a heightened incidence of fraud or other misbehavior on the part of advisers to private investment companies that would warrant additional government regulation. Further, the *Initial Statement* does not report whether the Department obtained information from California investors in private investment companies about their due diligence and investment monitoring processes and procedures.

The Proposed Rule Does Not Recognize The Types of Investors in Funds Advised by Managers Exempted Under Section 203(b)(3) of the Advisers Act.

As should be expected, the primary concern of the Department appears to be the protection of investors. However, the proposed rule change will not provide additional protection to investors. Rather, the removal of the current exemption for large advisers would divert regulatory resources from the protection of small investors and into an area that federal law and policy have determined does not need the type of safeguards required for small investors.

Hedge funds, in general, may accept only "accredited investors"[14] or "qualified purchasers"[15] -- persons and entities of such wealth and investment experience that they are presumed to be able to comprehend and withstand investment risks, to hire competent independent advisers and to perform appropriate "due diligence." Yet, as proposed, the registration rules under the CSL do not differentiate between advisers to retail investors and advisers to pools that are limited to accredited investors or qualified purchasers. In this vein, the Department should consider whether it has the resources and personnel to process registration applications and conduct examinations and inspections of a new class of registrants in addition to those that it already handles.

The Department has noted that retail investors may be exposed to hedge funds through participation in vehicles such as pension funds that may hold investments in hedge funds. However, the President's Working Group on Financial Markets -- a group which includes the heads of the U.S. Department of the Treasury, the Board of Governors of the Federal Reserve System, the Commodity Futures Trading Commission, and the SEC -- has found that investors such as participants in pension plans are protected by professional asset managers that are held to fiduciary standards, and that concerns with respect to such indirect exposure are "best …

[14] SEC Regulation D Rule 501(a); 17 C.F.R. § 230.501(a).

[15] Section 2(a)(51) of the Investment Company Act of 1940; 15 U.S.C. §§ 80a-2(a)(51).

addressed through sound practices on the part of the fiduciaries that manage such vehicles."[16] Most institutional investors engage in extensive due diligence practices and ongoing monitoring activities that far exceed the standard disclosure requirements contemplated by the proposed rule change.[17] The Department has provided no evidence that those due diligence practices employed by sophisticated investors are in any way deficient, let alone so lacking across the board as to require government intervention into the private contractual relationships among investors, funds and their advisers. In sum, if the proposal is adopted, the Department will be required to assign staff, time and resources to monitor advisers that cater to sophisticated investors who are demonstrably more than capable of defending their own interests, and take those resources away from protecting those investors who cannot be presumed to have the financial wherewithal or sophistication to protect themselves from fraudulent tactics or unscrupulous hucksters.

The Proposal Relies On The Physical Location Of An Adviser's Office Or The Residency Of Funds As The Basis For Regulation, And Not Upon Residency Of Investors.

The proposal would result in a wide range of unnecessary, and presumably unintended, consequences. For instance, under the revised rule, a large adviser with headquarters in New York or London and investors around the globe could be required to register in California if it maintained a one-person office in San Francisco for servicing a few institutional investors. Federal and California law treat the fund as the client of the adviser for the purposes of "counting" the adviser's number of clients. Consequently, the proposal does not provide its suggested investor protections to California *investors* but only creates a regulatory burden on those *advisers* who have a place of business in the State. Many hedge fund managers choose to locate in California for essentially discretionary reasons. It is logical to believe that many of those advisers with adjunct offices in the State will simply relocate those offices to states with regulatory regimes that more accurately match risks and regulation, or will simply close those offices altogether. In either event, the State may experience a significant decline in these desirable jobs.[18]

The Proposal Makes Unwarranted Distinctions Between Investment Strategies of Exempt Advisers.

Under the proposed rule change, an adviser to a venture capital fund composed exclusively of California investors would remain unregistered -- and unexamined. If the Department is concerned with the protection of investors, we see no reason why registration

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[16] *Agreement Among PWG And U.S. Agency Principals On Principles And Guidelines Regarding Private Pools Of Capital*, at 2 (Feb. 22, 2007) (available at http://www.treasury.gov/press/releases/reports/hp272_principles.pdf).

[17] See, for example, the due diligence and monitoring regime employed by the California Public Employees Retirement System at http://www.calpers.ca.gov/eip-docs/investments/policies/alternative/altern-invest-man-prog.pdf.

[18] In addition to unintended consequences, we note that the proposed rule does not include any references to a potential transition period (in contrast, the SEC, in its abandoned 2004 registration rule, provided for a transition period of over two years to allow advisers to plan and take appropriate action. See 69 F.R. at 72077). Nor does the proposal refer to or consider mutual recognition of registration with other U.S. federal and state regulatory authorities and comparable foreign jurisdictions.

should be required for advisers to privately-offered investment funds while an exception is maintained for advisers to venture capital funds.

Indeed, no credible case can be made that a venture capital fund is any less risky or difficult for an investor to analyze than a fund that invests in financial products. On the contrary, venture capital funds are frequently non-diversified companies that feature a high degree of risk. Moreover, due to the requirements of funding "start-up" companies, venture capital funds often impose substantial liquidation restrictions such that investments are "locked up" for a significant term of years, or until the fund's investments mature. Venture funds may even require investors to meet calls for additional capital contributions. In contrast, hedge funds generally allow redemptions on a yearly, semi-annual or quarterly basis, and do not require investors to meet capital calls. Accordingly, we believe that, at a minimum, the Department should not move forward with its proposal unless it can point to information that supports the imposition of a more burdensome regulatory system on one type of fund and not another.

As noted above, if this rule change is adopted, advisers to privately-offered investment funds may elect to close their California offices and transfer their operations to another state. Pursuant to § 203A and § 222(d) of the Advisers Act, such advisers would remain free to solicit and accept investments from any number of California investors without being required to register with the State. The *Initial Statement* notes that requiring venture capital companies to register would be "unduly burdensome, and may cause some such companies to relocate out-of-state in order to avail themselves of the licensing exemption … for advisers with no place of business in California and fewer than 6 clients [who are residents of California]."[19] There is no reason to believe that adopting the rule proposal would have a different effect with respect to hedge fund managers. It is therefore difficult to see how imposing this registration requirement would assist the Department in meeting its goal of protecting California investors.

The Proposal Does Not Consider Current Regulatory Developments and Reasonable Alternatives.

The *Initial Statement,* relying upon a four-year-old SEC staff study, fails to recognize significant developments since 2004. California's Government Code requires the Department to determine that no reasonable alternative that it considered or that was brought to its attention "would be more effective in carrying out the purpose for which the action is proposed or would be as effective and less burdensome to affected private persons than the proposed action."[20] Nonetheless, in formulating this proposal, the Department has not considered the following regulatory developments, which would address many, if not all, of its stated concerns:

- The SEC Has Adopted a Rule that Expressly Prohibits Fraud by Investment Advisers Against Investors in Pooled Investment Vehicles.

The *Initial Statement* indicates that the proposal is, in part, a response to the SEC's statement in 2004 that it perceived "a growing number" of enforcement cases where hedge fund

[19] *Initial Statement* at 1.

[20] Cal. Gov. Code § 11346.5 (a)(13).

advisers defrauded hedge fund investors.[21] This statement was itself challenged by two SEC Commissioners, who noted that the 2003 Staff Report stated that fraud was not rampant or relatively disproportionate in the hedge fund industry.[22] In any case, the Department has not considered the SEC's recent adoption of Rule 206(4)-8 under the Advisers Act.[23] This new Rule specifically prohibits investment advisers (regardless of whether they are registered under the Advisers Act) from (i) making false or misleading statements to investors or prospective investors in hedge funds and other pooled investment vehicles that they advise, or (ii) otherwise defrauding such investors. The Rule also makes clear that an adviser's duty to refrain from fraudulent conduct extends to the relationship with ultimate investors and not merely to the client fund managed. Finally, it establishes that the SEC may bring enforcement actions against investment advisers who defraud investors or prospective investors in such pooled investment vehicles.[24]

- The SEC Has Announced Proposed Revisions to the Accredited Investor Standard.

In January 2007, the SEC announced proposed changes to the definition of "accredited investor" in Regulation D[25] as applied to natural persons for purposes of private offerings of investments in pooled investment vehicles.[26] The proposed changes would raise the income and net worth requirements for investment in privately-offered investment pools in order to adjust for inflation and an increase in real estate values since the accredited investor definition was last revised.[27] The adoption of higher minimum eligibility requirements for investment in hedge funds is designed to address investor protection concerns (essentially investor sophistication and ability to bear the risks of a private offering) and should alleviate some of the Department's concerns in this area. This SEC proposal has received over 600 comments, and the SEC is giving them careful review. Yet, the Department has apparently overlooked this SEC proposal. We urge the Department to consider whether its proposal would be necessary if the SEC raised the necessary qualifications for investors in private placements of hedge funds, as it has proposed to do.

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[21] *Initial Statement* at 2, citing *Registration Under the Advisers Act of Certain Hedge Fund Advisers*, Rel. No. IA-2333 (Dec. 2, 2004) 69 F.R. 72054, 72055-72057 (Dec. 10, 2004).

[22] *Registration Under the Advisers Act of Certain Hedge Fund Advisers, Dissent of Commissioners Cynthia A Glassman and Paul S. Atkins*, Rel. No. IA-2333 (Dec. 2, 2004) 69 F.R. 72054, 72089 (Dec. 10, 2004).

[23] *Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles*, SEC Rel. No. IA-2628 (Aug. 3, 2007) 72 FR 44756 (Aug. 9, 2007).

[24] See 72 FR at 44757.

[25] 17 C.F.R. § 230.501 to 230.508.

[26] *Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles*; SEC Rel. No. 33-8766 (Dec. 27, 2006) 72 FR 400 (Jan. 4, 2007).

[27] 72 FR at 400, 404. While the *Initial Statement* states that "[t]he minimum investment requirements of these funds have decreased over time" (*Initial Statement* at 3), it appears that this may refer to minimum investment sizes that will be accepted by fund managers. In any event, the minimum eligibility standards set by federal regulations for investment in private offerings have not been reduced.

- The SEC Has Proposed to Enhance Form D to Gather Better Quality Data Regarding Private Offerings, Including Privately-Offered Pooled Investment Vehicles.

In July 2007, the SEC announced a proposal to implement an electronic filing requirement for Form D and to improve the Form as a source of information about private offerings for regulators and investors.[28] Form D is filed with the SEC and regulators in any state, including California, where interests in a private offering are sold. The Form provides notice to the state of the essential characteristics of the issuer, such as the identities of its management personnel, contact information, the nature of its business (including whether it is a pooled investment vehicle and the exemptions under the Investment Company Act of 1940 upon which it relies), as well as information regarding the expected use of the proceeds from the subject offering. Some segments of the hedge fund industry, including CPIC, have called upon the SEC to go even further in collecting important data from investment vehicles using Form D for their offerings.[29]

The Department has not considered the effect that enhancements to Form D could have on its regulatory program with respect to hedge funds. Of course, the State wishes to know when and how private offerings are being marketed to its residents. We suggest that the Department review its proposal in order to determine whether the SEC's proposed revisions to Form D could meet the State's informational requirements in this area, without requiring registration of otherwise exempt advisers.

- The President's Working Group on Financial Markets Has Created a Hedge Fund Advisory Group To Formulate Guidelines for Hedge Fund Practices.

In September 2007, the President's Working Group on Financial Markets formed an advisory group with the goal of formulating voluntary guidelines for hedge fund managers that would address such matters as systemic risk and investor protection. Investor representatives, including the Chief Investment Officer for the California Public Employees' Retirement System (CalPERS), are members of the advisory group.[30] In fact, the Chief Investment Officer of CalPERS serves as the chairperson of the Investor's Committee of the Advisory Group. We submit that the Department should permit the President's Working Group to complete its task before it considers revising the present exemption from registration.

- Principles Announced by the President's Working Group on Financial Markets Have Led to Enhanced Industry Standards.

As mentioned above, earlier this year, the President's Working Group on Financial Markets announced an *Agreement Among PWG And U.S. Agency Principals On Principles And Guidelines Regarding Private Pools Of Capital*, which outlined guidelines for sound fund

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[28] *Electronic Filing and Simplification of Form D*, SEC Rel. No. 33-88143 (Jun. 29, 2007) 72 FR 3736 (July 9, 2007).

[29] *See* Letter from James Chanos to Nancy M. Morris, SEC (Sep. 7, 2007) (available at http://www.sec.gov/comments/s7-12-07/s71207-12.pdf).

[30] *See* Press Release, Dep't of Treasury, *PWG Announces Private Sector Groups to Address Market Issues for Private Pools of Capital* (Sep. 25, 2007) (available at http://www.treas.gov/press/releases/hp575.htm).

management and oversight without increased regulation.[31] Following this announcement, in November, MFA revised its *Sound Practices for Hedge Fund Managers*, which embodies a set of recommendations for sound practices for managers of privately-offered pooled investment vehicles. The latest edition of this periodically updated volume includes sections addressing such matters as valuation, business continuity and risk management. In addition, MFA has supplemented its 2007 *Sound Practices* with a model due diligence questionnaire designed for use with all types of investors, including individuals and pension funds.[32]

Costs of Eliminating the Existing Exemption from Registration.

Finally, the Department should consider the impact of its proposal, if adopted, in driving advisers with places of business in California to simply leave the State and driving new and growing advisers to forego opening places of business in the State. The *Initial Statement* makes several sweeping declarations that the proposed rule change would have no costs for any state agency, would have no significant statewide adverse economic impact directly affecting businesses, would not impede the ability of California businesses to compete with businesses in other states, and would not significantly affect the creation, growth or elimination of jobs or businesses in the State.[33] The Department has not provided any justification (empirical evidence or otherwise) for these assertions, particularly in light of its determination that registration would be burdensome for venture capital companies.

We believe, however, that such costs would be considerable for fund managers and for the State. Certainly, the Department must anticipate that it will have to devote resources and staff hours to reviewing applications for a new type of registrant, training personnel with respect to hedge fund advisers' businesses, and conducting examinations. Of course, the proposal could result in no direct cost to the State at all, if hedge fund managers choose to relocate their places of business. If the proposal is adopted, an adviser to a privately-offered pooled investment vehicle will be required to register with the Department, register with the SEC, or relocate to another state. Registration, of course, entails significant costs, especially when compared to the costs of relocation to a state with less burdensome regulation.[34]

Rather than register with the State and be burdened with the corresponding compliance costs, advisers may therefore choose to move to another location (for the same reason, other fund advisers may elect to forego establishing places of business in California), which may have a chilling effect on the ability of California businesses to compete with businesses in other states. Ensuring the role of California as a center for the financial services industry is an important

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[31] *Agreement Among PWG And U.S. Agency Principals On Principles And Guidelines Regarding Private Pools Of Capital*, at 2 (Feb. 22, 2007) (available at http://www.treasury.gov/press/releases/reports/hp272_principles.pdf).

[32] *See MFA Issues Updated "Sound Practices" That Seek to Harness Investor Influence,* The Bureau of National Affairs, No. 214 at A-14 (Nov. 6, 2007); *Sound Practices for Hedge Fund Managers* (available at http://www.managedfunds.org/downloads/Sound%20Practices%202007.pdf).

[33] *Initial Statement* at 3.

[34] Such costs may include those associated with preparation of filings with regulators, maintenance of books and records, creation of compliance manuals and supervisory procedures, and continuing education. Fees for legal consultations with respect to registration requirements may be substantial. In addition, the time expended on registration matters can be significant.

policy objective. Hedge fund management is a sector of the financial services industry in which California has been successful in attracting and retaining firms and high-paying jobs. If implemented, these type of regulatory burdens, absent any empirical evidence for their need, create an impression of the State as having a hostile environment for firms participating in the nation's capital markets. The negative spillover effect upon other segments of the financial services industry should not be lightly discounted. For example, there are brokerage firms that maintain California offices specifically to support private fund business. Moreover, the relocation of a place of business may not only impose a burden on advisers; relocating any place of business means that office space will go vacant, office support workers will be less in demand, and office support services will no longer be needed. Finally, movement of professional personnel to another jurisdiction may even contribute to a reduced tax base for the State and local communities. We urge the Department to consider these costs, as it must, before proceeding further with respect to this proposal.

Conclusion.

We thank you for this opportunity to provide our thoughts with respect to this proposal. We urge the Department to carefully consider our suggestions, and we would be happy to discuss them at any time.

Sincerely,

James Chanos
Chairman
Coalition of Private Investment Companies

John G. Gaine
President
Managed Funds Association

cc: The Honorable Preston DuFauchard, Corporations Commissioner
Michael Santiago, Corporations Counsel