



MANAGED FUNDS ASSOCIATION

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Via Electronic Mail: pamela@iosco.org

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**RE: Consultation Report: Call for Views on Issues That Could be Addressed
by IOSCO on Funds of Hedge Funds (the “FOHF Report”)**

Ladies and Gentlemen:

Managed Funds Association (MFA) appreciates the opportunity to comment on the FOHF Report dated April 2007. We commend the effort of IOSCO’s Technical Committee to address the important investor protection issues raised in the FOHF Report.

We submit comments from the perspective of U.S. funds of hedge funds (“FOHF”) that are registered as investment companies with the U.S. Securities and Exchange Commission (“SEC”), and commodity pool operators (“CPOs”) that are registered with the Commodity Futures Trading Commission (“CFTC”) and operate FOHFs for which they did not claim any exemption from the reporting, disclosure and recordkeeping requirements that are generally applicable to commodity pools.

MFA Background

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 over \$1.5 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

MFA’s activities include several public and private sector initiatives affecting the hedge fund industry in the United States and internationally. With respect to the public sector in the United States, MFA undertakes educational outreach to and representation before the Securities and Exchange Commission, Commodity Futures Trading Commission, Federal Reserve, Treasury Department, state agencies and Congress. MFA participates in a number of private sector initiatives, as well. Most notably, MFA has

published *MFA's 2005 Sound Practices for Hedge Fund Managers* ("*MFA's 2005 Sound Practices*")¹ and is in the process of publishing an upcoming update thereto, *MFA's 2007 Sound Practices for Hedge Fund Managers* ("*MFA's 2007 Sound Practices*," and when herein referenced together with *MFA's 2005 Sound Practices*, "*MFA's Sound Practices*"). Moreover, MFA participates in other private sector efforts, such as working with the 18 major dealers in improving derivative market practices. As highlighted above, MFA also represents the views of the hedge fund industry before international advisory and governmental bodies such as IOSCO, the United Kingdom's Financial Services Authority, and the Securities Exchange Board of India.

U.S. Funds of Hedge Funds

IOSCO's FOHF Report focuses on issues with respect to FOHFs that issue shares to retail investors. With respect to the U.S. market, the FOHF Report refers to two types of entities: (1) CPOs that are registered with the CFTC and that operate privately offered FOHFs with respect to which the CPOs have not claimed any exemption from the reporting, disclosure and recordkeeping requirements that are applicable to registered CPOs; and (2) FOHFs registered with the SEC as investment companies under the Investment Company Act of 1940 ("Company Act"). The first type of funds and CPOs will be referred to herein, respectively, as "Full Part 4 Funds" and "Full Part 4 CPOs;" and the latter type of funds will be referred to herein as "Company Act FOHFs." Part 4 of the CFTC's regulations² contains the basic requirements applicable to CPOs.

The FOHF Report explains that the IOSCO Technical Committee Standing Committee on Investment Management's focus on FOHFs stems from "retail investors' increased investment in FOHFs" and that the IOSCO Report addresses and raises issues regarding *retail* investment in FOHFs. We do not believe that the suggestions in the IOSCO Report, if adopted, should be adopted with respect to Full Part 4 Funds and their CPOs, and Company Act FOHFs because, as explained in further detail below, (1) shares of these FOHFs are not sold to a retail market, and (2) U.S. FOHFs are already subject to a comprehensive regulatory regime.

Investors in Full Part 4 Funds are sophisticated. Full Part 4 Funds are privately offered pursuant to offering (disclosure) documents that contain CFTC-prescribed disclosure and are reviewed by the National Futures Association (NFA) for compliance. CFTC rules also contain specific reporting and recordkeeping requirements. NFA reviews CPO operations for compliance on a periodic basis. CFTC and NFA advertising rules provide further investor protection, as described below. Thus, most, if not all, of the

¹ See www.managedfunds.org.

² 17 C.F.R. § 4.1 *et seq.* (Part 4 - Commodity Pool Operators and Commodity Trading Advisors)



investor protection measures contemplated by the IOSCO Report already exist for investors in Full Part 4 Funds.

Company Act FOHFs are subject to the full panoply of regulatory and disclosure requirements in the Company Act. The Company Act and the rules thereunder set out detailed requirements on a registered fund's capital structure, ability to issue senior securities, its governing board and that board's review of management agreements, its reporting to shareholders, recordkeeping and its ability to engage in transactions with affiliated persons. In addition, advisers to Company Act FOHFs are required to be registered under the Investment Advisers Act of 1940, as amended (the "Advisers Act"). Advertising and sales literature prepared by broker-dealers with respect to Company Act FOHFs is required to be filed with and is reviewed by the Financial Industry Regulatory Authority (the product of the recent consolidation of the NASD and the member regulation, enforcement and arbitration functions of the New York Stock Exchange). Again, most, if not all, of the investor protection measures contemplated by the Report exist for investors in Company Act FOHFs.

Background

Investor Suitability; Manner of Offering

Retail investors do not purchase privately offered FOHFs. It is important to note that investors in privately offered Full Part 4 Funds are generally "accredited investors" as defined in Regulation D³ promulgated under the Securities Act of 1933, as amended (Securities Act).⁴ In order to avoid the registration requirements of the Securities Act with respect to the sale of their securities, Full Part 4 FOHFs, like most hedge funds offered in the United States, generally rely on the private offering exemption in Section 4(2)⁵ of the Securities Act and on the safe harbor contained in Regulation D. Section 4(2) exempts from registration securities sold without any "public offering." As a practical matter, this means that, unlike in an offering registered for sale to the public under the Securities Act, there can be no mass mailings about the fund, no meetings with prospective investors that have been solicited by a mass mailing, and no communication (electronic or otherwise) that could be viewed as a general solicitation or advertisement. As a result, investors in Full Part 4 FOHFs are generally not retail investors. Nor can substantial efforts be made to offer FOHFs to retail investors.

³ 17 C.F.R. § 230.501 *et seq.*

⁴ Some Full Part 4 Funds permit the sale of their securities in any offering to up to 35 non-accredited investors, provided that certain conditions are satisfied. Regulation D requires additional disclosure for offerings made to non-accredited investors.

⁵ 15 U.S.C.A. § 77d(2).



Company Act FOHFs are registered as closed-end investment companies which, unlike open-end investment companies (or “mutual funds”), are not required to provide daily liquidity to their investors. Company Act FOHFs limit the ability of shareholders to sell their interests, although some provide for periodic tender offers. Some Company Act FOHFs register their interests under the Securities Act but their offerings are not directed to the retail market. Those Company Act FOHFs generally require prospective investors to meet high net worth requirements or to be “accredited investors.” Company Act FOHFs that do not register their interests under the Securities Act generally require prospective investors to be “accredited investors” as well as “qualified clients” as defined in Rule 205-3 under the Advisers Act, which, as relevant here, means a natural person who has at least \$750,000 under management with the adviser or has a net worth of more than \$1.5 million. Furthermore, Company Act FOHFs generally impose initial investment requirements that exceed the minimums applicable to retail funds (ranging from \$50,000 to \$100,000, although some may be as low as \$25,000).

CFTC/NFA Oversight

CPOs are regulated by the CFTC and the National Futures Association (NFA) under the U.S. Commodity Exchange Act. Although the CPO rules have evolved, the fundamental obligations of CPOs have remained unchanged for more than 25 years. As described further below, the CFTC’s Part 4 rules govern in detail the content of CPO disclosure documents. Disclosure documents must be submitted to the NFA prior to use, and are reviewed by NFA staff for compliance with CFTC and NFA requirements. Disclosure documents may not be used if they are more than nine months old or become materially inaccurate. Updates to disclosure documents also must be filed with the NFA for review. Full Part 4 CPOs and their associated persons must be registered under the Commodity Exchange Act in those capacities, and are subject to fitness screenings and testing requirements administered by the NFA. CPOs are subject to recordkeeping requirements regarding their businesses and their pools and must prepare and distribute periodic and audited annual reports to investors. The annual reports also must be filed with the NFA. Finally, the NFA conducts periodic onsite compliance examinations of CPOs.

Company Act Registration

A FOHF that registers as an investment company under the Company Act subjects itself to the full panoply of the Company Act’s regulatory and disclosure requirements. The Company Act contains substantive restrictions on investment company operations in a number of areas, including the following:

- (a) If the Company Act FOHF is relying on any of several exemptive rules generally applicable to investment companies, a majority of its board members must be persons who are not “interested persons” of the Company Act FOHF or its investment adviser, as defined in Section 2(a)(19) of the Company Act; those rules also require that if the board has its own counsel, such counsel must be



independent; the board must perform an annual self-assessment; the independent board members must meet in executive session at least quarterly and have their own staff if they so desire;

(b) Company Act FOHFs are required to maintain custody of their assets with a bank; while the Company Act permits custody with a broker-dealer, those requirements are so onerous that bank custodians are generally used;

(c) Company Act FOHFs are required to have investment advisers that are themselves registered as investment advisers with the SEC under the Advisers Act;

(d) Both the Company Act FOHF and the adviser are required to have a chief compliance officer and to adopt compliance policies and procedures reasonably designed to prevent violations of the federal securities laws (for the company) and the Advisers Act (for the adviser); similarly, both the company and the adviser are required to adopt codes of ethics containing provisions reasonably necessary to prevent access persons from engaging in fraudulent or manipulative practices and require review of most personal securities transactions;

(e) Company Act FOHFs, except in very limited circumstances, may not engage in principal transactions with their affiliated persons without exemptive relief from the SEC; since ownership of 5% or more of the outstanding voting securities of an underlying fund is sufficient to make that fund an affiliated person of the FOHF, Company Act FOHFs may invest in non-voting interests of their underlying funds or waive their voting rights;

(e) Company Act FOHFs may engage in agency transactions with affiliates (including affiliated brokers) only if the commission to be charged is reasonable and fair compared to the commission received by other brokers in comparable transactions involving similar securities during a comparable period of time;

(f) Company Act FOHFs, as closed-end investment companies, cannot issue “senior securities” representing indebtedness unless they maintain asset coverage of 300% or senior securities representing stock unless they maintain asset coverage of 200%; the SEC interprets “senior securities” to mean company obligations that have a priority over its shares with respect to the payment of dividends or distributions of fund assets and includes borrowings and a number of derivative instruments as giving rise to senior security issues;

(g) The boards of Company Act FOHFs, including a majority of the independent board members, are required to review and approve advisory contracts at least annually;

(h) The registration statement under the Company Act requires Company Act FOHFs to declare their investment policies on industry concentration,



diversification, investment in real estate and other specified subjects, which policies may be changed only with shareholder approval,

(i) The Company Act provides for the right to sue for breaches of fiduciary duty involving personal misconduct in respect of a registered investment company and imposes on the adviser a fiduciary duty with respect to the receipt of compensation for services; and

(j) If the Company Act FOHF has a name that suggests that the company focuses its investments in a particular type of investment, it must have a policy to invest at least 80% of the value of its assets in that investment.

SEC Oversight

Company Act FOHFs are subject to the oversight of the SEC. Registration statements and periodic reports filed with the SEC by Company Act FOHFs are subject to SEC review for compliance with the relevant disclosure requirements and, in the case of registration statements filed under the Securities Act as well as the Company Act, must be declared effective by the SEC before shares may be offered. The Company Act registration statement must be updated annually within 120 days of the company's fiscal year unless the updated information is provided to shareholders in the annual report. Company Act FOHFs are required to send annual audited and semi-annual unaudited reports to shareholders within 60 days after the end of the fiscal period and to file them with the SEC, including the required Sarbanes-Oxley Act certifications⁶. Company Act FOHFs are also required to file with the SEC a schedule of their portfolio investments as of the end of the first and third fiscal quarters, along with the Sarbanes-Oxley Act certifications, and a report of the proxies voted by the company for the 12-month period ended June 30 of each year. Company Act FOHFs are further required to report to the SEC on certain regulatory matters twice a year on Form N-SAR. Since advisers to Company Act FOHFs are required to be registered under the Advisers Act, they also are subject to the oversight of the SEC. Both Company Act FOHFs and their advisers are

⁶ The company's principal executive and principal financial officers each must certify that: the report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made not misleading; the financial statements included in the report fairly present in all material respects the company's financial condition; the officers are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting and have designed such procedures to ensure that material information relating to the company is made known to them and to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes; the officers evaluated the effectiveness of the company's disclosure controls and procedures; and the officers have disclosed to the auditors and the audit committee all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to report financial information and any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.



subject to the detailed record-keeping requirements in the rules under the Company Act and the Advisers Act. The SEC conducts periodic onsite examinations of investment companies and investment advisers as well as “for cause” examinations and targeted “sweep” examinations that focus on a more limited area of investment company or adviser operations that is the subject of regulatory concern.

Disclosure Documents

Mandated Disclosures

CFTC Rule 4.24 requires CPOs to include in a Full Part 4 Fund’s disclosure document specific information about the fund and its operations. Some of the information must appear in a particular order. Full Part 4 CPOs must provide the disclosure document to investors no later than the time the CPO delivers a subscription agreement to a prospective investor. Disclosure documents must include:

- (a) two verbatim risk of loss disclosure statements on the cover page and first-inside page, respectively;
- (b) a table of contents on the second-inside page;
- (c) the business background of the CPO and any advisor allocated 10% or more of the Fund’s assets (“Advisors”) and each of their principals (including anyone making trading decisions for the fund);
- (d) risk factors, including risks relating to volatility, leverage, liquidity, and counterparty creditworthiness, as applicable;
- (e) the fund’s investment strategy and use of proceeds (including percentages of assets to be committed to commodities, securities and/or other types of trading, whether assets will be held inside and outside the U.S., and the manner in which the fund will fulfill its margin obligations, if any);
- (f) fees and expenses (including all costs incurred by anyone in connection with the fund whether paid for by the fund or not) and information concerning the investee funds of Advisors to which assets of the fund may be allocated;
- (g) a break-even chart calculated consistent with CFTC and NFA instruction, which advises investors of the amount the fund must earn in order to “break-even” at the end of one year of trading;



- (h) conflicts of interest (including soft dollar or directed brokerage arrangements and whether the CPO, Advisors or their principals will trade for their own accounts) and related party transactions;⁷
- (i) litigation against the CPO, Advisors and futures brokers employed by the fund;
- (j) past trading performance of the fund, the CPO and Advisors in a mandated format (or a statement that there is no past performance);
- (k) transferability and redemption rights;
- (l) tax aspects of an investment in the fund;
- (m) information concerning other accounts and ownership of the fund by the CPO, the Advisors and their principals;
- (n) the liability of investors in the fund (usually always limited to the amount of the investor's capital contribution plus any undistributed profits);
- (o) statements that the CPO is required to provide financial reporting to investors on a monthly (sometimes quarterly) and annual basis (the annual report must be audited); and
- (p) any other information that would be considered material to an investor's decision whether to invest in the fund.

In addition to the foregoing, the disclosure document must include information necessary for investors to understand the fundamental characteristics of the fund or to keep the disclosure document from being misleading.

Plain English Requirements

In addition to the substantive disclosure requirements detailed above, NFA Compliance Rule 2-35 requires the disclosure document for a Full Part 4 Fund to be in two parts. The first part may contain only: (i) the information required by the CFTC and the

⁷ We note that NFA periodically issues notices to its members to assist them in complying with applicable rules. Conflicts of interest disclosure to clients was recently the subject of one such notice. The Notice highlighted several specific examples of relationships that would require disclosure in CPO disclosure documents and provided guidance on what would constitute adequate disclosure with respect to certain types of conflicts. The Notice also reminded members and their principals to examine all of their relationships, paying particular attention to any arrangement pursuant to which fees or other compensation is directly or indirectly paid by or to the CPO or any of its principals or affiliates. See NFA Notice I-07-25 (May 24, 2007).



NFA; and, (ii) if applicable, information required by the Securities and Exchange Commission and state securities regulators. NFA Rule 2-35 requires the CPO to place non-required information in a supplementary document called the statement of additional information. Required disclosures must be written using plain English principles. Plain English disclosure is intended to convey significant information about the offering in a clear and concise manner using common terms.⁸

Company Act Disclosure Requirements

Company Act FOHFs register as closed-end investment companies and, if applicable, register their interests under the Securities Act, on Form N-2. The first part of Form N-2 (or the “prospectus”) requires the following information:

- a fee table in a prescribed format outlining sales loads as a percentage of offering price, dividend reinvestment and cash purchase plan fees and other transaction fees, and the following expenses as a percentage of net assets attributable to common shares: management fees, interest payments on borrowed funds, other expenses, acquired fund fees and expenses (the fees and expenses incurred indirectly by the FOHF as a result of investment in the underlying hedge funds) and total annual expenses. Company Act FOHFs are required to disclose immediately following the table an expense example that discloses how much an investor in the FOHF could expect to pay in expenses over one, three, five and ten years, assuming: (1) the expenses remain the same, (2) an initial investment of \$1,000 and (3) a 5% annual return.
- a description of the FOHF’s investment objectives, investment policies and risk factors, including those associated with the underlying funds;
- whether there is an established public trading market for the shares;
- a description of the FOHF’s management;
- disclosure regarding the adviser’s services, experience and compensation and the names, titles and length of service of the portfolio managers;

⁸ Plain English principles include:

- using the active, rather than passive, voice;
- using short sentences and paragraphs;
- breaking up the document into short sections;
- using titles and sub-titles that specifically describe the contents of each section;
- using definite, concrete words that are part of everyday language;
- avoiding legal jargon and highly technical terms;
- using glossaries to define technical terms that cannot be avoided;
- avoiding multiple negatives;
- stating something once where it is most important rather than repeating information; and
- using tables and bullet lists.



- disclosure regarding administrators and custodians;
- disclosure regarding the expenses for which the FOHF is responsible;
- whether the FOHF will use an affiliated broker;
- disclosure regarding the tax consequences of investment in the FOHF;
- disclosure regarding how the FOHF values its assets and how frequently it calculates its net asset value;
- a description of the FOHF's capital stock and rights as to dividends, voting, liquidation and other matters; and
- material pending legal proceedings to which the FOHF or the adviser is a party.

The second part, or the “statement of additional information,” includes the following:

- more detailed disclosure about the FOHF's investment policies, including those policies as to which an investment company is required to have a fundamental policy;
- detailed information about members of the board, including compensation, committee structure, ownership of shares of the FOHF and of other investment companies in the same “family of investment companies”;
- descriptions of the FOHF's and adviser's codes of ethics;
- descriptions of the FOHF's policies and procedures for proxy voting;
- more detailed disclosure about the adviser, custodians and independent registered public accounting firm, and whether any affiliated person provides services to the FOHF and the compensation paid therefor;
- with respect to each named portfolio manager, the number and types of other accounts managed by the portfolio manager, total assets within each category and whether any of those accounts pay performance fees; how each portfolio manager is compensated, the criteria on which compensation is based and whether there are any differences between how the portfolio manager is compensated with respect to the FOHF and those other accounts;
- a description of material conflicts of interest arising from management of the FOHF and management of other accounts, such as performance fees;
- the portfolio manager's share ownership in the FOHF;
- a description of how the FOHF effects transactions in portfolio holdings, how brokers are selected to effect securities transactions and use of soft dollars; and



- a detailed description of the FOHF's tax status and tax consequences to shareholders.

While the prospectus and statement of additional information can be provided in two separate documents, with the statement of additional information provided upon request, many Company Act FOHFs combine the disclosure requirements into a single document.

A Form N-2 that registers interests under the Securities Act contains the following additional disclosures in addition to those listed above:

- Information about the offering price to the public, sales loads and proceeds to the company and compensation to the underwriters, along with required legends about the availability of additional information about the company on its and the SEC's websites;
- cover page disclosure about the factors that make the offering speculative or of high risk;
- a summary of the information contained in the prospectus;
- the company's financial highlights if the company has had investment operations;
- the plan of distribution of the company's securities; and
- the use of proceeds of the offering.

Both the Securities Act and the Company Act require the disclosure of such information in addition to the required items as may be necessary to make the required statements, in the light of the circumstances under which they were made, not misleading.

Periodic and Annual Reporting

CFTC Rule 4.22 requires a CPO to deliver to investors a report of the fund's performance within 30 days of each month-end (or each quarter-end if the fund's assets are less than \$500,000) stating, in detail, the (a) net asset value of the fund as of the end of the period, (b) change in net asset value from the end of the previous period and (c) net asset value per outstanding unit as of the end of the period.

CFTC Rule 4.22 also requires the CPO of a fund of hedge funds to prepare and deliver to investors and file with the NFA, within 150 days of each year-end, annual financial statements for the fund that have been certified by an independent public accountant.

Periodic statements and annual reports must be prepared in accordance with U.S. generally accepted accounting principles using the accrual method of accounting.



Each monthly or quarterly statement and annual report must include an oath or affirmation from a person duly authorized to bind the CPO that, to the best of the knowledge and belief of the person signing the report, the information contained in the report is accurate and complete.⁹

Company Act Periodic Reports

Company Act FOHFs must mail to their shareholders audited annual reports and unaudited semi-annual reports within 60 days after the end of the fiscal period and file them with the SEC within 10 days thereafter. These reports must include graphs or tables illustrating the company's portfolio holdings and include statements about the availability of information regarding the company's proxy voting record and statements of portfolio holdings as of the first and third quarters of the fiscal year. These reports also include information on the company's performance. If an advisory contract was approved by the board during the period of the report, the report must include a discussion of the factors considered by the board in approving the contract. These reports are filed with the SEC on Form N-CSR, which, in addition to the required Sarbanes-Oxley Act certifications, also includes disclosure on the senior officer code of ethics adopted by the company (also a Sarbanes-Oxley requirement); whether the company has an audit committee financial expert; the audit, audit-related, tax and other fees paid by the company during the past two fiscal years and the audit committee's pre-approval policies and procedures; disclosure of proxy voting policies and procedures similar to that required in the Form N-2; disclosure on portfolio managers similar to that required in the Form N-2; share repurchases; and procedures for the recommendation of nominees to the board by shareholders.

The financial statements contained in the shareholder reports are prepared according to U.S. GAAP and include a portfolio of investments and a financial highlights table that includes total return.

Company FOHFs also file a schedule of portfolio investments with the SEC within 60 days after the close of the first and third quarters of the fiscal year, which include Sarbanes-Oxley Act certifications.

Company Act FOHFs also file with the SEC twice a year a Form N-SAR, which reports on a variety of regulatory and financial matters. The annual report on Form N-SAR includes an auditor's report on the company's system of internal accounting controls.

Recordkeeping

As noted in our earlier letters to IOSCO, CFTC registrants are subject to recordkeeping requirements. CFTC and NFA rules include specific recordkeeping

⁹ We note that the "oath or affirmation" requirement pre-dates the Sarbanes-Oxley certifications by two decades.



requirements that, among other things, permit Full Part 4 CPOs to demonstrate compliance with the disclosure and reporting rules described above.

Company Act FOHFs are subject to detailed recordkeeping requirements under the Company Act and their investment advisers are subject to detailed recordkeeping requirements under the Advisers Act. These books and records are subject to SEC review as part of the SEC oversight and inspection process.

Advertising Rules Applicable to CPOs

Full Part 4 CPOs are also subject to the CFTC's and the NFA's advertising rules.¹⁰ CFTC Rule 4.41 and NFA Rule 2-29 govern communications between futures professionals and the public. The rules generally prohibit fraud in connection with promotional material but also mandate or prohibit specific activity. CFTC Rule 4.23(a)(9) and NFA Rule 2-29 define "promotional material" very broadly to include virtually any communication with investors or prospective investors, no matter what the medium. Certain advertisements must be prefiled with NFA. We note that NFA offers a review service to its members that permits voluntary submission of advertisements for review by NFA's compliance staff.

Pursuant to CFTC and NFA rules, sales literature may not (i) contain material misstatements or omissions; (ii) mention the possibility of profit without an equally prominent statement of the risk of loss; or (iii) include performance without stating that past results are not necessarily indicative of future results. Performance information must be (i) representative of actual performance in all comparable accounts (*i.e.*, no "cherry-picking"); and (ii) presented net of all fees (even if gross performance is also presented). CPOs must maintain records to substantiate any performance claims. We note that NFA rules restrict the use of hypothetical or simulated performance information.

Advertising Requirements for Company Act FOHFs

NASD member firms that sell interests in Company Act FOHFs must file all advertising and sales literature with FINRA (formerly NASD Regulation). The NASD has issued a number of member alerts and enforcement actions relating to improper sales of hedge funds and FOHFs, and reminding member firms of their obligations to make sure that: the sales material provides a fair and balanced interpretation of the risks and potential disadvantages of the investment; after performing due diligence on the underlying funds, the member has a reasonable basis to conclude that the FOHF is a reasonable investment for any investor; the recommendation of a specific FOHF is suitable for that customer; and the member's internal controls, including supervision and compliance, ensures that sales of FOHFs are conducted in compliance with NASD and SEC rules.

¹⁰ We note that certain advertising rules apply to all CPOs, whether registered or not.



Conclusion

In conclusion and with the regulatory summary outlined above as a backdrop, we hope that you will agree that Full Part 4 CPOs and their funds, and Company Act FOHFs, are subject to a comprehensive regulatory structure that provides a solid framework for investor protection. We also hope that you will agree that the regulatory framework obviates the need for any additional requirements to be adopted that would be applicable to Full Part 4 CPOs or Company Act FOHFs.

We hope our comments are helpful to IOSCO. We welcome the opportunity to meet with you and act as a resource of information as you continue to evaluate hedge fund industry issues. For additional information, you may reach me at (202) 367-1140.

Very truly yours,



John G. Gain
President

