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**Business Law Section**
**Committee on Securities Regulation**

March 14, 2007

Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-9303

E-mail address: rule-comments@sec.gov

Attention: Nancy M. Morris, Secretary

Re: **File No. S7-25-06**
Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles;
Accredited Investors in Certain Private Investment Vehicles
Release No. 33-8766; IA-2576

Ladies and Gentlemen:

The Committee on Securities Regulation (the "Committee") of the Business Law Section of the New York State Bar Association appreciates the invitation in Release No. 33-8766; IA-2576 (the "Release") to comment on the Commission's proposed new Rule 509 and Rule 216 (collectively, the "Proposed Rules"). The Proposed Rules would require natural persons to have at least $2.5 million of "investments" (as defined in the Proposed Rules), in addition to meeting the current definition of "accredited investor" set forth in Rule 501(a) of Regulation D or Rule 215, in order to be eligible to invest in private investment vehicles that rely on Section 3(c)(1) of the Investment Company Act as an exemption from registration as an investment company (the "3(c)(1) Pools").

The Committee is composed of members of the New York State Bar Association, a principal part of whose practice is in securities regulation. The Committee includes lawyers in private practice and in corporation law departments. A draft of this letter was reviewed by certain members of the Committee. The views expressed in this letter are generally consistent with those of the majority of members who reviewed and commented on the letter in draft form. The views set forth in this letter, however, do not necessarily reflect the views of the organizations with which its members are associated, the New York State Bar Association, or its Business Law Section.

## I. Summary

For the reasons discussed below, we consider that the Proposed Rules are unnecessary in order to achieve the stated goals of an appropriate level of investor protection, and that any possible benefits of the Proposed Rules would be far outweighed by the burdens they impose. The Proposed Rules are likely to unjustifiably interfere with and frustrate the achievement of the investment objectives of the group of natural person investors that would now be prohibited from investing in 3(c)(1) Pools. We discuss other less drastic alternatives to the Proposed Rules, such as imposing the higher "qualified client" standard that is already being adhered to in practice by many 3(c)(1) Pool managers.

While we strongly disagree with the need for and approach of the Proposed Rules, we suggest that if they are adopted, natural persons already invested in a 3(c)(1) Pool as of a designated cut-off date should be allowed to maintain their existing investments in the pool and make additional capital contributions as well. We also suggest that partners, members and other principals of the 3(c)(1) Pool's investment adviser, as well as portfolio managers and other sophisticated professionals associated with such investment adviser, be excluded from the application of the Proposed Rules. We propose an exclusion for persons that due to their professional achievements, status or experience in the investment fund industry, do not require the protections of the Proposed Rules. Such persons should include, without limitation, chartered financial analysts, attorneys, certified public accountants, and principals and sophisticated professional employees of other investment advisers. In addition, we suggest limiting the scope of the Proposed Rules to Rule 506 transactions only.

Finally, we make some technical comments to the Proposed Rules, including that (i) if a minimum level of investments must be imposed, that a level of around $500,000 to $1 million would be more than adequate to assure that the natural person investor is financially sophisticated; (ii) investments held jointly with a person's spouse should be included; and (iii) other property held for investment that falls outside of the enumerated categories should also be included, such as collectible items (e.g. art, fine wines, rare coins).

## II. Comments to the Proposed Rules 509 and 216

A. <u>The Proposed Rules are unnecessary and overly restrictive in light of their potential benefits, and set the stage for possible adverse and unintended consequences</u>.

The present system strikes the right balance between investor protection and efficient capital formation, promotion of competition and free capital markets. The Proposed Rules would add an additional layer of legal complexity and unduly inhibit the formation of new 3(c)(1) Pools (and the continuity of existing ones). The Proposed Rules would also likely reduce the universe of investment choices for natural persons and in the long run, for private investment fund investors generally (whether institutional or natural persons). These issues and concerns are discussed below.

1. In practice, many if not most 3(c)(1) Pools already require their investors to meet higher net worth or liquid assets thresholds than what is required under the present accredited investor standard.

***Qualified client standard must be met to charge incentive fee on capital gains***

Even under the present rules, many 3(c)(1) Pools are restricted to investors that meet the "qualified client" standard of Rule 205-3 under the Investment Advisers Act of 1940 (the "Advisers Act"). That is because fund managers that are registered with the Commission as investment advisers under the Advisers Act may only receive a fee or performance incentive based on capital gains if the investor to be charged such fee or incentive is a qualified client. This fee or incentive is a fundamental part of the economics behind many of the 3(c)(1) Pools and is largely regarded as beneficial in that it tends to align the fund manager's interests with those of the investors.

In the case of natural persons, qualified clients are those that either have a net worth of $1.5 million or have invested at least $750,000 with the private fund manager. With respect to the latter prong of the test, in most cases investors who are able to place liquid funds with a private fund manager of $750,000 or more are likely to have investment assets far in excess of that amount. The $1.5 million net worth test is a closer approximation of the current minimum net worth requirement under Rule 501(a), after adjusting for inflation.

As stated above, under the Commission's rules the qualified client standard only applies to fund managers that are registered with the Commission. Not all fund managers are required or even eligible to register with the Commission, although many are otherwise required to so register with the applicable state authority. Many states impose a similar "qualified client" requirement in order for fund managers registered with the state or otherwise subject to its jurisdiction to charge a fee or incentive based on capital gains.

***Fund economics favor larger minimum investment requirements***

Many of the 3(c)(1) Pools require minimum investments of $500,000 to $1,000,000, regardless of the net worth or income levels of the investor. The reasons include the need to achieve a certain minimum scale in order to fully implement their investment strategy as well as to receive management fees sufficient to cover the 3(c)(1) Pools' minimum operating expenses. Taking small investments of $50,000 or even $100,000 or more would not be administratively or economically viable for many of the 3(c)(1) Pools.

This, together with the higher standard that is required if the fund manager wants to be able to charge a fee or incentive based on capital gains, in practice eliminates many would-be investors in 3(c)(1) Pools that may be characterized as "house rich but investment poor", i.e. persons who ostensibly meet the net worth requirement of Regulation D due to appreciation in their primary residence but that have relatively small amounts of other investments. These are the investors that the Commission seems to be most concerned about.

2. No evidence indicating greater levels of investment risk in 3(c)(1) Pools in comparison with Regulation D/Rule 215 private placements generally.

The Commission has presented no evidence or empirical data indicating that natural persons investing in 3(c)(1) Pools are being exposed to greater levels of investment risk or incidences of fraud, or are suffering greater amounts of loss, than investors in other types of securities privately-placed pursuant to Regulation D or Rule 215 that would not be covered by the Proposed Rules. Small and start-up companies seeking to raise capital through a private placement are some of the riskiest investments offered in the market. For example, private film finance limited partnerships are notorious for frequently resulting in a total loss of their investors' capital. Privately-placed oil exploration limited partnerships are yet another category of investment vehicles known for resulting on average in large losses for their investors. Yet, these types of offerings are allowed to exist because of their potential benefits to the economy from a macroeconomic perspective. The case can easily be made, however, that 3(c)(1) Pools are also quite beneficial to the economic and financial system. Among other things, they tend to provide additional liquidity and efficiency in financial markets, as well as financial innovation and efficient re-allocation of risks.[1] Also, private equity funds (a type of 3(c)(1) Pool) provide a more liquid market for emerging companies that have proven successful yet need additional capital prior to entering the public market.

Based on our collective experience, it is our view that hedge funds and private equity funds operating as 3(c)(1) Pools are not engaging in such inherently risky types of investment strategies or experiencing unusual losses that would generally warrant a heightened level of regulatory scrutiny over and above other types of private issuers. As seen from the examples cited in the previous paragraph, other types of privately-placed securities can be equally if not more risky than 3(c)(1) Pools from an investor's standpoint.

3. There are ample amounts of information and data available in the marketplace to enable even moderately diligent investors to adequately educate themselves about the structure, features and relevant terms of investing in hedge funds, private equity funds and other 3(c)(1) Pools.

The Commission's own efforts to educate the public about hedge funds and other private investment vehicles, including the comprehensive study about the industry that was undertaken by the Staff and published in September of 2003,

[1] See, e.g., Hedge Funds, Leverage and the Lessons of Long-Term Capital Management, Report of the President's Working Group on Financial Markets, April 1999.

have greatly enhanced the public's awareness. The study goes into great detail about the various kinds of vehicles, including the typical manager compensation arrangements. The Commission's website also has a section devoted to hedge funds.

Also, private investment vehicles, particularly hedge funds, receive a high level of attention in the financial and even mainstream media, as well as attention from regulators, special interest groups and members of Congress in the United States. There are numerous specialized publications in print and web-based about hedge funds and private equity funds. Also many books on the subject are available through retail and online booksellers.

Finally, it should not be overlooked that investors generally have become much more sophisticated over time. With the advent of online trading, individual retail investors now have easy access to a wealth of market data, charts and technical analytical techniques. The gap between the tools available to professional traders and retail investors is narrowing rapidly.

4. The Private Placement Memorandum and other offering documents used in the typical 3(c)(1) Pool offering tend to be quite detailed, often providing more detailed and candid information than a typical mutual fund prospectus, and are subject to general securities law provisions governing the prohibition of fraudulent or misleading statements and any disclosure requirements implied thereby.

Just because the 3(c)(1) Pool offering documents are not reviewed by the Commission does not mean that they do not provide the functional equivalent of a prospectus, that investors are not receiving adequate disclosure about the potential risks and conflicts of interest involved, or that investors are not protected from material misstatements or omissions in the pool's offering documents.

Private 3(c)(1) Pool offerings that rely on Regulation D (or even Section 4(2) of the Securities Act of 1933 (the "Securities Act"), while exempt from the registration requirements of Section 5 thereof, remain subject to the general Securities Act anti-fraud provisions and related remedies. This is coupled with the Commission's general anti-fraud jurisdiction over investment advisers (even those advisers not otherwise registered with the Commission), which jurisdiction will likely be enhanced if the proposed Rule 206(4)-8 that was also introduced in the Release is adopted. The foregoing, taken collectively, gives the Commission and investors a full suite of legal and regulatory protections against any misleading or fraudulent conduct on the part of adviser sponsors to 3(c)(1) Pools.

5. There is nothing inherently "illegitimate" about an investor's wealth increasing through market appreciation in value of his or her residence, and the Commission's policy should not favor one asset class over another.

After isolating for the effect of inflation (which can be easily extrapolated from the applicable inflation index), there is no particular reason to disqualify a person as an investor simply because their wealth increased due to market appreciation of their personal residence. A personal residence is one of many asset classes that a person can invest in, and there should be no discrimination against one asset class vis-à-vis another. A person can consciously choose to invest in a bigger and better home, or alternatively, a person can rent their residence and deploy their freed-up capital in the stock market, commodities or other investments. From a strategic standpoint, a decision to invest in personal real estate might carry with it an expectation of higher returns than investing in the types of investments defined in the Proposed Rules. For example, until recently, an investment in a personal residence offered some of the best returns in the market. Such an investment decision, rather than indicating less financial sophistication, actually may represent a greater financial sophistication.

The Proposed Rules would in fact force an investor that does not meet the standard outright to divest some or all of the equity in the investor's personal residence and convert it to "legitimate" investment assets (based on the Commission's reasoning) in order to qualify under the proposed new standard. If the investor did not do so, then his or her investment universe would be reduced to retail mutual funds and other retail financial products. This would be illogical and unjustified.

Finally, it should be pointed out that investors who have high levels of "investment" assets may have achieved them through market appreciation as well, and not necessarily because they are more sophisticated or engage in complex trading strategies on a personal level. Again, why should it be more legitimate for an investor to reach a certain wealth or asset level through market appreciation of their stock investments, for example, than through market appreciation of their personal residence?

6. <u>In practice, many 3(c)(1) Pool managers are in fact registered with the SEC or a state authority</u>.

It is our understanding that a significant portion (though certainly not all) of the hedge fund managers that registered with the Commission as investment advisers pursuant to the December 2004 rule change have remained registered even after the Goldstein decision. Even if not registered with the Commission, another significant portion of 3(c)(1) Pool managers are registered with or otherwise subject to the regulatory jurisdiction of state authorities. Thus, in practice there are not as many "unregulated" 3(c)(1) Pools operating as it might appear at first blush.

For its part, the Commission could embark on a program to encourage managers to voluntarily register. One step would be to reform the investment adviser examination process by giving regulated advisers more clear published guidance on the types of documents and records that must be maintained. Under the current system there is an element of "regulation by examination", whereby examiners request a burdensome level of documents and records that are not specifically required to be maintained (or given to the examiners) by the Commission's rules.

7. The Proposed Rules will add yet another layer of complexity in terms of multiple standards to apply, without adding any tangible benefits.

As other commentators have noted, the Proposed Rules will add yet another layer of complexity to an already overly complex system of regulatory definitions. This is a step in the wrong direction.

8. The Proposed Rules are anti-competitive.

We submit that it is not appropriate for the Commission to have as an unstated policy objective the elimination of a certain number of participants from the 3(c)(1) Pool market. We appreciate the concerns the Commission and other regulatory bodies may have about systemic risk in light of the active role that private investment funds generally play in the capital markets. The Proposed Rules are not the right way to address this concern, however. As the recent agreement with the President's Working Group on Financial Markets points out, the best way to address systemic risks are through market discipline imposed by the creditors, counterparties, investors and other parties in interest, not through greater government regulation. In any event, the pools of capital typically amassed by 3(c)(1) Pools are generally small in comparison with 3(c)(7) Pools and other institutional investors. Even the complete elimination of 3(c)(1) Pools would not make the financial markets less susceptible to system risk.

The Proposed Rules are, however, likely to have an anti-competitive effect that redounds to the detriment of investors generally. By shrinking the number of eligible investors in 3(c)(1) Pools, in the medium to long run it is likely that a number of fund managers will simply go out of business or choose not to start funds in the first place. This could likely lead to a dearth of investment choices for the natural person investors that remain eligible under the Proposed Rules, and thus competition would intensify *among such investors* for the shrinking pie of 3(c)(1) Pools (and investment funds generally). Such competition among investors may well result in their being forced to agree to terms less favorable to the investor than under the present system. As discussed below, this reduction in the available universe of private investment funds may eventually adversely affect the larger institutional market as well (even though not directly impacted by the Proposed Rules).

It is our view that the interests of the investing public (or the public generally) are never served by creating artificial barriers to entry that tend to prevent entrepreneurship and favor larger, more established players. According to a survey published in Absolute Return magazine (as recently reported in the financial press), there are already market dynamics that favor extremely large hedge fund complexes. The top 20 hedge fund firms control some $386 billion of the assets under management in these types of vehicles, or about one third of the entire market. Granted, this dynamic exists even in the absence of the Proposed Rules, but it is likely to accelerate if they are adopted.

Having a thriving "entrepreneurial hedge fund" market (the market area more associated with 3(c)(1) Pools) assures that investors have a valuable alternative to the large institutional market, which is of particular importance for natural person investors. Over time, the sponsors of the more successful 3(c)(1) Pools acquire the scale necessary to enter the larger institutional investor market, thus providing greater choice and competition at that level as well. If the entrepreneurial hedge fund market is eliminated or greatly reduced, the scope of choices, even for the larger institutional investors, will surely be reduced over time. This could tend to reinforce the "monopoly" position of the larger fund sponsors, resulting in less favorable terms for institutional investors generally.

B. Alternatives to the Proposed Rules

1. Extend the qualified client standard to fund managers not otherwise subject to registration with the Commission or a state authority that imposes the same minimum standard.

We consider that if a more strict standard than that afforded by the current accredited investor definition is necessary, then the "qualified client" standard of Rule 205-3 is the appropriate standard to adopt. As explained above, it is already widely followed, even in the 3(c)(1) Pool universe, and it would not add yet another legal definition with which the market has to deal.

This could be accomplished by imposing it as a condition to charging a performance fee on capital gains upon those advisers not otherwise subject to registration with the Commission, or cross-referencing the "qualified client" definition within the definition of accredited natural persons.

2. Amend Form D to give the Commission a heightened level of "census information".

The Commission could make amendments to Form D that would provide it with a heightened level of disclosure and "census" information, such as whether the fund sponsor is relying on Section 3(c)(1) to avoid registration as an investment company, and whether the pool charges a performance fee to its investors. The Commission could, after the end of say a one year period, revisit the issue of whether any further regulatory action is required.

C. Exceptions that should be made available if the Proposed Rules are adopted as proposed, or if other rule changes are made that increase the net worth or other requirements above what they are now.

1. Grandfather current investors existing as of the end of a phase-in period.

There simply is no compelling reason to not grandfather a 3(c)(1) Pool's existing investors so that they may continue to hold their existing investments and even make additional capital contributions. Existing investors already have experience investing with the pool and its manager, and likely have received detailed monthly or quarterly reports as to the progress of the pool's investments. Their investment decision about whether the manager and the pool are suitable for them has already been made, even if they add further capital voluntarily or pursuant to a capital call. To deny them this ability will likely cause unnecessary burdens on the investors and the fund managers.

The existing investors should be determined as of a cut-off date at least 6 months to a year after the effective date of the Proposed Rules (if adopted), as was done in the case of existing investors in hedge funds in the context of the investment adviser registration rules adopted by the Commission in December of 2004. That way, the market would have more time to adjust and deals currently in pipeline would not be jeopardized.

2. Exclude from requirement control persons, knowledgeable employees, other employees.

***There should be a general exclusion for principals and knowledgeable or professional employees of the 3(c)(1) Pool and its investment adviser.***

Any rule change that would increase the standard of qualification for natural persons must exclude employees of the 3(c)(1) Pools and of their investment adviser, general partner or managing member. The types of employees covered by the exclusion should encompass "knowledgeable employees" within the meaning of Rule 3c-5 under the Investment Company Act ("Knowledgeable Employees"), as well as other sophisticated employees beyond just principals of the adviser and portfolio managers.

The arguments in favor of excluding principals, portfolio managers and other employees from the higher standards are numerous, and include:

**(a) Commission policy has long recognized that employees have a special relationship to the investment vehicle or the adviser to the investment vehicle and need less protection than "outside" investors:**

(i) Knowledgeable Employees may invest in 3(c)(1) Pools without being counted toward the 100 person limit, and may invest in 3(c)(7) Pools without meeting the criteria of a "qualified purchaser";

It would be completely illogical and incongruous that Knowledgeable Employees could invest in a 3(c)(7) Pool but yet be precluded from investing in a 3(c)(1) Pool due to the operation of the Proposed Rules.

(ii) Investment advisers registered with the SEC may charge Knowledgeable Employees a performance fee based on capital gains, as such persons are deemed to be "qualified clients" under Rule 205-3 of the Advisers Act.

**(b) It would be ironic indeed if as a result of the application of the Proposed Rules the partners or members of an adviser to a 3(c)(1) Pool, as well as the pool's portfolio manager, could not invest in the very same pool they advise or manage. Investors often demand that the principals and portfolio managers have "skin in the game" (i.e. an investment of personal assets in the pool) so that their interests are aligned with those of the investors.**

If unable to utilize Regulation D, partners or members of an adviser and the portfolio managers of a pool may instead have to rely on Section 4(2) of the Securities Act in order to invest in the 3(c)(1) Pool. In such case there would be uncertainty whether the Section 4(2) statutory private placement exemption would be available given the risk of integration with the Regulation D offering, which, in turn would require that such persons be provided with the heightened Regulation D disclosure for unaccredited investors. This result borders on the absurd (particularly since often these are the same individuals that would be involved in preparing such disclosure). This introduces an unnecessary element of legal risk to the process without adding any meaningful levels of protection for the employees as investors.

**(c) Employees and other associated individuals are, due to their status as principals or employees of the 3(c)(1) Pool or its investment adviser, in a unique position to know about and understand the 3(c)(1) Pool and its manager, and are better able to evaluate the relative merits and risks of, and any conflicts of interests associated with, an investment in the pool.**

**(d) Employees make an "investment" in the 3(c)(1) Pool by becoming involved as principals or employees of the pool and its adviser, so why should they not be allowed to invest their assets in the pool?**

***The exclusion should extend to all professional employees of the 3(c)(1) Pool or its investment adviser (other than clerical or ministerial employees), rather than being limited to Knowledgeable Employees as defined in Rule 3c-5 under the Investment Company Act and Rule 205-3 under the Advisers Act.***

As the term is defined in both Rule 3c-5 and Rule 205-3 and interpreted by the Commission, "knowledgeable employees" would not include sophisticated professionals such as staff analysts, attorneys and accountants that are not otherwise involve in the portfolio management process.

3. <u>Create a new category of exclusion for "sophisticated professionals"</u>.

The Commission should consider creating an additional exception for persons that do not meet the level of investments standard to be an accredited investor, but that due to professional qualifications and/or their involvement and experience in the industry, have achieved the requisite level of financial sophistication and understanding such that investment in 3(c)(1) Pools would be appropriate for them ("<u>Sophisticated Professionals</u>"). Sophisticated Professionals could include Chartered Financial Analysts (CFAs), attorneys, certified financial planners, Certified Public Accountants (CPAs), and *even persons that are Knowledgeable Employees with respect to other unaffiliated 3(c)(1) Pools.*

Without this exception, several anomalous and perhaps unintended results may occur. For example, many attorneys advise fund managers and investment advisers on a daily basis as to a wide range of securities and corporate law issues, such as how to properly structure and document a pool offering and the appropriate level of disclosure of the material terms of the offering in the offering documents, and therefore are arguably as well positioned as any sophisticated investor to understand and appreciate the risks involved in a 3(c)(1) Pool. Many attorneys are not likely to meet the higher accredited investor standard that would be imposed by the Proposed Rules, however, unless they have been practicing law for several decades or have other independent sources of wealth.

Also, it is not uncommon for a portfolio manager (Manager A) to want to invest in another 3(c)(1) Pool managed by another adviser (Manager B) in order to test Manager B's strategy and share investment ideas. Manager A may wish to make the initial investment on a personal basis so as not to risk the pool's assets until a determination can be made that Manager B's pool is a good fit. If Manager A did not meet the proposed natural person accredited investor standard outright, he or she would have to commit pool assets at the outset, or find another way to structure the investment. In this case, it would make perfect sense to include Manager A in our proposed concept of Sophisticated Professional, and allow the investment as an exception.

4. Apply the requirements only to Rule 506.

The Commission should consider limiting the scope of the Proposed Rules to Rule 506 transactions. Rule 505 and Section 4(6) of the Securities Act, under which Rule 215 is promulgated, have had little utility in recent years and, because they are limited to offerings of $ 5 million, have certainly not been the exemption of choice for hedge funds. Thus, Rule 505 and Rule 215 are not the cause of the problems the Commission perceives and is trying to rectify. If the Commission in fact does restrict the availability of Rule 506 with respect to natural persons, some of the anticipated resulting shortfall in capital raising, particularly capital raising to benefit smaller and start-up ventures, could be remedied by use of Rule 505 and Section 4(6). Since neither of these exemptions is preempted from state regulation and because such offerings tend to be more localized than national due to their size limitations, if the problems the Commission perceives in Rule 506 offerings do translate into problems in Rule 505 and Section 4(6) offerings, state regulators as the local "cops on the beat" would be available to uncover and act upon any transgressions.

Likewise, the proposed accredited natural person standard, if adopted, should apply only for the narrow purpose of determining whether a natural person may invest in 3(c)(1) Pools. It should *not* extend to other areas that cross-reference the accredited investor standard, such as Regulation S, certain exemptions from registration as commodity pool operators or commodity trading advisers under the Commodity Exchange Act, or even state securities laws that key off of the Commission's definition of accredited investor. The Commission should make this clear in any final rules that it may adopt.

D. Technical comments to the Proposed Rules themselves.

1. If there must be a minimum investment level imposed, it should be $500,000 to $1 million.

The Commission has not indicated why the level of $2.5 million in investments is necessary to achieve financial sophistication, other than that it is half of the "qualified purchaser" standard under Section 3(c)(7) of the Investment Company Act.

We would argue that the level of investments that would indicate a person is financially sophisticated is something much lower, such as between $500,000 to $1 million. Indeed, as discussed above, given the level of sophistication of the retail investor in the Internet age, an individual that is actively managing a portfolio of even $100,000 may in fact be trading options, futures and other sophisticated financial products, and using hedging and shorting techniques. Such an individual should not have any particular difficulty understanding and appreciating the risks associated with a 3(c)(1) Pool investment.

2. Assets held jointly with a spouse should be included in the calculation of "investments".

It is unfair and unjustified for the Commission to deviate from its own policy in Rule 2a51-1 under the Investment Company Act by excluding a portion of assets held jointly with a spouse. Whether or not this may reflect the distribution of assets in a divorce proceeding is irrelevant for purposes of determining whether a person is financially sophisticated.

3. Real estate held for investment.

The Commission should clarify that real estate may be included as an investment even if it is being used or occupied by a related person for that related person's personal purposes, provided that such related person pays rent for the privilege of occupying such real estate pursuant to a lease agreement with terms comparable to an arms-length market transaction. Why should real estate investment property be excluded merely because it is being rented to a family member of the prospective investor, assuming that family member is paying rent to the investor on terms comparable to the market?

4. Commodities contracts.

The value of commodities held for investment should include any excess cash or equity balances held in a customer's segregated commodities account, in addition to any initial margin. It is not clear that such excess cash or equity balances would qualify as a cash or cash equivalent, since they are not being held in the customer's bank account and typically do not earn interest.

5. Other property held for investment.

Again, in the interest of not favoring one asset class over another, the Commission should consider adding an additional category – "other property held for investment" – to the definition of "investments". This could include such things as collectible art, antiques, rare coins, vintage wines, antique automobiles and other collectibles that are often held for investment purposes and have a readily determinable fair market value. We observe as an aside that there are hedge funds dedicated to investments in such collectibles. These types of property would otherwise be excluded from the definition of "investments" since they are not commodities and do not trade on a recognized exchange.

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We are grateful for the opportunity to provide these comments and for the Commission's attention and consideration. We would be happy to discuss these comments further with the Staff.

Respectfully submitted,

COMMITTEE ON SECURITIES REGULATION

By: /s/ Jeffrey W. Rubin
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Chair of the Committee

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