

THE FINANCIAL SERVICES ROUNDTABLE



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Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, NW
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RICHARD M. WHITING
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Re: "Registration Under the Advisers Act of Certain Hedge Fund Advisers," SEC Release No. IA-2266, File No. S7-30-04

The Financial Services Roundtable¹ is pleased to offer its comments on the above-captioned proposed rule by the Securities and Exchange Commission (the "Commission" or the "SEC"). The Commission has proposed that advisers to certain investment vehicles, popularly known as "hedge funds" and defined in the proposed rule as "private funds," be required to register as investment advisers under the Investment Advisers Act. Roundtable members are not convinced that developments in the marketplace demonstrate a need for additional regulation of these advisers. Roundtable members further are concerned that the proposal, if adopted, could have unintended adverse consequences for U.S. securities markets. The Roundtable suggests that there are other, less intrusive methods to achieve the goals identified by the Commission.

Role of Hedge Funds in U.S. Securities Markets

Hedge funds² often serve as an important source of liquidity in the U.S. markets. They typically are able to take on greater leverage than other investors and are not subject to the same portfolio concentration limits as registered investment companies. As the Commission has noted, many hedge funds are large and frequent traders of securities.³ Federal Reserve Chairman Alan Greenspan has testified regarding the role that hedge funds play in the U.S. capital markets:

¹ The Financial Services Roundtable unifies the leadership of large integrated financial services companies. Its membership includes nearly 100 firms from the banking, securities, investment and insurance sectors. In addition to communicating the benefits of integrated financial services to the American public, the Roundtable is a forum in which financial services industry leaders address critical public policy issues.

² For purposes of this letter, by "hedge fund" the Roundtable refers to investment companies excluded from the definition of "investment company" under Sections 3(c)(1) and 3(c)(7) of the Investment Company Act. Section 3(c)(1) excludes investment companies that do not offer their securities publicly and whose securities are held by 100 or fewer persons. Section 3(c)(7) excludes investment companies that do not offer their securities publicly and whose securities are held only by "qualified purchasers."

³ "Registration Under the Advisers Act of Certain Hedge Fund Advisers," SEC Rel. No. IA-2266, File No. S7-30-04 ("Proposing Release"), at Section I.A.

“the value that these institutions have is to create a very significant amount of liquidity in our system, and I think that while they have a reputation of being a peculiar type of financial group, they have been very helpful to liquidity and hence the international flexibility of our financial system.”⁴

Hedge funds and their advisers are already subject to the full antifraud authority of the Federal securities laws, regardless of the registration status of their advisers. The SEC already can order both hedge funds and their advisers to produce documents and testimony. Many hedge funds are already subject for at least some of their activities to regulation by or reporting requirements of other regulators, including the Board of Governors of the Federal Reserve System and the Commodity Futures Trading Commission (“CFTC”).⁵

Concerns in Relation to the SEC Proposal Overall

While Roundtable members appreciate that the SEC proposal to require registration of hedge fund advisers does not directly address the behavior of the funds, they are nonetheless concerned about unintended consequences. Hedge funds are an important source of liquidity to the marketplace. They are able to supply this liquidity not just because of their size but also because of their ability to take on leverage and to engage in a myriad of trading strategies, such as short selling.

Roundtable members are concerned that registration could lead to changes in hedge fund behavior, depriving marketplaces of needed liquidity. The Proposing Release notes that registration subjects an investment adviser to examination by the Commission and that “[e]xamination of hedge fund advisers should serve the same deterrent role that it does with respect to other types of advisers.”⁶ The Roundtable is concerned that registration would deter not only the types of fraudulent activity cited by the Commission but also the types of innovative and active trading that serve the marketplace as a whole. As Chairman Greenspan testified,

I grant you that registering advisors in and of itself is not a problem, but the questions is what is the purpose of that unless you are going to go further, and therefore, I feel uncomfortable with that issue.⁷

The Roundtable believes that additional regulation of hedge fund advisers could lead them to relocate offshore.

⁴ “Federal Reserve’s First Monetary Policy Report for 2004,” Hearing Before the Committee on Banking, Housing and Urban Affairs, United States Senate, February 12, 2004, S. Hrg. 108-488 (“Greenspan Testimony”), at 37.

⁵ More than half of hedge fund complexes with assets over \$1 billion have entities that are sponsored, operated, or advised by commodity pool operators and/or commodity trading advisers registered with the CFTC. Testimony of Patrick J. McCarty, General Counsel of the CFTC, before the U.S. Senate Committee on Banking, Housing and Urban Affairs, July 15, 2004, at 3.

⁶ Proposing Release at text accompanying note 75.

⁷ Greenspan Testimony at 37.

The Proposing Release cites the “retailization” of hedge funds, referring to the direct or indirect exposure of smaller investors to hedge funds, as a concern.⁸ The Roundtable notes that if retail investors are inappropriately participating directly in hedge funds that are not registered as “investment companies,” the SEC has authority to make changes to the definition of “accredited investor.” To the extent retail investors are participating through “funds of hedge funds,” the SEC has full authority over those registered investment companies. Finally, the Roundtable notes that investments by public and private pension funds in hedge funds are overseen by the regulators of those funds, including the Department of Labor.

Specific Comments on SEC Proposal

If the SEC requires the registration of hedge fund advisers, the Roundtable suggests that the agency exempt advisers that are already registered with the CFTC as commodity pool operators or commodity trading advisors. This is in keeping with the policy of the Investment Advisers Act, which exempts banks and bank holding companies from registration.⁹ Requiring CFTC-regulated entities to register with the SEC could subject them to duplicative and conflicting regulatory oversight. Sharing of information by the CFTC with the SEC would be a less intrusive solution.

The Roundtable also suggests that the Commission draw a distinction for advisers to funds whose investors consist only of qualified purchasers. Certain recordkeeping and other requirements, intended primarily for the protection of retail investors, might not be appropriate or necessary for these advisers.

If the SEC goes forward with the proposal, the Roundtable believes it is important to retain within the definition of “private fund” the requirement that investors be able to redeem their investment within two years of purchase.¹⁰ Without this provision, the definition would pick up private equity and real estate funds that we believe are not intended to be covered and that do not present the same concerns as those raised in the SEC proposing release. Alternatively, the SEC could create an exemption for private equity and real estate funds based on the nature of their portfolios, which are generally not marked to market, and their general prohibition on redemptions or ongoing subscriptions after an initial offering period.

Roundtable members are also concerned about the proposed requirement that non-U.S. investment advisers register if they have more than 14 U.S. clients.¹¹ The proposal does not appear to recognize that such advisers may be subject to regulation in their home jurisdictions. To respond specifically to a question posed by the SEC, registration would present difficulties because of conflicts with the laws of other jurisdictions. Subjecting these advisers to dual and potentially inconsistent regulation would be burdensome and

⁸ Proposing Release at I.C.

⁹ Investment Advisers Act Sec. 202(11), 15 U.S.C. Sec. 80b-2(11).

¹⁰ Proposing Release at II.D.

¹¹ Proposing Release at II.C.3.a.

anticompetitive. If the SEC goes forward with a hedge fund adviser registration rule, it should not subject advisers to registration if they are regulated in their home jurisdictions.

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The Financial Services Roundtable appreciates the opportunity to comment on these issues. We look forward to discussing our comments and the Commission's proposals further with the Commissioners and staff. If you have any further questions or comments on this matter, please do not hesitate to contact me or John Beccia at (202) 289-4322.

Sincerely,



Richard M. Whiting
Executive Director and General Counsel