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August 31, 2004

By Hand

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: IA-2266 Registration Under the Advisers Act of Certain Hedge Fund Advisers
File No. S7-30-04

Dear Commissioners:

We are submitting these comments on behalf of an unregistered investment adviser to hedge funds. Our client prefers not to identify itself for various professional and personal reasons. The comments are solely those of our client.

COMMENTS REGARDING PROPOSED REGULATION OF HEDGE FUNDS

Our firm and its predecessor entities have been an unregistered investment advisor to hedge funds for over 10 years, and during recent years have managed funds with equity capital in excess of five hundred million dollars. We always have employed fewer than a dozen people in all capacities. Our partners and employees work hard and happily in an entrepreneurial environment. For most of the last 10 years, we either have been closed to new capital or have only accepted a portion of the investor capital available to us. When attractive investment opportunities have been scarce we have encouraged investors to withdraw capital. Most recently we have not been replacing significant capital withdrawals (despite substantial demand therefor from new and existing investors) in order to strictly limit the size of our capital and organization.

We believe these limitations on the size of our capital base have enhanced the returns we generate to our investors and helped maintain a high quality work environment. Our success in these goals is measurable. Despite the fact that we employ no leverage in our portfolio, over the long run and in most years our investment returns are among the very highest of those funds that employ a similar investment strategy. Over the last 1, 3, 5 and 10 years, our investors' net investment returns also are higher than the vast majority of all mutual funds. We also have not had a single employee leave our group during those 10 years except for those above the age of 65. Our decision to limit our capital base undoubtedly has substantially reduced our income, a sacrifice we willingly made for the aforementioned goals. The proposed regulations would impose substantial burdens in the form of high opportunity costs and a less satisfying work experience. We previously have decided not to grow our staff despite extremely attractive incremental profit opportunities and now would need to hire at least one or two additional people.

Adding an additional person, particularly one that comes with bureaucratic tasks and responsibilities, would be a major negative event for our organization. Dealing with various compliance obligations and the additional person will significantly reduce our firm's human resources available to pursue successful investments. Even our much smaller direct costs of compliance will be a multiple of those estimated by the proposed rule (although this is a much smaller concern for us).

If the proposed rule is implemented, we would if necessary consider drastic changes to our business. One possible alternative is to force investor redemptions so that we would have 14 ultimate investors. We would need to dramatically increase the size of each investor's investment with us in order to make that a viable alternative, which may not be possible. Unfortunately, this alternative would deprive most of our current investors of the opportunity to invest with us, would make our capital base less steady as a result of reduced diversity, and might deprive us of desired amounts of capital that would otherwise be available during periodic capital markets crises (when we historically have invested our cash reserves and accepted additional investor capital). Ironically, to pursue this alternative, we would have to redeem the investments of some of our longer-standing, largest and most sophisticated investors that have billions of dollars invested in hedge funds because of the proposed rules' application of look-through rules in counting investors.

Another possible alternative is to accept defeat in our effort to keep a small, unbureaucratic and entrepreneurial firm and to start running the firm for adviser profits. We could add compliance and organizational employees, investment analysts, and investor relations personnel, multiply our assets under management, and become a larger, more profitable firm (for the investment adviser principals) like many of our more heavily regulated peers. Unfortunately, there undoubtedly would be a decline in our investment returns, the quality of our work experience and the stability of our employees.

The SEC notes that many hedge fund advisers voluntarily register under the Advisers Act in order to meet client needs or requirements. It then infers that, in practice, advisers do not consider registration burdensome. For this adviser, and many unregistered advisers it is familiar with, this inference is false. We believe that for certain advisers the benefits of registration exceed the costs and for others the reverse is true, and that the gulf can be substantial. Advisers that are marketing oriented (like most mutual funds) may obtain more benefits from registration and may not care as much about the direct costs, indirect costs and opportunity costs associated with registration. Similarly, more bureaucratic advisers may not experience costs as large as those of less bureaucratic advisers. The rapid growth of hedge funds and the large number of advisers that choose to be unregistered in our opinion should be considered evidence of the attraction, efficiency, effectiveness and desirability of managing investments subject to state and federal securities laws, fiduciary obligations under state laws and the anti-fraud rules of the Advisers Act, but without the additional burden of registration under the Advisers Act. On the issue of the cost of registration, we note that a large investment cooperative which invests billions of dollars on behalf of endowed charitable organizations warned in its last quarterly report that the proposed regulatory charges could "propel hedge fund expense ratios from the stratosphere into the ionosphere." We assume that this large investor, with certain staff members dedicated to hedge fund investments, has concluded that the direct cost of registration will be borne by investors and that the cost to investors will be substantial. We believe that direct investor costs may rise even further, as many hedge fund advisers that are capacity-constrained may consider raising fees to offset the indirect costs and opportunity costs registration would impose upon them.

The SEC postulates that the proposed mandatory registration would provide a "benefit to hedge fund advisers" by leveling the playing field through the imposition of the burdens of regulation on all. In addition to appearing inconsistent with its inference that hedge fund "advisers do not consider regulation burdensome," it fails to consider the current benefits of imposing registration only on those hedge fund advisers whose business models make it justifiable on a cost/benefit basis. Currently advisers can reasonably choose whether to run their businesses in a way that makes registration necessary or advisable and investors can choose whether they prefer the benefits of investing with registered advisers. The market is working.

We believe that the bulk of the SEC's goals can be met in a less burdensome manner. We agree with many of the dissenting Commissioner's observations and also would support portions of the Bryan Cave proposal dated August 16, 2004 (principally using an expanded Form D) made in response to the Commission's proposed rule. We would also like to make certain other suggestions:

(1) Most of the SEC's goals could be met if it exempted from registration investment advisers that accept capital only from truly wealthy and sophisticated investors. We would propose that the SEC utilize the existing "qualified purchaser" standard under section 3 (c) 7 of the Investment Company Act for this purpose. Many qualified purchasers conduct extensive due diligence investigations on key personnel, the investment process and back office operations of hedge fund advisers, prior to as well as periodically after making investments. Qualified purchasers who choose to conduct less rigorous due diligence on investment advisers still will benefit from the diligence conducted by other qualified purchaser investors. Also, unregistered advisers could be required to make themselves known to the Commission in a manner similar to the one proposed by the Commission for offshore advisers to offshore funds, through an

amended Form D as proposed by Bryan Cave, or some other limited registration that does not impose most of the substantive provisions of the Advisers Act. This limited reporting would give the SEC additional information about hedge funds, that when combined with the information available from the large number of registered advisers and the investments made by registered investment companies and brokerage firms (which employ large amounts of capital in the same strategies employed by hedge funds), should be adequate for the informational purposes cited in the proposal. Advisers who are intent on perpetrating frauds likely will not register under any system, but legitimate advisers that would be subject to the reduced reporting requirements would know that the SEC has their address. This would accomplish much of the deterrent effect of full registration with drastically fewer costs and burdens. Further, all advisers could be required to provide contact information for the SEC's enforcement staff in their offering documents. This minimally burdensome requirement could have a deterrent effect and likely would enhance one of the largest sources of the discovery of frauds -- tips.

(2) We believe that if the proposed rules are adopted, it is critical that the proposed two-year rule on redemptions be maintained so that at least some currently unregistered advisers can remain unregistered without more drastically changing their business. We would suggest a further exemption for redemptions if the investor has been invested in the fund continuously for at least five years and if the redeemed amount that was invested during the prior two years was less than 20% of the total amount redeemed. Private equity funds sometimes require small follow-on investments near the maturity of the funds. In addition, a long term investor that chooses to redeem for unanticipated reasons should not be required to maintain a tail-end investment to avoid an adviser registration problem.

(3) Finally we propose that all registered advisers be permitted 150 days to deliver financial statements under Rule 206(4)-2. Virtually all hedge funds and other private funds operate on a calendar fiscal year. Most funds are not ready to commence their audit for a few weeks after year end. This puts an enormous crush on auditor resources during a three-month period. An additional 30 days will in certain cases improve the quality of an audit and will avoid significant adverse consequences from the occasional audit delay that results from incomplete data, legitimate valuation questions and other delays. The aforementioned crush will be even greater if the proposed rule on mandatory registration is enacted.

In our opinion, fraud is a much smaller source of investor misallocation of capital, unjustified investment expenses and substandard investment returns than is the sale of investment products by investment advisers, brokers and other salespeople that are focused on their own income rather than the interests of the investors. Changes to the regulatory scheme that facilitate the marketing and sale of hedge funds in a manner that resembles the sale of mutual funds and insurance products could cause much more investor damage than the possible benefits that the Commission hopes to achieve.

For the aforementioned reasons we respectfully request that the Commission reconsider certain elements of the proposed rules. Incremental regulation can be added later if justified based on the SEC's experience.

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Questions for our client may be transmitted via the undersigned.

Respectfully submitted,

Richard H. Rowe