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September 14, 2004

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

RE: File Number S7-30-04, Registration of Hedge Fund Advisers Under Investment Advisers Act

Dear Mr. Katz:

The purpose of my letter to you today is to express my strong support for the Securities and Exchange Commission's proposed new Rule 203(b)(3)-2 that would require hedge fund advisers to register with the Commission under the Investment Advisers Act of 1940. I believe that the proposal, calling for hedge funds with more than $25 MM in assets and a minimum of 15 clients to register as investment advisers, will enhance investor protection without exacting unduly burdensome compliance requirements for managers. I applaud Chairman Donaldson and indeed, all the SEC Commissioners for encouraging a thorough and thoughtful debate of the issues related to proposals for increasing regulatory oversight of the hedge fund industry (as a personal testimonial, over the past year I have referred many industry colleagues to the SEC's website to tap the impressive wealth of industry knowledge that contributed to a comprehensive review of the issues and solicited input to draft the current regulatory proposals). I fully support Chairman Donaldson's vision for instituting a regulatory framework that enhances investor protections while encouraging the entrepreneurial nature of the industry, and ultimately provides a solid foundation for controlled industry growth and the dynamic evolution of organizational structures, investment vehicles, management and operational teams, product mixes, clients and fee structures.

As to my motivation for writing this letter, I have always been a strong advocate for alternative investments and the benefits that can be achieved by diversifying a traditional investment portfolio with allocations to hedge funds, private equity and other alternative investments. I have also been in the industry long enough to know that hedge fund registration is an idea whose time has come. I don't think I can even count the number of times over the past few years when the media has highlighted how the lack of transparency and lack of accountability has lead investors, among other constituencies, down the slippery slope of profound financial loss and regret. Whether the topic is corporate greed, military service provider contracts and/or investment scams and schemes, negative outcomes seem to be more likely when firms and/or managers are allowed to operate in the shadows with no accountability to anyone but themselves. So my response for the hedge fund industry is " Let there be light." More light on the industry will better illuminate fund management and better serve individual and institutional investors.

THE CASE FOR HEDGE FUND ADVISER REGISTRATION

When establishing a regulatory framework, it's always a good idea for leaders to have a vision for the future and to recognize how events have evolved to shape the present state of the union. This is where I believe Chairman Donaldson excels. Clearly, his vision is honed from years of experience in considering the issues from all perspectives (regulator, securities industry executive, entrepreneur, etc.). The vision must accommodate the reality of how explosive the growth in this industry has been over the past decade but more importantly, must recognize that the industry's overall size today is likely only a small fraction of what it will be a decade from now. Thankfully, we live in country that thrives on the capitalistic attributes of competition, innovation, and opportunism. If there is a strong profit-motivation, sooner or later, firms will devise a way to offer hedge funds to the masses, or "retailization". If individual investors can short ETFs or securities themselves, why shouldn't they be allowed to hire a hedge fund firm to short securities on their behalf. It would seem only equitable that educated investors have equal access to such a diversified menu of products to better insulate their portfolios across market cycles. Indeed, the seeds are already being planted with recent media headlines such as: "Firm to Bring Hedge Fund Strats to 401(k) Mart (Alternative Investment News, August 9, 2004)." How long before the trickle of these announcements becomes a torrent? I simply do not understand comments from those opposing the regulatory changes who say: "The case for mandatory investment adviser registration of hedge fund managers has not been made." How many billions need to be allocated by pension funds and 401(k)'s before a case for registration is made? Ignoring an opportunity to be proactive at this critical juncture in the hedge fund industry's evolution would seem to be a bit risky and short-sighted. The SEC has taken the bull by the horns on these issues and I completely support their conclusions and proposals for increased hedge fund oversight.

PERSONAL PERSPECTIVE ON INDUSTRY EVOLUTION

My own personal perspectives on hedge funds have clearly been shaped by my own unique professional experiences (as is true for everyone in this business). During the course of my career, I too have taken a place on multiple sides of the table as regards alternative investments. About four years ago, I founded my own small-business, Long Trail Capital, LLC, and I am a Registered Representative affiliated with APB Financial Group, Inc., a NYC-based broker/dealer. My firm currently serves as a marketing partner with a select group of alternative investment management firms, all registered investment advisers. As background, I started in the securities business with Salomon Brothers in NYC about 20 years ago, where I was a member of the firm's Treasury Group and Asset Liability Management Committee (it was there that I honed my skills at drafting Comment letters directed to the Federal Reserve, SEC, etc.). From there I joined Dartmouth College's Investment Office, then U.S. Trust (West Coast), then Constellation Investments (Baltimore), then Paradigm Consulting (NJ-based hedge fund consultant), and now my own company, Long Trail Capital. I am also a CFA, Cornell MBA and a member of NYSSA. To summarize, I worked for Salomon Bros. in the 80's (the "mother" of all hedge funds), I've allocated to alternatives on behalf of plan sponsors (E+F's, Pensions and Corporate Taxable Accounts, etc.) and family offices (US Trust), I've been a hedge fund consultant advising institutional and family office clients and now work in an institutional marketing capacity for hedge fund firms. I am a huge advocate for alternative investment programs for investors, provided that managers/funds offer transparency and accountability.

I would like to draw on some observations from my own career in alternative investments to support my views on mandatory SEC registration for hedge fund managers. Perhaps my strongest views and lessons learned were formulated while working at Salomon Bros. (to this day, the love of my corporate life, an experience never to be duplicated). I believe that my most significant contribution to the firm during my five plus years there was the development of a contingency funding plan and global liquidity management system that ultimately enabled Salomon to live to see another day during the liquidity crisis of 1991. By 1991, we completed the creation of a system at Salomon that provided DAILY summary updates on every position in the B/D, what that collateral was worth (market value/loan value), how it was financed and where it was located globally--and everyone at the firm was relying on it to manage the downsizing of a $200 bn firm to a $100 bn firm (with about $800 MM off-balance sheet). When unsecured funding gets pulled from a large, complex securities firm, you either pledge the collateral or sell it--and you better know what it's worth and where it's located. One of the business publications of the time headlined a story "The Bomb Shelter that Salomon Built." Well, let me tell you what, it took a village to build that bomb shelter--and it got done over more a few dissenting voices, requiring several years to complete (money and resources always seem to be directed to pursuits that generate P/L, not absorb it). As I recall, when I started the liquidity management project, the firm was solidly profitable (an understatement) and the overwhelming opinion was that a rigorous, global liquidity management system was not necessary. Everything worked extremely well in that environment, and besides, who really wants anyone to know the traders' proprietary positions (sound familiar)? Fortunately at the time, the Treasurer, CFO and the Asset Liability Management Committee had a different vision, and thus allocated resources to the project. My point is, the firm didn't NEED the system until it really NEEDED the system. My average day during my last 5-6 months with Salomon ran from 8 am to 4 am and started again at 8 am the following day. I will never forget the lessons I learned at Salomon.

From my perspective, I view the early 1990's as the beginning of Phase II in the growth of the hedge fund industry--an explosion in the number of investment vehicles and strategies offered to individual and institutional hedge fund investors. A December 1993 Barron's article estimated that there were over 800 hedge funds representing approximately $40 billion (at the time, one-third of that was managed by Soros, Steinhardt and Tiger). By January of 2001, it was estimated that the hedge fund industry approximated $400 billion in net assets, with over 6,100 hedge funds worldwide (for an average annual growth rate of 39%). During that period, Salomon was sold/integrated into CitiGroup and all across Wall Street, proprietary trading desks were de-emphasized as P/L drivers. In general, SB and other prop desk traders either landed at other hedge fund firms or started their own funds. Wall Street essentially outsourced "regulated traders/employees managing firm/proprietary capital" to their new status as "unregulated traders/clients managing investor capital." Wall Street has effectively converted their former regulated employees, with internal trading positions formerly subject to B/D net capital requirements, into unregulated clients that clear, settle and finance their hedge fund trades with the B/D's. I guess I don't really follow the logic as to why hedge fund managers and their trading positions should not be subject to regulatory oversight if they are managing investor capital and only should be subject to mandatory regulatory oversight if they are employed by Wall Street and managing prop desk capital.

The upside for investors in the industry evolution/revolution is that the majority of these very talented and capable individual hedge fund managers have a significant financial investment in their own hedge funds and thus have a strong entrepreneurial incentive to make sure that their businesses not only survive, but thrive. The downside is that unlike regulated Wall Street proprietary trading desks that had to worry about creditors pulling unsecured financing during a market/industry/firm-specific storm, hedge funds, also needed to worry about investors who may withdraw their equity capital, subject to fund redemption provisions (in addition to worrying about a ill-timed margin call related to leverage from their B/D). As hedge fund investors have discovered, high leverage, illiquid/concentrated positions and monthly/quarterly investor equity redemption schedules really don't mix well together. Significantly, when the proprietary traders initially left Wall Street, they didn't take along the full-service staff of the B/D's including employees from the Finance Desk, Regulatory Reporting, Treasury, Accounting and/or Human Resources experts. The thought by many of the former Wall Street traders was "gee, we're making all this money and it's going to subsidize all these other cost-centers; if we start our own hedge fund and exclude these cost-centers, we could make a lot more money." Again, Salomon had a bomb shelter because it took a village to build one--a diverse employee/experience base. The firm had its bases covered (it's also noteworthy that the majority of firm inventory at the time of the liquidity crisis was in very liquid Treasury/government securities).

HEDGE FUND INDUSTRY PHASE III

Notwithstanding the growing pains, the hedge fund industry has matured from a proprietary trading desk orientation into an entrepreneurial, investor-centric industry. The hedge fund industry has evolved into a very attractive place for investors to allocate capital both for capital preservation and for capital appreciation purposes. The industry continues to attract the best and the brightest investment talent. Current projections forecast the industry will be managing up to $2 trillion in three years. So the challenge for the hedge fund industry and for regulators is to make sure that all of the bases are covered given the evolution of the industry over the past decade. It would seem logical that hedge fund platform firms that offer multiple single manager strategies and/or FOF options to clients may evolve to represent the preferred organizational structure. These firms offer single hedge fund managers a centralized back-office and operational capability with accounting, risk management, regulatory compliance, capital-raising and performance reporting (and possibly, financing, securities borrow/loan, etc.). Wall Street or alternatively, other innovative administrative service providers may also continue to step into that role and offer one stop shopping for risk management and regulatory compliance. Again, for the hedge fund industry, hedge fund manager registration is an idea whose time has come. Although I believe that monitoring hedge fund activities through the B/D's that finance their trades is a good discipline, in and of itself, it is not a replacement for hedge fund registration and regulatory oversight for reasons including, but not limited to: 1) if a B/D has no ownership interest in the hedge fund and/or has no accountability to the hedge funds investors, but only a profit motive related to a client relationship, these are not the right incentives for oversight function (in addition, Wall's Street's move back to internal prop trading operations represents competition to externally managed hedge funds), 2) use of multiple prime brokers by the largest funds complicate the monitoring of individual funds by this method, 3) regulatory oversight needs to incorporate the complete balance sheet including investments in private equity, real estate, and/or other illiquid assets, not just publicly traded securities cleared by prime broker, 4) need for due diligence reporting to fund investors to align with verifiable sources of information (position pricing, aum, manager capital, etc.), 5) hedge fund managers need to be accountable to an overseer with primary mission to protect investor interests, an ever expanding mandate.

SUMMARY

I know this has been long-winded; but the SEC has put the issue on the table and now is the time to respond. Thank you, Chairman Donaldson for your leadership and vision during a very critical juncture in the growth and evolution of the hedge fund industry. And thank you SEC Commissioners for maintaining the courage of your convictions amidst strong dissenting winds coming in from every direction. My objective in writing this letter is simply to support the SEC's proposed rules for hedge fund oversight and to encourage the SEC to fast track the vote to get it done by year-end. Achieving consensus and approving the proposal will be a great accomplishment, but execution is key. I look forward to working in this industry for a long time to come and I believe that the SEC's proactive hedge fund initiatives to enhance investor protections, while ensuring a stable and solid platform for future industry growth will make that possible.

I thank you for the opportunity to summit my comments. If you have any questions or comments, please do not hesitate to contact me at (802) 296-3120.

Respectfully,

Beverly J. DeRouchey

Beverly J. DeRouchey, CFA
Managing Director