



**NASAA**

**NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.**

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December 4, 2003

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

Re: File No. 4-476  
Request for Comment on Hedge Funds

Supplemental Comment Opposing General Advertising for Hedge Funds  
Absent Corresponding Changes to Private Offering Exemptions

Dear Mr. Katz:

The North American Securities Administrators Association, Inc. (NASAA)<sup>1</sup> is taking this opportunity to supplement comments it submitted on July 8, 2003, concerning the hedge fund industry and the Commission's study regarding the need for regulation. This further comment is prompted by recent published reports to the effect that the Commission is considering allowing general solicitation and advertising by hedge funds.

The September 2003 staff study on "Implications of the Growth of Hedge Funds" recommends at pages 100-101 that the Commission consider permitting general solicitation in the case of hedge fund offerings pursuant section 3(c)(7) of the Investment Company Act of 1940 ('40 Act). This recommendation raises a number of problematic issues. Hedge funds are created under the combination of three distinct securities laws: the '40 Act, the Securities Act of 1933 ('33 Act), and the Investment Advisers Act of 1940 (IA Act), yet the proposal fails to discuss how the material differences between these laws would be coordinated.

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<sup>1</sup> The oldest international organization devoted to investor protection, the North American Securities Administrators, Inc. was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico and Puerto Rico. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

The first problematic issue is that general solicitation and advertising is presently prohibited both under the '40 Act for 3(c)(7) companies and for securities offered to investors pursuant to Section 4(2) of the '33 Act and implementing rules promulgated pursuant to Regulation D. The second problematic area is that while the term "qualified purchaser" is defined in the '40 Act it is only mentioned, but has not been defined as it relates to the '33 Act. The third problematic area involves IA Act restrictions on performance advertising by Investment Advisers.

### **General Solicitation and Advertising by Hedge Funds are Prohibited Under Both the '33 and '40 Acts**

A hedge fund typically begins its venture by offering securities to investors utilizing Section 4(2) of the '33 Act and the safe harbor rules of Regulation D, particularly Rule 506. Under Rule 506, the offering of the fund does not have to be registered as a security with the Commission or any state, but instead employs a notice filing. A main premise of *this* rule is that there will be no general solicitation or advertising.

Since hedge funds are primarily engaged in the business of investing and trading in securities, they fall under the '40 Act definition of an investment company unless they can claim an exception to the definition. The hedge funds then look to Section 3(c)(1) or 3(c)(7) for an exception from the definition of investment company. A condition of qualification for the exemption both from registration of the security and from registration as an investment company is that the hedge funds are prohibited from public offerings, general solicitation and advertising under each applicable rule. In proposing to allow general solicitation and advertising for 3(c)(7) funds, the Commission has not addressed how the statutory provisions prohibiting general solicitation and advertising would be overcome.

### **"Qualified Purchaser" is Not Defined for '33 Act Securities**

Hedge funds generally employ the exceptions to the definition of investment company offered under the '40 Act or, in the alternative, they register as investment companies. If a fund seeks an exception under Section 3(c)(7), sales of interests in the fund are limited to "qualified purchasers." The term "qualified purchaser" is defined in Section 2(a)(51) of the '40 Act. The definition covers a number of circumstances, but can be broadly summarized as applying to natural persons owning at least \$5,000,000 in investments. Hedge funds owned exclusively by qualified purchasers are excluded from the definition of investment company under Section 3(c)(7) where a public offering of the securities is not intended. A main premise of *this* rule also is that there will be no general solicitation or advertising.

The term qualified purchaser is also used in other areas of securities law that pertain to hedge funds. For example, Section 18(b)(3) of the '33 Act defines securities that are sold to “qualified purchasers” as “covered securities” and authorizes the Commission to define the term differently for different categories of securities. While the term is defined in the '40 Act, and mentioned in the '33 Act, it has not been defined as it relates to the '33 Act or the related rules under Regulation D. The Commission did propose in late 2001 equating the '33 Act definition with the Regulation D of “accredited investor” in Release No. 33-8041, but no final rule has been promulgated.<sup>2</sup>

NASAA is concerned that if the ban on general solicitation is lifted for hedge funds established pursuant to Section 3(c)(7) of the '40 Act, confusion will result with respect those funds' ability to use Section 4(2) and Rule 506 private offerings. Investor protection also could suffer unless applicable standards are coordinated when individual investors, whether qualified or not, are exposed to advertising and “cold calls.”

NASAA strongly urges the Commission not to permit general solicitation and advertising of Section 3(c)(7) hedge funds without proposing how these funds will be able to continue to use private offerings in compliance with the prohibitions under the '33 Act as described above.

Thank you for your consideration of these concerns. Please do not hesitate to contact me or Mark Davis of NASAA's Legal Department if you have any questions.

Sincerely,

*Patricia D. Struck*

Patricia D. Struck  
NASAA Investment Adviser Section Chair  
Administrator, Wisconsin Division of Securities

Cc: Commissioners

Enclosure

[Note: The enclosure may be found at  
[http://www.nasaa.org/nasaa/Files/File\\_Uploads/qlfdpurchaser.37317-63930.pdf](http://www.nasaa.org/nasaa/Files/File_Uploads/qlfdpurchaser.37317-63930.pdf) .]

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<sup>2</sup> NASAA filed comments in March 2002, a copy of which are enclosed for reference, objecting to the Commission's approach because the definition of accredited investor is over 20 years old and needs to be adjusted. NASAA instead suggested that the definition of qualified purchaser for the '33 Act be equated with the statutory definition under the '40 Act.