NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

NASAA

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

Submitted Electronically to
hedgefunds@sec.gov

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

Dear Mr. Katz:

The North American Securities Administrators Association, Inc. (NASAA)[1] appreciates the opportunity to comment further on the hedge fund industry and the Commission's study regarding the need for regulation. This letter supplements the presentation made by Kristina Kneip, Senior Examination Attorney, Securities Division, Washington State Department of Financial Institutions, at the Hedge Fund Forum in May of this year.

NASAA supports the Commission's proactive position in studying how hedge funds are regulated and how the public might be better served under future regulatory regimes. At present, many members of the public, press and the industry incorrectly believe that hedge funds are not regulated. While this is not the case, it true that the hedge fund industry is presently regulated in a haphazard manner that presents gaps in investor protection. Since many states treat hedge funds differently than the Commission, we believe that it important to convey our regulatory experience and suggestions in this growing area.

NASAA believes that there are five areas the Commission should consider in weighing the possible steps it can take regarding hedge fund regulation. These suggestions focus on the positive impact that would result from regulation in providing increased investor protection through registration, examination and disclosure.

Registration of Hedge Fund Managers

A major difference between the Commission's and states' approach to hedge fund regulation is that many states require hedge fund advisers to register as investment advisers. While those advising hedge funds fit the definition of an investment adviser used by both the Commission and the states, registration turns on the question of how

[1] 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.

many customers the adviser has. The Commission counts each fund as a customer, whereas many states count the individual persons who have interests in the fund as customers. As a result, only hedge fund managers of 15 or more funds must register with the Commission. Those managing 1-14 fund managers are left to the states to regulate. Some of these "smaller" funds (from an investor count) have well over $100,000,000 in assets under management.

The SEC's present method of counting hedge fund customers allows large investment advisers to avoid regulation unless they operate in states requiring registration of hedge fund managers, or they operate a commodity pool subject to CFTC oversight. NASAA suggests that the SEC consider changing the policy governing how "customers' are counted in relation to persons acting as investment advisers

Examination of Hedge Funds

Any expansion of hedge funds registered with the Commission would entail an assessment of examination resources. States that require registration of hedge funds subject them to examination in the same manner as other investment advisers, despite the fact that many of these funds have over $25 million under management. A shift to SEC registration would bring the firms under the auspices of OCIE's examination program.

Change the Accredited Investor Standard

Hedge funds often are offered under Section 506 of Regulation D and thus may sell to an unlimited number of accredited investors. Commission Rule 501 now defines "Accredited Investor" to include natural persons with a net worth exceeding $1,000,000 or income exceeding $200,000. This standard has not been adjusted for many years. Many investors are may not have the level of sophistication necessary to fully understand the nature and extent of hedge fund risks. Especially if their net worth is based upon the value of homes or other illiquid property, they also may not have sufficient funds to undertake necessary due diligence. Absent registration and examination of hedge funds, these investors will not be protected. NASAA suggests that the net worth requirement and income levels necessary to meet the "Accredited Investor" standard in Rule 501 be raised and indexed for inflation.

Require Private Placement Memorandums to be Filed with the Form 506

Rule 506 of Regulation D requires a fairly simple form to be filed with the Commission and notice filings with the states where the offering will be made. The Rule 506 offering is not substantively reviewed by the states, pursuant to NSMIA; the Commission also does not perform a substantive review. While undertaking a full review of Rule 506 offerings would be burdensome to the Commission, NASAA suggests that, at a minimum, entities should file a copy of the Private Placement Memorandum for offering. This would enable regulators and members of the public to obtain these documents from an official source, should the need arise.

Add a Hedge Fund Check Box to Form 506, defining "Hedge Fund" as Necessary

It now is impossible to discern from Form D whether an offering is a hedge fund. This contributes to the uncertainty about the need for further hedge fund regulation because no one can determine how many hedge funds actually exist. A one line question with a yes/no box asking if the offering intends to be a hedge fund would help the Commission and the states identify the universe of hedge funds and ensure that they are registered where necessary. This, of course, would necessitate the Commission establishing a definition of "hedge fund" for the purpose of the form. We believe that such a definition would be helpful to regulators at all levels, as well as informative to potential investors.

NASAA appreciates being given the opportunity to comment on these issues. We look forward to continuing to work closely with the Commission on matters of mutual interest.

Sincerely,

Patricia D. Struck

NASAA Investment Adviser Section Chair
Administrator, Wisconsin Division of Securities