The Long and Short of Hedge Funds: Effects of Strategies for Managing Market Risk

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Before the

Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

United States House of Representatives

May 22, 2003

Chairman Baker, Ranking Member Kanjorski and Members of the Subcommittee:

Thank you for inviting me to testify today to discuss hedge funds generally and the Securities and Exchange Commission's ongoing fact-finding review of hedge funds. As you know, the Commission hosted a two-day Roundtable on hedge funds last week. The event was a great

success and proved to be informative and lively. We had terrific public turnout for the event and a large number of listeners on the webcast, which highlights just how important hedge funds have become. As I said at the close of the Roundtable, it was an excellent example of how the SEC can operate as an effective regulator, by assembling a highly knowledgeable group of experts representing a variety of viewpoints to debate important issues. I appreciate having the opportunity to discuss the Roundtable and our fact-finding review of hedge funds with you.

Fact-Finding Mission and Roundtable

The Commission embarked on a fact-finding mission last year to look into hedge funds. The Commission's Division of Investment Management, alongside our Office of Compliance Inspections and Examinations, has been gathering information on a variety of investor protection issues associated with hedge funds. The staff obtained and reviewed documents and information from 67 different hedge fund managers representing over 650 different hedge funds and approximately $162 billion under management. The staff also visited and engaged in discussions with a number of different hedge fund managers.

As a complement to our inquiries directed to specific hedge funds, the staff has met with a variety of experts, consultants, academics and observers

of the industry to get their perspectives on the hedge fund industry. In addition, a number of foreign jurisdictions are revisiting their approaches to the regulation of hedge funds, and we continue to benefit from discussions with our foreign counterparts.

Participating in our Hedge Fund Roundtable were hedge fund managers, consultants, service providers (such as auditors and attorneys), academics, prime brokers, investment bankers, investors and foreign and U.S. regulators. These experts discussed key aspects of hedge fund operations – how they are structured and marketed, investment strategies they use, how they impact our markets, how they are regulated, and whether the regulatory framework should be modified.

I want to stress that the Roundtable was not the culmination of our fact-gathering and that we have not yet reached any conclusions. I have asked the SEC staff to prepare a report to the Commission on the results of our various fact-finding efforts. Additionally, we have called for public comment on the issues surrounding hedge funds. The public comment period will close approximately 45 days from today, on July 7th. I have asked the staff to consider these views when preparing the staff report, which will be delivered to the Commission, with the intention of making it publicly available shortly thereafter.

So, while it is too early to draw any conclusions or make recommendations about the regulation of hedge funds, I do want to share with you some of the issues and areas of interest explored during the Roundtable, including (1) growth of hedge funds, (2) hedge fund trading strategies and market impact, (3) trends in the hedge fund industry, (4) the differences between hedge funds and registered investment companies, (5) hedge fund fraud, (6) the regulatory framework applicable to hedge funds, and (7) investor education.

Growth of Hedge Funds

One of the reasons the Commission determined to embark on its fact-finding mission is because of the tremendous growth of hedge funds. Over the past few years, the number of hedge funds and their assets under management has continued to increase. As was reiterated last week at the Roundtable, there are no precise figures available regarding the number, size and assets of hedge funds. This is due, in part, to the fact that there is no industry-wide definition of hedge fund; in part, because those that track hedge fund data rely on self-reporting by hedge funds; and in part because hedge funds generally do not register with the SEC, so we cannot independently track the data.

Nonetheless, during our Roundtable, knowledgeable sources confirmed that there are between 6,000 and 7,000 hedge funds operating in the United States today with approximately $650 billion under management. To put this number in perspective, today there are approximately $6.3 trillion of assets under management in the mutual fund industry. Over the past few years, the panelists estimated that there has been, on average, approximately $25 billion a year in new assets invested in hedge funds. One panelist estimated that, in the next decade, assets under management in hedge funds will top $1 trillion.

Hedge Funds and Their Trading Strategies

As was noted in the Roundtable, the term "hedge fund" is undefined, including in the federal securities laws. Indeed, there is no commonly accepted universal meaning. As hedge funds have gained size and popularity, though, "hedge fund" has developed into a catch-all classification for many unregistered, privately-offered, managed pools of capital, generally excluding, in particular, funds principally involved in venture capital or similar private equity investments. This is, I believe, a far cry from the original concept of hedge funds in the early 1950s, when hedge funds characteristically were long/short equity funds that engaged in fundamental hedging strategies.

Hedge funds today engage in a wide variety of trading strategies based on mathematical models, as well as strategies developed to take advantage of perceived market inefficiencies. There are hedge funds focused on equity strategies, others focused on fixed income strategies, and still others focused on a combination of the two. Panelists said that hedge funds are net providers of liquidity to the markets, and that they are active and informed traders whose research fosters more accurate market prices, and so they play an important role in promoting efficient pricing of financial instruments.

Panelists noted that trading by hedge funds is subject to the same market rules as other traders, although some strategies may be more accessible to, or feasible for, hedge funds than to regulated entities. While hedge funds sometimes engage in substantial short selling, that activity usually reflects a belief that a company is overvalued, or is part of a hedging strategy. It was also pointed out that short selling is subject to greater regulation, at least in exchange-listed stocks, than most other trading activities. Moreover, if short sellers make false statements about issuers for the purpose of lowering their stock prices, that conduct is actionable under the anti-fraud and anti-manipulation provisions of the federal securities laws.

There was some debate about whether hedge funds present systemic risk to the markets. It was noted that there are some market-driven controls on the risk that hedge funds can take. For example, firms that supply prime brokerage services to hedge funds said that they protect themselves by carefully screening them for business model consistency, credit quality, leverage, and other areas of risk management. However, a prime broker is not necessarily aware of all of a hedge fund's activity. Some panelists stated that volatility in hedge funds was less than that of stocks. Others noted that, while volatility may be lower and relatively few hedge funds have failed, some strategies used by hedge funds have led to spectacular failures that could threaten the financial system, notably Long Term Capital Management. One participant recommended that the Commission analyze every hedge fund failure to identify possible causes to alleviate systemic problems.

Trends in the Hedge Fund Industry

Roundtable panelists explored trends in the hedge fund industry. These trends included not only an increase in the number of hedge funds and the assets of those hedge funds, but also an increase in the number and type of institutions, such as pension plans and endowments, investing in hedge funds and a continuation of the entrepreneurial management that has been a

hallmark of hedge funds. According to our panelists, the institutional investors that are placing a portion of their assets with hedge funds typically are very sophisticated and perform extensive due diligence prior to investing, often taking months to research a hedge fund before making an investment. As with many of the panelists' positions, the Commission and staff are, of course, not currently in a position to verify their assertions.

Another trend involves so-called "retailization" and the recent emergence of registered funds of hedge funds. These are registered investment companies that invest all, or substantially all, of their assets in an underlying pool of hedge funds. These products offer a means of increased availability of hedge funds to public investors. The Commission's Division of Investment Management has seen a boom in these funds. In the summer of 2002, the first fund of hedge funds became eligible to sell its securities to the public. Subsequently, there have been approximately 19 other funds of hedge funds cleared for the public market.

All of these funds currently have minimum investment requirements of at least $25,000. Also, these funds currently limit their investors to accredited investors (i.e., investors with an income for the last two years of $200,000 or net worth of $1 million). But, there is currently no federal requirement for a minimum investment or for limiting eligible investors, and

it is likely that funds might seek to lower these requirements, thus making these types of funds available to a greater number of investors with less capital. As was discussed at our Roundtable, the emergence of these products also implicates the need to focus on suitability determinations and sales practices of those marketing hedge funds and funds of hedge funds.

Funds of hedge funds raise special concerns because they permit investors to invest indirectly in the very hedge funds in which they likely may not invest directly due to current legal and regulatory restrictions. Many of our Roundtable participants noted that registered funds of hedge funds, because of their size and influence, can compel the underlying hedge funds to provide more information to investors than they would typically receive. However, even funds of hedge funds do not get the same volume and frequency of information as investors in a registered investment company or mutual fund. Investors in these funds receive very little information on an on-going basis regarding the underlying funds and, because the underlying hedge funds are not subject to our examination authority, we have very little information regarding them as well. Our further work in this area will include consideration of the type and level of information available to funds of hedge funds, and their investors, from the underlying hedge funds.

Prime Brokers. As I mentioned earlier, another trend discussed at the Roundtable was the importance of the role of prime brokers. Hedge funds generally use one or more broker-dealers, known as "prime brokers," to provide a wide variety of services.

Prime brokerage is a system developed by full-service broker-dealers to facilitate the clearance and settlement of securities trades, and other aspects of portfolio management, for substantial retail and institutional customers including, especially, those who are active market participants. Prime brokerage involves three distinct parties: the prime broker, the executing broker, and the customer. The prime broker is the broker-dealer that clears and finances the customer trades executed by one or more executing broker-dealers at the behest of the customer. The prime broker is responsible for all applicable margin and Regulation T requirements for the customer.

Generally, customers, such as hedge funds, believe a prime brokerage arrangement is advantageous because the prime broker acts as a clearing facility and a source of financing for the customer's securities transactions wherever executed, as well as a central custodian for all the customer's securities and funds.

Prime brokers offer certain other services to hedge funds that are typically offered to other substantial customers such as margin loans and risk management services, but prime brokers may also offer other services that are particularly directed to their hedge fund customers. For example, some prime brokers provide "capital introduction" services to hedge funds. These services, which range from sponsoring investor conferences to arranging individual meetings and preparing informational documents, are aimed at bringing hedge fund managers together with potential investors. We are looking into these services, their impact and the manner in which they are disclosed to investors.

Differences between Hedge Funds and Registered Investment Companies

Trading Strategies. Several of our Roundtable participants focused on comparing and contrasting hedge funds with registered investment companies. For example, one panel explored how hedge fund investment and trading strategies compared with mutual fund investment and trading strategies, particularly in terms of risk. This panel also explored whether, because hedge funds are not subject to the liquidity, diversification and senior security coverage requirements imposed on registered investment companies, they increase their potential exposure to market fluctuations. On the flip side, the panel also considered whether the current investment,

leverage and redemption limitations imposed on registered funds through the Investment Company Act of 1940 are too restrictive and whether the growth of unregistered funds is due in part to these restrictions on registered funds.

Performance Fees. Panelists reviewed the differences in compensation structures for mutual fund managers and hedge fund managers. One of the predominant characteristics of hedge funds is that hedge fund managers typically receive a performance fee. In addition to a 1-2% management fee, the general partner or manager of a hedge fund usually also shares in any profit of the hedge fund. A typical performance arrangement provides that the manager will receive a certain percentage-- typically 20% -- of the net appreciation of the fund in excess of a specified benchmark. Mutual funds, on the other hand, are limited to a type of performance fee known as a "fulcrum fee" in which the manager is compensated for performance above an index, but is correspondingly penalized for performance below an index. According to panelists, only a small number of mutual funds, estimated at less than 2%, have fulcrum fees.

Some of our institutional investor panelists noted that performance fee arrangements align the interests of the hedge fund manager with the investors, as the manager's compensation structure provides a monetary incentive to perform well. It should be noted that performance fees of the

types generally used in hedge funds align manager and investor interests on the upside but not on the downside. Some panelists also indicated that it was important to them that the hedge fund manager have a significant portion of his or her personal net worth invested in the hedge funds to further align their interests.

Hedge fund performance fees also raise a conflict of interest issue when an investment adviser manages both a hedge fund and a mutual fund or some other kind of account without a performance fee. The adviser has an incentive to allocate the best trades, ideas and attention to the hedge fund because of the potential to increase the performance fee. Roundtable panelists generally agreed that this situation does raise a conflict of interest that requires appropriate disclosure, allocation and other procedures on the part of the adviser.

Performance Reporting. Another area of comparison focused on performance reporting. Mutual funds must report their performance in a standardized format, meant to enable an investor to make meaningful comparisons between different mutual funds. Currently, there are no requirements dictating how a hedge fund should report its performance. Some of the Roundtable panelists suggested that it might be helpful for hedge funds to have standardized performance reporting, although I should

note that the marketplace itself has taken steps in analogous situations to address the issue of standardized performance reporting.

Valuation. Related to performance reporting is the issue of valuation. The Roundtable featured a lively discussion of valuation of hedge fund holdings. Registered investment companies must price their portfolio securities at market or, if there is no reliable market price, at their current "fair value" – determined in good faith by the fund's board of directors. Hedge funds are not specifically subject to these requirements. Thus, for example, hedge funds may determine that the appropriate price of a security is its inherent price, a price that looks to the future. Or it may substitute the manager's determination of the value of a security for a market price. Valuation determinations can be further complicated by the fact that hedge fund portfolios may have a large number of illiquid securities in them about which valuation information is further limited, thereby making the manager's valuation all the more subjective.

These valuation determinations are, of course, subject to the antifraud provisions of the federal securities laws. Ultimately, it may be impossible for an investor to know the actual value of a hedge fund's portfolio securities. Panelists did note, however, that the hedge fund industry is

moving in the direction of involving independent third parties in the valuation of hedge fund assets.

Finally, some panelists observed that a hedge fund adviser's timing of disclosing changes in valuation, including substantial decreases, is subject to general anti-fraud principles.

Disclosure and Transparency. Performance fees and valuation raise the broader issue of disclosure and transparency generally. Panelists discussed the nature of hedge fund disclosure through the private placement memorandum, compared to the mandated disclosure provided in a registered investment company's prospectus. Many agreed that there is room for disclosure improvement on both fronts but that much could be done to improve the usefulness of the private placement memorandum. Panelists also discussed the need for increased transparency, particularly of hedge fund risk characteristics, as opposed to portfolio position disclosure. Finally, some panelists discussed the need for ongoing disclosure to investors, in addition to the disclosure received when making the initial investment decision.

Hedge Fund Fraud

Fraud is, of course, always a primary concern to us. I emphasize that I am not suggesting that hedge funds or their managers engage

disproportionately in fraudulent activities. Indeed, some at our Roundtable, including the CFTC, which oversees futures trading activities of that portion of the hedge fund universe that operate as commodity pools, asserted that commodity pools, especially large commodity pools, have been relatively free from major frauds.

However, the Commission has seen an increase in the number of hedge fund frauds that we have investigated and that have resulted in enforcement action. In fact, last year we instituted 12 hedge fund related enforcement actions, which was almost twice the number of enforcement actions against hedge funds or their managers than we instituted in any of the four previous years, having instituted 7 hedge fund actions in 2001, 6 in 2000, 2 in 1999 and 1 in 1998.

Examples of charges filed by the Commission include:

making false or misleading statements in offering documents;
misappropriating assets;
market manipulation in a variety of guises;
reporting false or misleading performance, including with respect to valuation of securities; and
fraudulently allocating investment opportunities.

These charges generally are not unique to hedge funds, and fraud may not be more prevalent at hedge funds. But hedge funds present us with a unique challenge. Because hedge funds typically are not registered with us, we are limited in our ability to detect problems before they result in harm to

investors or the securities markets. We will continue to come down hard when we see fraudulent activities involving hedge funds, or any investment entity, and I would disabuse any fraudsters who might believe that hedge funds provide a safe haven for engaging in fraudulent or manipulative activity.

Regulation of Hedge Funds under the Federal Securities Laws

As was noted at our Roundtable, the exclusions from registration under the federal securities laws that apply to hedge funds and their securities offerings are central to the questions that currently surround hedge funds. The exclusions define the investment strategies that hedge funds may pursue, the types of investors who generally may invest in hedge funds, and how hedge fund securities may be sold. Hedge funds are able to avoid regulation by meeting criteria that are laid out in four general exclusions or exceptions: (1) the exclusion from registration of the fund under the Investment Company Act of 1940, (2) the exemption from registration of the fund's securities under the Securities Act of 1933 (3) the exception from registration of the hedge fund manager under the Investment Advisers Act of 1940, and (4) the exception from reporting requirements under the Securities Exchange Act of 1934.

Exclusion from Registration under the Investment Company Act of 1940. Hedge funds typically do not register with the SEC. They rely on one of two exclusions under the Investment Company Act of 1940 to avoid registration. The first exclusion under Section 3(c)(1) of the Investment Company Act limits investors in the hedge fund to 100 persons, while the second exclusion under Section 3(c)(7) of the Investment Company Act, which was added to the Investment Company Act in 1996, imposes no numerical limit on the number of investors.[1] Instead, it generally looks to the size and nature of the investments of an individual. Thus, investors in funds that utilize the 3(c)(7) exemption generally must be "qualified purchasers." Qualified purchasers are defined to include high net worth individuals (generally individuals who own certain specified investments worth at least $5 million) and certain institutional investors. The operating principle behind 3(c)(7) is that sufficiently wealthy investors do not need the full protections of the registration provisions of the federal securities laws.

Exemption from Registration under the Securities Act of 1933. Importantly, both of these exclusions require hedge funds to sell their securities in non-public offerings. Thus, most hedge funds rely on one of a

[1] Although there is no specific numeric limitation on the number of investors in a Section 3(c)(7) fund, the federal securities laws generally require any issuer with 500 or more investors and $10 million of assets to register its securities and to file public reports with the Commission. Most hedge funds do not wish to register their securities, and therefore they stay below the 500 investor level.

handful of exemptions under the Securities Act in order to avoid making a public offering. In order to be classified as a non-public offering, the hedge fund securities may not be offered for sale using general solicitation or advertising. Additionally, hedge funds generally sell their securities only to those who qualify as "accredited investors." The term "accredited investor" includes individuals with a minimum of $200,000 in annual income or $300,000 in annual income with their spouses, or a minimum, with their spouses, of $1,000,000 in net assets. It also includes most organized entities with over $5,000,000 in assets, including registered investment companies.[2]

Because these limitations under the Securities Act apply at lower levels than the "qualified purchaser" exemption for 3(c)(7) funds, these 3(c)(7) funds may only be offered or sold to investors who are qualified purchasers as well as accredited investors. Other hedge funds, that do not qualify as 3(c)(7) funds, including 3(c)(1) funds, may be offered and sold to accredited investors, whether or not they are also qualified purchasers.

The monetary amounts used to determine accredited investor status essentially have remained the same since 1982. With the sustained growth in incomes and wealth in the 1990's, however, more investors meet this

[2] This exemption also permits a private issuer to sell to up to 35 non-accredited investors, but in that case, those investors must be "sophisticated" persons – meaning that they must be capable of evaluating the merits and risks of their investment – and the issuer must provide disclosure to those investors comparable to that in public offerings.

standard, despite recent economic downturns. Although the Commission is not aware of any systematic investor losses or other failures caused by the current accredited investor standard, we could of course consider adjusting it, if warranted. In that respect, it may be appropriate to consider whether the definition should be updated to increase the levels of income or assets. It also may be anachronistic to use the definition as a surrogate for investor sophistication, and it may also be worthwhile to revisit that concept. A global change to the standard, however, could impact significantly the availability of securities registration exemptions to other companies. In particular, we would carefully consider the effect of any adjustment to the standard on the opportunities for small business capital formation before proposing any change.

In addition, the Internet has changed forever how companies communicate with their current and prospective investors. Just plugging the term "hedge fund" into any search engine will elicit hundreds of responses. If hedge fund sponsors fail to follow the law, every investor with access to the Internet could easily obtain materials that could constitute an offering of securities to the public, triggering registration and other requirements under the securities laws. Appropriate regulation of Internet offerings is a challenge for the Commission, as it is for other regulatory agencies. The

Commission staff watches how the Internet is used to offer securities to the public, including offerings by hedge funds. Our policy goal is to strike a balance between encouraging use of the Internet for legitimate capital formation and at the same time preventing fraud and abuse. If we become concerned that our rules and guidelines need to be changed, or enforcement action needs to be taken, to prevent abuse by hedge funds or others engaged in purported capital formation activity, we will act accordingly.

Exception from Registration under the Investment Advisers Act of 1940. Managers of hedge funds meet the definition of "investment adviser" under the Investment Advisers Act of 1940 because they are in the business of providing investment advice about securities to others. Under this Act, an investment adviser with fewer than 15 clients that does not publicize itself generally as an investment adviser is not required to register with the Commission. Because Commission regulations permit an adviser to count each hedge fund, rather than each investor in the hedge fund, as one client, some hedge fund managers may not be required to register with the Commission.[3] Unregistered advisers are not directly subject to the Commission's examination and inspection program. But, it is important to

[3] We understand that some hedge fund managers voluntarily register with the Commission because some investors, particularly many foreign investors, prefer their managers to be registered. Others register because they also advise registered investment companies, which are required to be advised only by registered investment advisers.

note that all hedge fund managers -- whether registered as investment advisers or not -- are subject to the antifraud provisions of the Investment Advisers Act.

One issue that was raised at a number of the panels at the Roundtable was the SEC's lack of examination and inspection authority over hedge funds, due to the fact that hedge funds typically are not registered with the Commission, and many of their managers are unregistered as well. Some of our panelists argued that if the SEC staff were able regularly to examine hedge fund managers, not only would incidents of fraud potentially decrease, but investors would have more information upon which to make their investment decision. However, other panelists noted that there is cost to any additional registration and examination of hedge fund managers and cautioned the Commission to consider a cost/benefit analysis of the registration of hedge fund managers. With respect to the registration of hedge fund managers as investment advisers, there seemed to be general consensus that the industry is moving in that direction because of market forces—some investors, particularly certain institutional investors, demand that a manager be registered as an investment adviser before investing money in that manager's hedge fund.

Exception from Reporting Requirements under the Securities Exchange Act of 1934. Hedge funds generally are not subject to the periodic reporting requirements of the Securities Exchange Act because they are operated so as not to trigger registration of their securities under that statute. However, if a hedge fund holds large public equity positions, the manager, like any other large institutional manager, must publicly disclose those positions. This disclosure, however, does not necessarily provide significant insight into any particular hedge fund's portfolios or strategies because the manager is permitted to aggregate all clients' holdings into one report. In addition, there may not be comparable disclosure required of short and debt positions.

For long positions, hedge funds have the same disclosure requirements as other market participants. Sections 13(d) and 13(g) of the Exchange Act require the reporting of information with respect to long positions relevant to corporate control and its transfer. Generally, any person who, directly or indirectly, acquires beneficial ownership of more than 5% of a class of equity security registered pursuant to Section 12 of the Exchange Act is required to report such acquisition. In addition, Section 13(f) requires institutional investment managers, including hedge fund managers, who exercise investment discretion over $100,000,000 or more of

equity securities registered under Section 12 to disclose their securities positions on a quarterly basis.

Similarly, hedge funds are subject to the same disclosure obligations as other market participants with regards to short sales. While the Commission's rules generally do not require the disclosure of most short sales or short security positions, rules of self-regulatory organizations require their members to report once a month aggregate short positions in exchange-listed and Nasdaq securities to all customer (including hedge fund customers) and proprietary accounts. This information is publicly available.

The more general issue of short sale and short position disclosure has been raised in the past. In the late 1980s and early 1990s, there were discussions on whether there should be comparable disclosure of short positions in equity securities as there are for long positions. The Subcommittee on Commerce, Consumer and Monetary Affairs of the House Committee on Government Affairs held hearings on the market role of short selling.[4] Further, a bill was introduced in 1990 that, among other things, proposed requiring the public reporting of material short security positions. Congress did not take any action on the bill.

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[4] See Short Selling Activity in the Stock Market: The Effects on Small Companies and the Need for Regulation, Hearings Before the Subcomm. on Commerce, Consumer and Monetary Affairs of the House Comm. on Government Affairs, 101st Cong., 1st Sess. 192 (1989).

In addition, the Commission published a concept release in 1991 soliciting public comment on whether the Commission should require public reporting of material short security positions in publicly traded companies in a manner analogous to the reporting requirements for material long security positions.[5] Subsequently, the Commission did not propose or adopt such proposals, in part, because Commission staff reasoned that:

- It could be unlikely that a reporting requirement would reach any significant portion of the alleged short sale abuses, because a short seller rarely sells as much as 5% of an issuer's outstanding stock. A lower threshold would impose substantial costs, and it could be difficult to justify a lower threshold for short positions than long positions.

- A reporting requirement would not add significantly to the information already available. SROs require members to report short positions in all customer and proprietary accounts and aggregate information, by security, is published monthly. Issuers, through their industry contacts, probably have little difficulty in identifying very large short sellers.

I believe that the current level of disclosure provides investors with some information on both long and short security positions, including hedge fund positions. However, as part of our hedge fund fact-finding investigation, we will consider proposals that would enhance position transparency and increase investor protection in this area.

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[5] See Exchange Act Release No. 29278 (June 7, 1991).

Investor Education Efforts

Before I close, I would like to discuss investor education. Roundtable panelists were nearly unanimous in their call for increased education to alert investors to the risks and rewards of hedge fund trading techniques. The Commission takes its investor education responsibilities very seriously. And in light of the Roundtable comments, we are reviewing possible ways to better educate investors. However, we already have taken several steps.

Since the creation of the Commission's website at www.sec.gov, we have used the website to educate and alert investors to issues relating to securities. Among other things, the website generally discusses hedge funds and funds of hedge funds. We have also used that website to provide investors with important questions that they should ask before investing in these products.

In addition, Commission staff developed a website advertising a simulated hedge fund, Guaranteed Returns Diversified, Inc. ("GRDI" or "greedy", for short). This website demonstrates how easy it is to be taken in by false statements and seeks to sensitize investors to their vulnerability. The Commission's website provides a link to the fake scam, although we've discovered that most are finding it by surfing the Internet looking for quick

and easy returns. Since we launched this website on February 13, 2003, we have had over 80,000 hits on it!

Conclusion

In conclusion, the Commission is far along on its hedge fund fact-finding mission. And we will continue to proceed with a focus on how to best protect investors and our securities markets. I am anxious to take the next step in the process, which is to consider a broad range of issues on the hedge fund industry. I view this as an important next step, as we need to hear from all segments of the hedge fund industry, including those not represented at the Roundtable, as well as those of the investing public. While we had many distinguished, thoughtful and helpful panelists, I am mindful that in such a public forum as a roundtable, we may have heard a guarded version of the state of the industry. It is our duty as the investors' advocate to ensure that we have *all* of the relevant information as we formulate a course of action.

Next, the Commission will have the staff prepare a report outlining its findings from the fact-gathering mission, the Roundtable and public comments. I anticipate the report will address the key issues that have been a focus of our inquiry, including (1) hedge fund trading strategies and market impact, (2) the increasing availability of hedge fund exposure to

retail investors, (3) the disclosures investors receive when investing in hedge funds and on an ongoing basis, (4) the differences between hedge funds and registered investment companies, (5) conflicts of interest, including those created by the fee structures of hedge funds and funds of hedge funds, (6) the role of prime brokers, (7) hedge fund fraud, (8) the regulatory framework applicable to hedge funds, and (9) investor education. I have instructed the staff to include in its report any recommendations for change in the regulatory framework governing hedge funds. I look forward to reviewing this report, analyzing its recommendations and sharing the report with you.

Thank you again for this opportunity to share my insights on the Commission's recent activities relating to hedge funds. I would be happy to answer any questions that you may have.