CAN THE RICH FEND FOR THEMSELVES?: INCONSISTENT TREATMENT OF WEALTHY INVESTORS UNDER THE PRIVATE FUND INVESTMENT ADVISERS REGISTRATION ACT OF 2010

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I. INTRODUCTION

The federal securities laws are littered with exemptions for wealthy investors.[1] The rationale underlying these exemptions is that wealthy investors can "fend for themselves" because they either possess sufficient financial sophistication to make informed investment decisions or can acquire the services of advisers who possess such sophistication.[2]

On July 21, 2010, President Barack Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (more commonly referred to as the "Dodd-Frank Act") into law to "promote the financial stability of the United States by improving accountability and transparency in the financial system . . . [and] protect consumers from abusive financial

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1. *See infra* Part II.

2. *See, e.g.*, Proposed Revision of Certain Exemptions From the Securities Act of 1933 for Transactions Involving Limited Offers and Sales, Securities Act Release No. 6339, 46 Fed. Reg. 41,791, 41,802 (Aug. 18, 1981); Resale of Restricted Securities: Changes to Method of Determining Holding Period of Restricted Securities Under Rules 144 and 145, Securities Act Release No. 6806, 53 Fed. Reg. 44,016, 44,027–28 (Nov. 1, 1988); C. Edward Fletcher, III, *Sophisticated Investors Under the Federal Securities Laws*, 1988 DUKE L.J. 1081, 1123 (1988); U.S. SEC. & EXCH. COMM'N, IMPLICATIONS OF THE GROWTH OF HEDGE FUNDS, 87 (Sept. 2003), *available at* http://www.sec.gov/news/studies/hedgefunds0903.pdf.

services practices."[3] The Dodd-Frank Act includes the Private Fund Investment Advisers Registration Act of 2010 (the "Private Fund Registration Act"), which becomes effective on July 21, 2011, and generally requires advisers to "private funds" with over $150 million in assets under management to register with the U.S. Securities and Exchange Commission and be subject to registration, reporting, recordkeeping, and examination requirements.[4] As defined in the Private Fund Registration Act, "private funds" generally include private equity and hedge funds limited to wealthy investors, but not venture capital funds.[5]

This comment analyzes the inconsistent treatment of wealthy investors under the federal securities laws in light of the passage of the Private Fund Registration Act. Part II summarizes the exemptions in the federal securities laws for wealthy investors. Part III provides an overview of private equity and hedge funds, including their investment strategies, size, and structure. Part IV summarizes the regulation of private funds under the Private Fund Registration Act. Part V analyzes the regulation of private funds under the Private Fund Registration Act in light of the exemptions in the federal securities laws for wealthy investors. This comment concludes with policy recommendations to eliminate the inconsistent treatment of wealthy investors under the federal securities laws.

II. FEDERAL SECURITIES LAW EXEMPTIONS FOR WEALTHY INVESTORS

Exemptions for wealthy investors are scattered throughout the federal securities laws. Under the Securities Act of 1933, the issuance of securities to public investors generally requires the filing of a registration statement with the U.S. Securities and Exchange Commission and delivery of a prospectus containing detailed information about the issuer.[6] Pursuant to Rule 506 promulgated by the Commission under the Securities Act, the issuance of securities to "accredited investors" is generally not considered a "public offering" and is therefore exempt from the registration and prospectus delivery requirements in the Securities Act.[7] "Accredited investors" are defined in Rule 501 of the Securities Act to include specified

3. Pub. L. No. 111-203, 124 Stat. 1376 Preamble (2010).

4. *Id.* at Title IV.

5. *Id.* at §§ 402, 407; DAVIS POLK & WARDWELL LLP, SUMMARY OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT 64 (July 21, 2010), *available at* http://www.davispolk.com/files/Publication/efb94428-9911-4472-b5dd- 006e9c6185bb/Presentation/PublicationAttachment/efd835f6-2014-4a48-832d-00aa2a4e3fdd/070910_Financial_Reform_Summary.pdf; KIRKLAND & ELLIS LLP, TIME FOR MANY PRIVATE FUND MANAGERS TO PREPARE FOR INVESTMENT ADVISER REGISTRATION 1 (July 21, 2010), *available at* http://www.kirkland.com/siteFiles/Publications/628D32C2C3EA7D6857B9B4F29134390D.pdf; *see also infra* Part III.

6. 15 U.S.C. §§ 77e–g, 77j, 77aa (2009).

7. 17 C.F.R. § 230.506 (2010).

institutional investors and individuals with a net worth of over $1 million or annual income of over $200,000.[8] Pursuant to Rule 144A promulgated by the Commission under the Securities Act, resales of securities to "qualified institutional buyers" are also exempt from the registration and prospectus delivery requirements in the Securities Act.[9] "Qualified institutional buyers" are defined in Rule 144A to include specified institutional investors that own and invest at least $100 million on a discretionary basis in securities of issuers that are not affiliated with the entity.[10]

Under the Investment Company Act of 1940, issuers that hold themselves out as being primarily engaged in the business of investing, reinvesting, or trading in securities are required to register with the Commission and be subject to investment restrictions and reporting, organizational, recordkeeping, and examination requirements.[11] Pursuant to Section 3(c)(1) of the Investment Company Act, issuers whose outstanding securities are owned by no more than 100 persons and which are not making and do not propose to make a "public offering" of their securities (i.e., their securities are only issued to "accredited investors") are exempt from the requirements in the Investment Company Act.[12] Pursuant to Section 3(c)(7) of the Investment Company Act, issuers whose outstanding securities are owned by "qualified purchasers" and which are not making and do not propose to make a "public offering" of their securities are also exempt from the requirements in the Investment Company Act.[13] "Qualified purchasers" are defined in Section 2(a)(51) of the Investment Company Act to include individuals that own at least $5 million in investments and institutional investors that own and invest at least $25 million on a discretionary basis.[14]

Finally, Section 205(a)(1) of the Investment Advisers Act of 1940 prohibits investment advisers from entering into investment advisory contracts with clients that provide for compensation to the investment adviser based upon the capital gains or appreciation of the client's funds.[15] However, Section 205(b)(4) of the Investment Advisers Act permits investment advisers to enter into investment advisory contracts that provide for compensation to the investment adviser based upon the capital gains or appreciation of client funds with issuers exempt from the Investment Company Act pursuant to Section 3(c)(7) (i.e., issuers whose outstanding

8. 17 C.F.R. § 230.501 (2010).
9. 17 C.F.R. § 230.144A (2010).
10. *Id*.
11. 15 U.S.C. §§ 80a-1 et. seq (2009).
12. 15 U.S.C. § 80a-3(c)(1) (2009).
13. 15 U.S.C. § 80a-3(c)(7) (2009).
14. 15 U.S.C. § 80a-2(a)(51) (2009).
15. 15 U.S.C. § 80b-5(a)(1) (2009).

securities are owned by "qualified purchasers").[16] Furthermore, Rule 205-3(a) promulgated by the Commission under the Investment Advisers Act, permits investment advisers to enter into investment advisory contracts with "qualified clients" that provide for compensation to the investment adviser based upon the capital gains or appreciation of client funds.[17] "Qualified clients" are defined in Rule 205-3(d) promulgated by the Commission under the Investment Advisers Act to include individuals or institutional investors that have at least $750,000 in assets under the management of the investment adviser, a net worth of more than $1.5 million, or are "qualified purchasers" as defined in the Investment Company Act.[18]

III. PRIVATE EQUITY AND HEDGE FUNDS

Private equity funds generally acquire companies using leverage (i.e., debt) for the purpose of restructuring the companies (through acquisitions, divestitures, elimination of unprofitable business segments, and alignment of management incentives with those of the private equity funds through profit participation) for their eventual sale or public offering of securities.[19] On the other hand, hedge funds generally implement a wide array of investment strategies (including long or short positions in equity securities, arbitrage, and event-driven investments) to produce risk-adjusted positive returns from various market opportunities.[20]

According to the research firm Prequin Ltd., 96 private equity funds raised approximately $107 billion in 2009 (compared with 220 private equity funds raising approximately $248 billion in 2008 and 228 private equity funds raising approximately $246 billion in 2007), and private equity funds acquired 1,050 companies for an aggregate value of approximately $82 billion in 2009 (compared with 1,521 companies for approximately $186 billion in 2008 and 2,556 companies for approximately $659 billion in 2007).[21] According to the research firm International

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16. 15 U.S.C. § 80b-5(b)(4) (2009).

17. 17 C.F.R. § 275.205-3(a) (2010).

18. 17 C.F.R. § 275.205-3(d) (2010).

19. *See, e.g.*, Steven M. Davidoff, *Black Market Capital*, 2008 COLUM. BUS. L. REV. 172, 183–84 (2008); Adam H. Rosenzweig, *Not All Carried Interests Are Created Equal*, 29 N.W. J. INT'L L. & BUS. 713, 717 (2009); HEDGE FUNDS AND OTHER PRIVATE FUNDS: REGULATION AND COMPLIANCE § 12:1 (Gerald T. Lins et. al. eds., 2009); U.S. SEC. & EXCH. COMM'N, *supra* note 2, at 7.

20. *See, e.g.*, Davidoff, *supra* note 19, at 191–92, 198–200; Henry Ordower, *Demystifying Hedge Funds: A Design Primer*, 7 U.C. DAVIS BUS. L. J. 323, 366 (2007); HEDGE FUNDS AND OTHER PRIVATE FUNDS, *supra* note 19, at § 1:2; U.S. SEC. & EXCH. COMM'N, *supra* note 2, at viii, 3–4, 33–34.

21. PREQUIN LTD., THE 2010 PREQUIN PRIVATE EQUITY BUYOUT REVIEW 1 (2010), *available at* http://www.preqin.com/item/2010-preqin-buyout-review/0/2774; *see also* Camille Ricketts, *Private Equity Fund-Raising Hit A Five-Year Bottom in 2009*, N.Y. TIMES (Jan. 7, 2010), http://www.nytimes.com/external/venturebeat/2010/01/07/07venturebeat-private-equity-fund-raising-hit- a-five-year-76029.html; Deborah Cust & Henry Gibbon, *Review of the Half Year*, ACQUISITIONS MONTHLY,

Financial Services, London, approximately 10,000 hedge funds had $1.5 trillion in assets under management in 2008 (compared with approximately 11,000 hedge funds with $2.1 trillion in assets under management in 2007 and approximately 10,000 hedge funds with $1.8 trillion in assets under management in 2006).[22] Hedge funds also account for between twenty percent and fifty percent of the trading volume in equities and almost twenty percent of the trading volume in fixed-income securities.[23]

Private equity and hedge funds have historically been structured to avoid regulation under the federal securities laws,[24] and are generally structured as limited partnerships with the financial sponsor as the general partner and investors as the limited partners.[25] Investment in private equity and hedge funds is generally limited to fewer than 499 "qualified purchasers" or fewer than 100 "accredited investors" in order to avoid the registration and prospectus delivery requirements under the Securities Act; the registration and reporting requirements under the Securities Exchange Act of 1934;[26] and the investment restrictions and registration, reporting, organizational, recordkeeping, and examination requirements under the Investment Company Act.[27] Furthermore, investment in private equity and hedge funds is generally limited to "qualified purchasers" or "qualified clients" to permit fund advisers (which are generally affiliates of the firm organizing the fund) to enter into performance fee arrangements pursuant

July 2010, at 6, *available at* http://www.aqm-e.com/pdfs/AM/Q2_2010.pdf. Private equity and hedge funds have generally not been required to publicly disclose their existence, capital raised, or assets under management. Therefore, the figures for these measures in this comment are estimates based upon publicly available information and voluntary disclosure made to private database services.

22. INTERNATIONAL FINANCIAL SERVICES, LONDON, HEDGE FUNDS 2009 1 (April 2009), *available at* http://www.thehedgefundjournal.com/research/ifsl/cbs-hedge-funds-2009-2-.pdf; *see also Hedge Fund Industry – Assets Under Management*, BARCLAYHEDGE LTD., http://www.barclayhedge.com/research/indices/ghs/mum/HF_Money_Under_Management.html (last visited Aug. 19, 2010); NORA JORDAN, YUKATO KAWATA & LEOR LANDA, ADVISING PRIVATE FUNDS: A COMPREHENSIVE GUIDE TO REPRESENTING HEDGE FUNDS, PRIVATE EQUITY FUNDS AND THEIR ADVISERS § 2:2 (2010).

23. Davidoff, *supra* note 19, at 193; Timothy Inklebarger, *Hedge Funds Pick Up the Pace in Fixed-Income Trading*, PENSIONS & INVESTMENTS (Aug. 13, 2010), *available at* http://www.pionline.com/article/20100813/REG/100819933; JORDAN, KAWATA & LANDA, *supra* note 22, at § 2:2.

24. *See, e.g.*, HEDGE FUNDS AND OTHER PRIVATE FUNDS, *supra* note 19, at § 4:1; JORDAN, KAWATA & LANDA, *supra* note 22, at § 13:1; U.S. SEC. & EXCH. COMM'N, *supra* note 2, at ix-x, 7, 11–21.

25. *See, e.g.*, JORDAN, KAWATA & LANDA, *supra* note 22, at § 27:2; JOSEPH W. BARTLETT, EQUITY FINANCE: VENTURE CAPITAL, BUYOUTS, RESTRUCTURINGS AND REORGANIZATIONS § 24 (2010); HEDGE FUNDS AND OTHER PRIVATE FUNDS, *supra* note 19, at §§ 4:18, 5:5.

26. Pursuant to Section 12(g)(1) of the Securities Exchange Act of 1934 and Rule 12g-1 promulgated thereunder, issuers with total assets of more than $10 million and a class of equity securities held by 500 or more persons are required to register with the U.S. Securities and Exchange Commission and be subject to reporting requirements. 15 U.S.C. § 78*l*(g)(1) (2010); 17 C.F.R. § 240.12g-1 (2010).

27. *See, e.g.*, HEDGE FUNDS AND OTHER PRIVATE FUNDS, *supra* note 19, at §§ 4:12, 4:19, 4:21, 4:22, 4:27, 4:51; JORDAN, KAWATA & LANDA, *supra* note 22, at §§ 2:3, 3:2, 3:11, 13:1, 13:3, 13:5, 13:6, 14:6.

to Section 205(b)(4) of the Investment Advisers Act and Rule 205-3(a) promulgated thereunder.[28]

Prior to the enactment of the Private Fund Registration Act, advisers to private equity and hedge funds relied upon the exemption in Section 203(b)(3) of the Investment Advisers Act to avoid the registration, reporting, recordkeeping, and examination requirements in the Investment Advisers Act.[29] Under Section 203(b)(3) of the Investment Advisers Act, investment advisers with fewer than fifteen clients were exempt from the registration, reporting, recordkeeping, and examination requirements in the Investment Advisers Act.[30] Private equity and hedge fund advisers historically interpreted Section 203(b)(3) of the Investment Advisers Act to only require the fund being advised to count as a client within with the meaning of the statute (as opposed to counting each investor in the fund, which calculation methodology would have eliminated the ability of most private equity and hedge fund advisers to rely upon the exemption in Section 203(b)(3)).[31]

IV. PRIVATE FUND REGISTRATION ACT OF 2010

The Private Fund Registration Act eliminates the exemption in Section 203(b)(3) of the Investment Advisers Act historically relied upon by private equity and hedge fund advisers,[32] and permits the U.S. Securities and Exchange Commission to require such advisers to "maintain such records of, and file with the Commission such reports regarding, private funds advised by the investment adviser, as necessary and appropriate in the public interest and for the protection of investors, or for the assessment of systemic risk by the Financial Stability Oversight Council."[33] In

28. *See, e.g.*, HEDGE FUNDS AND OTHER PRIVATE FUNDS, *supra* note 19, at § 3:24, 4:40; JORDAN, KAWATA & LANDA, *supra* note 22, at § 3:30.

29. *See, e.g.*, HEDGE FUNDS AND OTHER PRIVATE FUNDS, *supra* note 19, at § 3:2; JORDAN, KAWATA & LANDA, *supra* note 22, at § 6:18.

30. 15 U.S.C. § 80b-3(b)(3).

31. *See, e.g.*, HEDGE FUNDS AND OTHER PRIVATE FUNDS, *supra* note 19, at § 3:5; JORDAN, KAWATA & LANDA, *supra* note 22, at § 6:18. Although the U.S. Securities and Exchange Commission in 2004 tried to prevent private equity and hedge funds advisers from interpreting Section 203(b)(3) in this manner through the adoption of Rule 203(b)(3)-2 promulgated under the Investment Advisers Act, 17 C.F.R. § 275.203(b)(3)-2, the U.S. Court of Appeals for the District of Columbia Circuit in 2006 overturned Rule 203(b)(3)-2 as being contrary to the purpose of Section 203(b)(3). Goldstein v. S.E.C., 451 F.3d 873, 884 (D.C. Cir. 2006).

32. Private Fund Registration Act, *supra* note 4, at § 403.

33. *Id*. at § 404. The Financial Stability Oversight Council was established by the financial reform bill to, among other things, "identify risks to the financial stability of the United States." *Id*. at tit. I § 112(a). Under the Private Fund Registration Act, the Commission is required to make available to the Financial Stability Oversight Council "copies of all reports, documents, records and information filed with or provided to the Commission" by private equity and hedge fund advisers "as the Council may consider necessary for the purpose of assessing the systemic risk posed by a private fund." *Id*. at § 404. The reports, documents, records, and information provided by private equity and hedge fund advisers to

particular, the Private Fund Registration Act requires advisers to private equity and hedge funds to maintain records of:

(A) the amount of assets under management and use of leverage;
(B) counterparty credit risk exposure;
(C) trading and investment positions;
(D) valuation policies and practices of the fund;
(E) types of assets held;
(F) side arrangements or side letters, whereby certain investors in a fund obtain more favorable rights or entitlements than other investors;
(G) trading practices; and
(H) such other information as the Commission, in consultation with the Financial Stability Oversight Council, determines is necessary and appropriate in the public interest and for the protection of investors or for the assessment of systemic risk.[34]

The Private Fund Registration Act also requires the Commission to "issue rules requiring each investment adviser to a private fund to file reports containing such information as the Commission deems necessary and appropriate in the public interest and for the protection of investors or for the assessment of systemic risk."[35] Finally, the Private Fund Registration Act requires the Commission to conduct periodic inspections of the records maintained by private equity and hedge fund advisers pursuant to the Investment Advisers Act, and permits the Commission to conduct "such additional, special, and other examinations as the Commission may prescribe as necessary and appropriate in the public interest and for the protection of investors, or for the assessment of systemic risk."[36]

V. ANALYSIS

The registration, reporting, recordkeeping, and examination requirements imposed upon private equity and hedge fund advisers under the Private Fund Registration Act "for the protection of investors" (as opposed to "for the assessment of systemic risk") are inconsistent with the exemptions for wealthy investors in the federal securities laws.[37] The

the Commission (and by the Commission to the Financial Stability Oversight Council) are generally afforded confidential treatment and exempt from disclosure under the Freedom of Information Act. Private Fund Registration Act, *supra* note 4, at § 404.

34. *Id*. at § 404.

35. *Id*.

36. *Id*.

37. *C.f.* Troy A. Paredes, *On the Decision to Regulate Hedge Funds: The SEC's Regulatory Philosophy, Style and Mission*, 2006 U. ILL. L. REV. 975, 991 (2006) (noting that when the Commission

rationale underlying the exemptions for wealthy investors in the federal securities laws is that wealthy investors can "fend for themselves" because they either possess sufficient financial sophistication to make informed investment decisions or can acquire the services of advisers who possess such sophistication.[38] As noted by Commissioner Troy Paredes, "[t]his animating principle reflects an implicit cost-benefit analysis that the costs of SEC intervention in such instances exceeds the benefits" to wealthy investors of such intervention.[39]

The Private Fund Registration Act regulations impose substantial compliance costs upon private equity and hedge fund advisers and substantial regulatory costs upon the U.S. Securities and Exchange Commission. According to the Congressional Budget Office, the Commission is expected to expend approximately $140 million from 2010 through 2014 to implement the Private Fund Registration Act, and private equity and hedge fund advisers are expected to expend up to $139 million per year to comply with the Private Fund Registration Act.[40]

The beneficiaries of these costs, to the extent that they are borne "for the protection of investors" (as opposed to "for the assessment of systemic risk"), are the wealthy investors in private equity and hedge funds, whose due diligence and monitoring efforts with respect these funds are subsidized by the public through the Commission's enforcement of the Private Fund Registration Act. This public subsidy of wealthy investors is inapposite to the exemptions for wealthy investors in the Securities Act (where "accredited investors" and "qualified institutional buyers" are not given the benefit of a prospectus from issuers relying upon Rule 144 or Rule 144A promulgated thereunder) and the Investment Company Act (where "qualified purchasers" and certain "accredited investors" are not given the benefits of the registration, reporting, organizational, recordkeeping, and examination requirements therein from issuers relying upon Sections 3(c)(1) and 3(7) thereunder).[41]

Furthermore, the Private Fund Registration Act regulations for the protection of wealthy investors in private equity and hedge funds are contrary to the normative principle that such investors can "fend for themselves" and therefore do not require the benefit of the federal securities laws, as reflected in the abovementioned provisions in the Securities Act and the Investment Company Act as well as the Investment

attempted to regulate hedge funds in 2004 through the adoption of Rule 203(b)(3)-2, *see supra* note 31, "the SEC has decided to regulate an industry dominated by presumptively sophisticated investors" who "are considered able to 'fend for themselves'").

38. *See supra* note 2 and accompanying text.

39. Paredes, *supra* note 37, at 991 n.65.

40. CONG. BUDGET OFFICE, COST ESTIMATE: PRIVATE FUND INVESTMENT ADVISERS REGISTRATION ACT OF 2009 (Nov. 13, 2009), *available at* http://www.cbo.gov/ftpdocs/107xx/doc10727/hr3818.pdf.

41. *See supra* Part II.

Advisers Act (where "qualified clients" and "qualified purchasers" are deemed sufficiently sophisticated to enter into investment advisory contracts that provide for compensation to the investment adviser based upon the capital gains or appreciation of client funds).[42]

The inconsistency of the Private Fund Registration Act regulations "for the protection of investors" with the exemptions for wealthy investors in the federal securities laws does not relate to the provisions of the Private Fund Registration Act designed "for the assessment of systemic risk." The utility of the analysis by the Commission of private equity and hedge fund assets under management, trading and investment positions, counterparty credit risk exposure, types of assets held, and other related information "for the assessment of systemic risk" is irrelevant to the inconsistency of the Private Fund Registration Act regulations "for the protection of investors" with the exemptions for wealthy investors in the federal securities laws. In addition, the fact that the Commission will be analyzing information provided by private equity and hedge fund advisers "for the assessment of systemic risk" does not militate in favor of the Commission analyzing additional information "for the protection of investors" when such additional regulation is costly, subsidizes wealthy investors who are deemed to be able to "fend for themselves," and is inconsistent with exemptions for wealthy investors elsewhere in the federal securities laws.

The collapse of large hedge funds such as Long-Term Capital Management in 1998 (which necessitated a $3.65-billion private bailout facilitated by the Federal Reserve because the hedge fund had positions in the market in excess of $100 billion and an equity base of only $1 million) and Bear Stearns Company, Inc., hedge funds in 2007 (which required Bear Stearns to incur $1 billion in write-downs prior to its own collapse in March 2008) also do not support the proposition that private equity and hedge fund advisers should be subject to inconsistent investor protection regulation under the federal securities laws, since the central issue in these collapses was whether they would cause disruption in international markets (i.e., systemic risk and not whether investors were defrauded).[43]

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42. *See supra* Part II.

43. *See, e.g.*, Barbara C. George, Lynn V. Dymally & Maria K. Boss, *The Opaque and Under-Regulated Hedge Fund Industry: Victim or Culprit in the Subprime Mortgage Crisis?*, 5 N.Y.U. J. L & BUS. 359, 369, 399 (2009) (citing CHARLES R. MORRIS, THE TRILLION DOLLAR MELTDOWN 52–53 (2008)); Lydie N.C. Pierre-Louis, *Hedge Fund Fraud and the Public Good*, 15 FORDHAM J. CORP. & FIN. L. 21, 76–77 (2009). Although Barclays Bank PLC, a shareholder in the umbrella fund that managed the Bear Stearns hedge funds, sued Bear Stearns for fraud alleging that Bear Stearns concealed one of the funds' declining value, Barclays eventually dropped the lawsuit with prejudice. George, Dymally & Boss, *supra*, at 402. Furthermore, two managers of the Bear Stearns hedge funds were acquitted of criminal fraud charges, although a civil lawsuit by the Commission is still pending. Zachery Kowe & Dan Slater, *Two Bear Stearns Fund Leaders Are Acquitted*, N.Y. TIMES, Nov. 10, 2009, http://www.nytimes.com/2009/11/11/business/11bear.html; U.S. Sec. & Exch. Comm'n v. Cioffi, No. 08-CV-2457, 2008 WL 4693320 (E.D.N.Y. Oct. 23, 2008).

Furthermore, the multi-billion dollar Ponzi scheme orchestrated by Bernard Madoff through his hedge funds also does not support the proposition that private equity and hedge fund advisers should be subject to inconsistent investor protection regulation under the federal securities laws, since the Commission conducted three examinations of Madoff's operations in 1992, 2004, and 2005 and was notified of credible and specific allegations regarding the fraud on six occasions between June 1992 and December 2008 yet failed to uncover the fraud.[44] Finally, the Private Fund Registration Act's regulations "for the assessment of systemic risk" (such as disclosure of trading and investment positions, types of assets held, and trading practices) provides the Commission with sufficient information to determine whether hedge funds such as those operated by Madoff are Ponzi schemes, and the risk of Ponzi schemes in hedge funds is the same as in private issuers relying upon the exemptions for wealthy investors in the Securities Act.

VI. CONCLUSION

As described in Part V, the registration, reporting, recordkeeping, and examination requirements imposed upon private equity and hedge fund advisers under the Private Fund Registration Act "for the protection of investors" are inconsistent with the exemptions for wealthy investors in the federal securities laws.[45] In order to eliminate this inconsistent treatment of wealthy investors under the federal securities laws, Congress should remove the investor protection requirements imposed upon private equity and hedge fund advisers under the Private Fund Registration Act. On the other hand, if it determines (as many have argued) that wealthy investors cannot "fend for themselves,"[46] Congress should eliminate the exemptions for wealthy investors in the federal securities laws. However, it should be noted that the elimination of the exemptions in the federal securities laws for wealthy investors would require many new issuers to register with the

44. OFFICE OF INVESTIGATIONS, U.S. SEC. & EXCH. COMM'N, INVESTIGATION OF FAILURE OF THE SEC TO UNCOVER BERNARD MADOFF'S PONZI SCHEME (Aug. 31, 2009), *available at* http://www.sec.gov/news/studies/2009/oig-509.pdf; *see also* Jacob Preiserowicz, *The New Regulatory Regime for Hedge Funds: Has the SEC Gone Down the Wrong Path?*, 11 FORDHAM J. CORP. & FIN. L. 807, 835–40 (2006) (questioning whether registration of hedge fund advisers under the Investment Advisers Act would deter fraud in hedge funds).

45. Although not discussed in this comment, the author would like to note the inconsistent exemption of venture capital funds from regulation under the Private Fund Registration Act as well as the inconsistent definitions of wealthy investors under the federal securities laws (i.e., the different definitions for "accredited investors," "qualified purchasers," and "qualified clients").

46. *See, e.g.*, John E. Girouard, *The Sophisticated Investor Farce*, FORBES (Mar. 24, 2009, 12:30 PM), http://www.forbes.com/2009/03/24/accredited-investor-sec-personal-finance-financial-advisor-network-net-worth.html; Wallis K. Finger, *Unsophisticated Wealth: Reconsidering the SEC's 'Accredited Investor' Definition Under the 1933 Act*, 86 WASH. U. L. REV. 733, 748 (2009); Howard M. Friedman, *On Being Rich, Accredited and Undiversified*, 47 OKLA. L. REV. 291, 301 (1994).

U.S. Securities and Exchange Commission under the Securities Act, the Exchange Act and the Investment Company Act and be subject to the reporting requirements under the Exchange Act and the reporting, organizational, recordkeeping, and examination requirements and investment restrictions under the Investment Company Act. Consequently, the Commission would require a substantial increase in its budget to effectively enforce these regulations for the benefit of wealthy investors.

Amending the federal securities laws as set forth above will help ensure that the securities market is subject to uniform, principled regulation as opposed to regulation that is inconsistent and appears politically expedient.

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