Hedge funds are one of the fastest growing and most controversial segments of the financial market. Most people know very little about hedge funds other than that they are the investment vehicle of choice for well-heeled investors – the place where the rich put their money in order to get even richer.

In fact, hedge funds thrive on the lack of knowledge about what exactly it is that they do. Without the ability to keep their trading strategies confidential, hedge funds argue they would not be able generate the impressive returns that keep them in business.

And so when the Securities and Exchange Commission, (“SEC” or “Commission”), implemented a rule requiring most hedge fund operators to register their names and open their books for inspection, it is no wonder that it triggered cries of outrage in the industry. Many hedge fund managers threatened to simply move their operations offshore (though it is not clear how many were actually prepared to follow through on that threat). Others took the battle to court.

The result of one of those legal battles, Goldstein v. SEC was a decision in June 2006 by the United States Court of Appeals for the D.C. Circuit, in which the court ordered the SEC to scrap the new rule. The decision effectively allowed hedge funds to maintain the anonymity they desired. That decision and the
 developments in the law that led to it, are the subject of this paper.

While the decision represents an important victory for hedge funds, the debate about whether hedge funds should be more closely regulated continues in Congress and the popular media. This article outlines recommendations for what the SEC or politicians should do in regard to hedge fund regulation.

These recommendations can best be summarized as “do nothing.” However, if courts were inclined to make such recommendations, it would likely be one the Goldstein court would agree with. Although not central to the decision, it is clear that the SEC failed to convince the court that there was much of a compelling reason for the new rule on hedge funds because none of the dangers that the SEC warned about actually materialized.

Following a brief introduction to the relevant securities laws, this paper examines the development of the specific law at issue in Goldstein. It then examines the arguments that each side made and analyzes the outcome. The paper concludes with recommendations that I believe stem directly from the court’s finding and the logic that underlies it.
II. INTRODUCTION

By any measure, hedge funds have become some of Wall Street’s biggest players. Hedge funds now control some $1.4 trillion in assets, up from $240 billion in 1998,¹ when the near-collapse of Long-Term Capital Management (“LTCM”) threatened the global financial system and first raised serious concerns about the lack of oversight of hedge funds. Today, hedge funds are behind more than one in every four stock trades² and they are wielding increasing and often over-sized influence on public companies.³

Graph 1: Growth in Hedge Funds

Despite this tremendous growth in size and market influence, hedge funds have been largely unregulated by the SEC, the nation’s market watchdog. And now a recent decision by the U.S. Court of Appeals for the D.C. Circuit promises

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¹ Shivani Vora and Mark Gongloff, Hedge-Fund Milestones, WALL ST. J., Jan. 29, 2007, at A14. The $1.4 trillion in assets controlled by hedge funds represents 5% of all assets under management in the United States. Id.
² Id.
to extend this immunity from regulatory oversight.

In Goldstein v. SEC, the court held that the SEC’s so-called Hedge Fund Rule, which would have given the SEC greater oversight over hedge funds, was invalid because it was arbitrary and in conflict with the purpose of the underlying statute in which the new rule was included. The decision seems to shut the door on any SEC-led move to strengthen oversight of hedge funds and effectively leaves it to Congress to decide if increased oversight of hedge funds is needed.

At the heart of the decision was the court’s interpretation of the definition of “client” under the Investment Advisers Act of 1940. Before 2006, the SEC did not consider investors in hedge funds to be clients of hedge fund advisers. Rather, only the funds they managed were considered clients of the adviser. Because the Investment Advisers Act says that advisers who have fewer than fifteen clients do not have to register with the SEC, this earlier interpretation of “client” meant most hedge fund advisers did not have to register with the SEC. The Hedge Fund Rule, would have effectively eliminated this exemption for most hedge fund advisers by including fund investors in the definition of clients for purposes of the registration requirement.

This change would have resulted in sweeping changes in the industry. Before the SEC implemented the new regulation last year, the only hedge fund advisers who registered with the SEC were the relatively small number of hedge fund advisers who had fifteen or more client funds, those who advised a registered company and/or those who registered voluntarily. Registration would have required more disclosure of financial information and subjected hedge funds to inspections by the SEC. Overall, the SEC estimates that fewer than half of hedge fund advisers were registered before the hedge fund rule was implemented.

To reach its conclusion that hedge fund investors are not clients of fund advisers for the purpose of the IAA’s registration requirement, the Goldstein court drew heavily from the Supreme Court’s decision in Lowe v. SEC, which held that while hedge fund advisers owe a direct fiduciary duty to their funds, this fiduciary duty does not extend to the people who invest in those funds.

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6 Goldstein, 451 F.3d at 876.
7 Id.
8 Id. Also see, Investment Advisers Act of 1940, 15 U.S.C. § 80b-3(b)(3) (2006), which exempts from the registration requirement “any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company registered under subchapter I of this Chapter ...”
9 Goldstein, 451 F.3d at 877.
11 Goldstein, 451 F.3d at 874.
12 Staff Report, supra note 10, at 22.
14 Goldstein, 451 F.3d at 880.
A. Background: the Development of Hedge Funds and Relevant Securities’ Laws

Before looking more closely at how the court reached this conclusion, it is useful to place the dispute in a historical context by briefly examining the development of hedge-fund regulations.

In 1940, Congress enacted two comprehensive acts to regulate markets: the Investment Company Act (“ICA”) regulated securities firms and the kinds of products they could offer, while the Investment Advisers Act (“IAA”) was a kind of rulebook for people who offered investment advice professionally. The acts aimed to protect investors by regulating any conflicts of interest between securities companies and investment advisers, on the one hand, and the investing public on the other.

The ICA required companies selling securities to register with the SEC, imposed certain disclosure requirements on firms and laid out restrictions on the kind of securities they could issue. The ICA directs the commission to regulate any issuer of securities that “is or holds itself out as being engaged primarily . . . in the business of investing, reinvesting, or trading in securities.”

From the beginning, the ICA intentionally left out small investment companies. Specifically, the law, and its attendant registration and disclosure requirements, expressly did not apply to companies that did not offer securities to the public and had a hundred or fewer owners and investors. Most hedge funds are exempt from the ICA’s coverage either because of this exception or because they accepted investments only from so-called “qualified” or high net-worth investors. Congress, thus, explicitly and intentionally created a way for hedge funds, even if they were not then called that, to fly under the radar of federal regulation. And within a decade after the act went into effect, hedge-fund like companies took advantage of this provision and began offering investments free from regulation.

The IAA, on the other hand, prohibits investment advisers from engaging in fraudulent or deceptive business practices. The SEC required advisers to register under the act, so that it can respond quickly to any complaints about deceptive
The IAA defines hedge fund advisers as a person who “for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities . . . .”

However, most hedge fund managers will also qualify for an exemption from registration under a section of this Act which exempts “any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company registered under [the Investment Company Act].” The SEC had interpreted “client” as referring to the partnership or fund-entity itself. And so most hedge fund managers were exempt because even the largest of them normally managed fewer than fifteen funds.

In summary, the result of all these exceptions to the Investment Companies Act and the Investment Advisers Act is that hedge fund advisers normally don’t have to register with the commission and thus are not required to disclose their financial conditions or investment positions. Hedge funds are also free from the kinds of restrictions on investment activities placed on mutual funds and other companies that are required to register. For example, unlike registered companies, hedge funds face no restrictions on trading on margin, entering into short sales or investing in commodities and real estate.

The SEC estimated that less than half of hedge fund advisers, or some 2,500, were registered with the Commission as of June 2006 and that about half of those registered only after the Commission enacted its Hedge Fund Rule.

The landscape for hedge funds remained largely unchanged until 1992 when the SEC’s Division of Investment Management recommended expanding the private-investment-company exception to the ICA. Recognizing the important role that these investment companies played in raising capital for small business, the SEC recommended that Congress revise the ICA to allow even more companies to operate free from regulation by creating another exception for investment funds held exclusively by so-called “qualified purchasers” or those wealthy investors who, because of their wealth and subsequent financial sophistication, did not need the ICA’s protections. The revision effectively eliminated the one-hundred-or-

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25 15 U.S.C. § 80b-2(a)(11) (2006). See also Abrahamson v. Fleschner, 568 F.2d 862, 869-71 (2d Cir. 1977) (holding that the general partners of a hedge fund are considered “investment advisers,” though the ruling is somewhat ambiguous as to who (or what entities) are considered the clients of the general partner/investment adviser).
27 Id.
31 Opening Br. of Pet’rs Phillip Goldstein, Kimball & Winthrop, Inc., and
fewer-investors-limitation and created an environment for larger, unregulated hedge funds.

Where the ICA cleared a wide path for hedge fund companies to operate largely unfettered by regulation, the IAA, as we have seen, created similar exceptions for investment advisers, including those who ran hedge funds. The IAA defines investment advisers as persons who “for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities.” Although the IAA stipulates that most investment advisers must register with the SEC, the statute carved out an exception from the registration requirement for “any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who [does not] hold himself out generally to the public as an investment adviser.” Those who qualify for the exemption do not have to maintain detailed transaction records, which they must periodically provide to SEC inspectors, or retain a compliance officer.

This does not mean, however, that advisers who are exempt from the registration requirement are completely free from any regulatory oversight. The IAA prohibits any investment adviser from engaging in fraud and applies equally to advisers who are required to register and those who are not. Courts have interpreted this provision of the act to do more than just prohibit fraud. The Supreme Court in SEC v. Capital Gains Research Bureau, Inc. ruled that the anti-fraud provision establishes a fiduciary duty between advisers and their clients. This fiduciary duty, requires that advisers have a reasonable basis for their investment advice and disclose any conflicts of interest to their clients.

The Commission helped clarify the extent of this liability for at least one class of advisers in 1985 with the adoption of its so-called “safe harbor” rule for general partners in an investment partnership. The rule says that only the limited partnership itself, i.e. the legal entity, is counted as a client of a general partner who provides investment advice based on the investment objectives of the partnership. Notably under this rule, the investors in a limited partnership are not considered clients of the general partner and so the general partner’s fiduciary duty does not extend to them.

Like the creation of an exemption for funds that catered to qualified purchasers under the Investment Companies Act, this change to the Investment Companies Act, this change to the Investment


39 Goldstein, 451 F.3d at 880.
40 Id.
41 Id.
Advisers Act also created greater opportunity for hedge funds to operate with minimal regulatory oversight.\footnote{17 C.F.R. § 275.203(b)(3)-1(a)(2) (2007).}  

**B. The Move to Strengthen Oversight of Hedge Funds**

However, it was not long after these revisions were enacted that the tide seemed to turn against hedge funds as regulators and the broader financial community began to call for tougher oversight. The single event most responsible for this shift was probably the near-collapse of Long-Term Capital Management in 1998.

The fund was founded just four years earlier by the former head of bond trading at Salomon Brothers who put together an impressive team of financial gurus. Following a series of misplaced and highly-leveraged bets, the fund faced a life threatening credit crunch.\footnote{Vora and Gongloff, supra note 1.} Widespread concerns that the fund’s sudden collapse might threaten the stability of the global financial system prompted the Federal Reserve to orchestrate an emergency $3.6 billion bailout by a consortium of Wall Street firms including Goldman Sachs & Co.\footnote{Id.}

Just how much of a threat to financial markets a collapse would have been was the subject of some debate. Nonetheless, the incident prompted creation of a series of high-level study groups to consider what could be done to insure that a small group of investors would not be able to easily upset global markets.\footnote{Adopting Release, supra note 38, at 72,058}

The result was calls for greater scrutiny of secretive hedge funds, and a series of discussions of regulatory changes culminating in the SEC’s issuance of its Hedge Fund Rule.\footnote{Id.}

The SEC proposed the rule in July 2004 to address a lack of basic information about hedge fund advisers and the hedge fund industry.\footnote{Registration Under the Advisers Act of Certain Hedge Fund Advisers, Investment Advisers Act Release No. 2266, 69 Fed. Reg. 45,172, 45,177 [hereinafter Proposing Release] (July 28, 2004).} The rule imposed the registration requirement on virtually all hedge fund advisers.\footnote{Id. at 45,183. Specifically, the new rule said that for purposes of determining whether the adviser qualifies for the registration exemption “you must count as clients the shareholders, limited partners, members, or beneficiaries ... of the fund.” Adopting Release, supra note 38, at 72,088.} It accomplished this by requiring advisers to a private fund to count shareholders in that fund as clients, for the purposes of determining whether the adviser qualifies as a client, advisers had to count anyone who had a stake in the fund.\footnote{Id. at 45,183. Specifically, the new rule said that for purposes of the Investment Advisers Act “you must count as clients the shareholders, limited partners, members, or beneficiaries ... of the fund.” Adopting Release, supra note 38, at 72,088.} Because most hedge funds have more than fifteen investors, the result was that the vast majority
of hedge fund advisers no longer qualified for the registration exemption.\textsuperscript{51}

Under the new rule, private funds were explicitly defined as investment companies that are exempt from regulation under the “fewer-than-100-shareholders” or the “qualified-purchasers” exemption—the precise exemptions under which most unregulated hedge funds were operating.\textsuperscript{52}

The SEC said the rule was necessary because of three recent changes in the hedge fund industry: first, the rapid growth of the industry over the previous decade; second, an increase in fraud by hedge funds; and third, a broadening of the types of investors who were investing in hedge funds.\textsuperscript{53}

The rule went into effect on February 10, 2005 and advisers who were required to register because of the change must have done so by February 1, 2006.\textsuperscript{54}

Of course, the new rule was not popular among hedge funds, which were required to add compliance officers and divulge more information about their funds.\textsuperscript{55}

C. The Dissent to the Hedge Fund Rule

The rule also did not have universal support even within the SEC.\textsuperscript{56} Notably, two of the five commissioners dissented to the rule.\textsuperscript{57} The dissenters said the new rule marked a departure from the Commission’s established approach of determining whether a client relationship exists by examining whether or not an adviser tailored his investment advice to the objectives of the individual investor.\textsuperscript{58}

The argument of the dissenters, was very similar to the argument that Goldstein used to challenge the new rule. The two Commissioners who opposed the new rule wrote a detailed and sharply-worded dissent in which they began by pointing out that the new regulation was adopted amid strong opposition from a large and diverse group of financial-system professionals and observers.\textsuperscript{59}

The dissenters cited a litany of reasons why they believed the rule was ill-advised. Broadly speaking, their complaints fell into three categories: (1) that there were alternative ways to get information about hedge fund advisers short of imposing a mandatory registration requirement,\textsuperscript{60} (2) that the SEC’s stated reasons

\textsuperscript{52} Proposing Release, supra note 47, at 45,184 n.138.
\textsuperscript{53} Id. at 45,174-75,178.
\textsuperscript{54} Adopting Release, supra note 38 at 72,054.
\textsuperscript{56} Adopting Release, supra note 38, at 72,089.
\textsuperscript{57} Id.
\textsuperscript{58} Id. at 72,097 n.94.
\textsuperscript{60} Adopting Release, supra note 38, at 72,089.
for the rule, retailization of hedge funds and rampant fraud, were a pretext because there was no indication that either was actually occurring and finally, (3) that the SEC’s already limited resources will be further stretched to conduct examinations of hedge funds.

In regard to the first point, the dissenters argued that “the needed information about hedge funds can be obtained from other sources, including other regulators and market participants, as well as through a notice and filing requirement. The Commission should have collected and analyzed the existing information and determined what new information would be useful before imposing mandatory registration.”

The most critical language of the dissent was used when they argued that the SEC’s rationale for the new rule did not withstand scrutiny. According to the dissenters, the Commission’s staff

... found that fraud was not rampant in the hedge fund industry, and that retailization was not a concern. Nonetheless, the majority repeatedly asserts that these issues justify imposition of the rulemaking. The fallacy of the majority’s approach is apparent when one notes that registration of hedge fund advisers would not have prevented the enforcement cases cited by the majority, and the rulemaking will have the perverse effect of promoting, rather than inhibiting, retailization.

As for diverting the resources of the SEC, the dissenters argued that “under this rulemaking, the Commission will have to allocate its limited resources to inspect more than 1,000 additional advisers.” What’s more, the dissenters said their concerns were validated when shortly after the rule was enacted, the SEC began talking about shifting resources from oversight to small advisers in order to conduct the duties created under the new regulation. The dissenters argued that “this possible shift should have been raised during the open meeting and weighed by the Commission in deciding whether to adopt the rule.”

D. Development of the Law: Interpretations of the Term “Client” in Securities Law

Until the SEC adopted its Hedge Fund Rule, the term “client” had been undefined in both the Investment Advisers Act and the Investment Companies Act. The Supreme Court of the United States addressed this question in 1985 in Lowe v. SEC, an appeal of an injunction against publication of an investment newsletter by a group of former investment advisers whose registrations had been revoked by the

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61 Id. at 72,089-90.
62 Id. at 72,090.
63 Id. at 72,089 (emphasis added).
64 Id.
65 Id. at 72,089-90.
66 Id. at 72,090.
67 Id.
68 Id.
The petitioners argued that they should not be prohibited from publishing their newsletter because in doing so, they were not acting as investment advisers because they were not offering personalized investment advice but rather only generalized advice.70

The Supreme Court agreed, holding that the Investment Advisers Act was designed to apply to “those who provide personalized advice attuned to a client’s concerns, whether by written or verbal communication.”71 Although the court in Lowe did not specifically offer a definition of the term “client” for the purposes of the Advisers Act, the holding outlined the requirements for finding the existence of an adviser-client relationship.72 The court wrote,

the mere fact that a publication contains advice and comment about specific securities does not give it the personalized character that identifies a professional investment adviser. Thus, petitioners’ publications do not fit within the central purpose of the Act because they do not offer individualized advice attuned to any specific portfolio or to any client’s particular needs.73

In particular, the court held that an adviser-client relationship requires the exchange of direct, personalized advice when it found that “fiduciary, person-to-person relationships . . . are characteristic of investment adviser-client relationships.”74

Few, if any, other cases have interpreted the particular language at issue in Goldstein, that is, the meaning of the word “client” under the Investment Advisers Act. However, there is a rich vein of cases dealing more generally with how to interpret the meaning of terms in statutes.

The starting point is usually to look to the statute itself for definitions of key terms. Where the term is not defined, as is the case with the word “client” in the Investment Advisers Act, courts will first often seek to determine whether the meaning of the term is ambiguous.75 However, the absence of a statutory definition does not necessarily render a term ambiguous.76

One of the basic rules for determining the meaning of statutory terms is that the term should be read in the context of the overall statutory scheme, considering the problems Congress sought to solve by enacting the particular law.77

Another fundamental rule of statutory interpretation that courts have relied on says that when Congress uses the same term in various parts of a statute, it usually has the same meaning throughout.78

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70 Lowe, 472 U.S. at 189.
71 Id. at 208.
72 Id.
73 Id.
74 Id. at 210.
77 See PDK Labs. Inc. v. DEA, 362 F.3d 786, 796 (D.C. Cir. 2004); Davis v. Michigan Dep't of Treasury, 489 U.S. 803, 809 (1989).
78 See Sullivan v. Stroop, 496 U.S. 478, 484 (1990); Energy Research Found. v. Defense Nuclear...
On top of these basic rules of interpretation, courts will often overlay consideration of whether a regulatory entity’s interpretation of a statute is reasonable. Reasonableness usually requires conformity between the meaning of terms at issue and the purpose of the regulation as well as consistency with previous interpretations. In Abbott Labs v. Young, the court held that the “reasonableness of an agency’s construction depends, in part, on the construction’s fit with the statutory language, as well as its conformity to statutory purposes.”\(^{79}\) In Northpoint Technology, Ltd. v. FCC, the court held that an interpretation that represented an unexplained departure from the agency’s prior practice was not a reasonable one.\(^{80}\)

III. ANALYSIS

A. Outline of the Arguments in Goldstein

Philip Goldstein, an investment adviser and part owner of a hedge fund, argued that the commission misinterpreted the meaning of client and that its definition conflicted with other definitions of the term that the SEC itself used in other parts of the same Act.\(^{81}\)

Goldstein first argued that the term client was unambiguous as it was used in the section on who qualifies for an exemption to the IAA’s registration requirement.\(^{82}\)

In the absence of a statutory definition for “client” in the Act itself, Goldstein argued that a natural starting point would be a dictionary definition of the term.\(^{83}\) According to Black’s Law Dictionary, a “client” is “a person or entity that employs a professional for advice or help in that professional’s line of work,”\(^{84}\) a definition which, Goldstein argued, was not in accord with the Commission’s interpretation because, in the case of a hedge fund, it is the fund itself that directly employs the adviser, not the investors in the fund.\(^{85}\)

Goldstein argued that Congress intended the term “client,” as used in the Act, to mean a person who received personalized investment advice.\(^{86}\) The SEC was therefore wrong to interpret “client” as including a hedge fund’s investors, Goldstein argued, because investors do not receive personalized investment advice from the adviser.\(^{87}\) Specifically, Goldstein highlighted the language of 15 U.S.C. § 80b-2(a)(11) which defines investment advisers as persons who “advise others,
either directly or through publications and writings." In *Lowe*, the Supreme Court held that Congress, by using this language, intended that “fiduciary, person-to-person relationships” were “characteristic of investment adviser-client relationships.” Goldstein argued that investors who merely bought shares in a hedge fund do not have the one-on-one, individualized relationship to an adviser that was necessary for there to have been what the Advisers Act would consider a client relationship.

In addition, Goldstein reasoned that Congress showed a specific intention not to regulate hedge funds in both the Investment Advisers Act and the Investment Companies Act. Although the Investment Companies Act is a comprehensive set of laws to regulate the relationship between investment companies, advisers and the investing public, Congress, in 15 U.S.C. § 80a-3(c)(1), (c)(7) chose to specifically exclude private investment entities such as hedge funds, Goldstein argued. What’s more, Congress expanded the kind of companies that would not be regulated with its later exemption from regulation for entities owned by “qualified purchasers.”

Similarly, by providing an exemption from the registration requirement for advisers with fewer than fifteen clients while at the same time requiring advisers to registered investment companies to register under the IAA, Goldstein argued, Congress demonstrated an intention not to regulate hedge fund advisers. Therefore, “the regulatory framework that Congress designed is thus clearly set out in the statutes. When a person invests in a private investment entity, there is no regulation of the investment entity, its adviser or its security holders.” Goldstein contended. To that end, Congress did not require the registration of an adviser to a private investment entity, such as a hedge fund.

Goldstein also argued that the definition of “client” under the SEC’s new rule was unreasonable because it was inconsistent with the commission’s past interpretation of the term and because it created a practical dilemma that Congress could not have intended.

Goldstein asserts that including hedge fund investors as clients of the fund’s investment adviser would create a practical problem because the interests of the fund itself would often be in conflict with the interest of individual investors. And an adviser who was expected to maintain a fiduciary duty to both the fund, and its investors, would not be able to reconcile those competing interests. Such a conflict would create an intractable ethical dilemma for an adviser who found the

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89 *Lowe*, 472 U.S. at 210.
90 *Goldstein*, 451 F.3d at 880.
92 Id.
95 Id. at 35.
96 Id. at 33-35.
97 Id. at 37-38.
98 Id.
objectives of individual investors at odds with the objectives of the fund as a whole, Goldstein argued.99

B. The SEC’s Argument

The SEC cited three reasons for the need to regulate hedge funds more closely: the rapid growth of hedge fund assets, even after the failure of LTCM; the trend toward “retailization” of hedge funds so that ordinary investors were becoming increasingly exposed to them and; the increase in fraud by hedge funds.100 The SEC argued that against this backdrop, and given that the term “client” is not specifically defined in the IAA statute, it had the authority to extend the definition to cover hedge fund investors.101

The SEC pointed out that being exempt from registration meant that hedge funds, unlike normal mutual funds, did not have to disclose investment positions or their financial condition, either to regulators or even to their own investors.102 This allowed hedge funds to implement secretive investment strategies.

The SEC asserted that the IAA itself gave it the authority to make a rule interpreting the scope of the registration exemption.103 The Commission relied on Section 211(a) of the IAA, which states that the SEC can “make, issue, amend, and rescind such rules . . . as are necessary or appropriate to the exercise of the functions and powers conferred upon the Commission elsewhere in this subchapter,” and, in exercising this authority, to “classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters.”104 The SEC also cited Section 206(4) of the IAA, which gave it authority to adopt rules that are “reasonably designed to prevent” fraudulent, deceptive, or manipulative acts.105

The SEC argued further that it had the authority to interpret the IAA because Congress did not specify how clients should be counted.106 Nothing in the act prohibited the SEC from “looking through” an investment fund to count individual investors for the purposes of the registration exemption, the Commission argued. And because hedge funds did not exist at the time the act was put in place in 1940, the commission noted, it is impossible to say now whether Congress envisioned the fund itself, or the fund’s investors as clients of the adviser for purposes of the registration exemption.107 Thus, the Commission submitted, Section 203(b)(3) is ambiguous as to a method for counting clients.108

Not only has Congress never resolved this ambiguity, the Commission went

99 Id.
100 Goldstein, 451 F.3d at 877.
102 Id. at 2-5.
103 Id. at 19.
107 Id. at 20-21.
108 Id. at 21.
on, but its subsequent amendments suggest that Congress left open the interpretation that hedge fund investors could be counted as clients.\textsuperscript{109} Specifically, the Commission pointed to a 1980 revision to Section 203 (b)(3) that provided that in the case of a business development company, “no shareholder, partner, or beneficial owner . . . shall be deemed to be a client of such investment adviser unless such person is a client of such investment adviser separate and apart from his status as a shareholder, partner or beneficial owner.”\textsuperscript{110} The Commission argued that such a revision would have been unnecessary had Congress already intended that shareholders of such companies could not be considered clients of investment advisers.\textsuperscript{111} Even if the specific type of entity at issue in \textit{Goldstein} was different from the type of entity that was the subject of the 1980 revision, the fact that Congress felt compelled to clarify how “clients” should be interpreted there, the SEC argued, indicated that it recognized the term’s ambiguity.\textsuperscript{112} The SEC then argued that since it established the term as ambiguous, courts should defer to its interpretation of the statute.\textsuperscript{113}

The SEC dismissed Goldstein’s argument that its interpretation of “client” under the Hedge Fund Rule was inconsistent with its interpretation of the term elsewhere in the IAA.\textsuperscript{114} The SEC argued that it interpreted the IAA as allowing it to “look through” investment funds in certain circumstances to count investors as clients.\textsuperscript{115} In particular the SEC highlighted its 1985 creation of the so-called Safe Harbor Rule, which allowed advisers to count a legal entity as a single client as long as his or her investment advice was aimed to satisfy the objectives of the entity and not the objectives of its individual investors.\textsuperscript{116} Although the SEC ultimately adopted the approach of allowing advisers to count only their funds as clients, the SEC made of point of noting at the time it implemented this rule that there were, nonetheless, alternative approaches to counting clients.\textsuperscript{117} In addition, the Commission argued that Congress implicitly acknowledged that the term “client” was ambiguous as used in the advisers act.\textsuperscript{118} The SEC based this argument on a 1980 revision to separate section of the IAA and the fact that Congress included language in that revision that said explicitly that investors should not be counted as clients of advisers under that section.\textsuperscript{119} If Congress felt it was necessary to define how clients should be counted in that section, it must have been because it felt the term was ambiguous in the act overall, the Commission argued.\textsuperscript{120}

\textsuperscript{109} \textit{Id.} at 20-22.
\textsuperscript{112} \textit{Id.} at 22.
\textsuperscript{113} \textit{Id.} at 28, fn9.
\textsuperscript{114} \textit{Id.} at 26-28.
\textsuperscript{115} \textit{Id.}
\textsuperscript{116} \textit{Id.} at 27-28.
\textsuperscript{117} \textit{Goldstein}, 451 F.3d at 879-80.
\textsuperscript{119} \textit{Id.} at 21.
\textsuperscript{120} \textit{Goldstein}, 451 F.3d at 879-80.
The SEC also countered Goldstein’s contention that Congress intentionally chose not to regulate hedge funds by creating the private investment company exemption in the Investment Company Act.\textsuperscript{121} Here, the SEC argued that just because Congress created an exemption from the registration requirement under the IAA for private investment companies with fewer than one hundred beneficial owners should not be taken as an indication that Congress also intended to exempt hedge fund advisers under the IAA.\textsuperscript{122} That is, while Goldstein basically argued the two acts should be considered together as a comprehensive package of regulation of the investment industry, the SEC countered that the acts are independent and, thus, an exemption created in one, said nothing about Congress’s intention in the other.\textsuperscript{123}

Finally, the SEC argued that Goldstein’s reliance on \textit{Lowe v. SEC} was misplaced because that case dealt with different issues and the interpretation of a different section of the Advisers Act.\textsuperscript{124} The SEC argued that \textit{Lowe} dealt narrowly with the meaning of the exclusion from the definition of investment adviser in section 202(a)(11)(D) of the IAA for “the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation.”\textsuperscript{125} The SEC argued that the court in \textit{Lowe} did not interpret the meaning of the term “client” because that term was not part of the section at issue there.\textsuperscript{126} The SEC further argued that the role of publishers was in no way analogous to hedge fund advisers because while publishers give investment advice through general circulation publications that investors use to make their own investment decisions, hedge fund advisers directly manage investments and make all investment decisions.\textsuperscript{127}

\textbf{C. Analysis of the Arguments}

\textit{1. The SEC’s Argument}

The SEC faced an uphill battle to convince the court that the term “client” should encompass the shareholders of hedge funds, rather than just the fund entity itself, because until the SEC promulgated the Hedge Fund Rule, it embraced the latter meaning.\textsuperscript{128} As the Commission itself wrote earlier, when “an adviser to an investment pool manages the assets of the pool on the basis of the investment objectives of the participants as a group, it appears appropriate to view the pool – rather than each participant – as a client of the adviser.”\textsuperscript{129}

\textsuperscript{122} \textit{Id.} at 30-31.
\textsuperscript{123} \textit{Id.}
\textsuperscript{124} \textit{Goldstein}, 451 F.3d at 880.
\textsuperscript{127} \textit{Id.} at 34-35.
\textsuperscript{128} \textit{Goldstein}, 451 F.3d at 880.
Nonetheless, the SEC put forth the argument that because the IAA does not define the term “client,” it is therefore ambiguous as to the method of counting clients.\(^\text{130}\) The Commission then relied on *Chevron U.S.A. Inc. v. Natural Resources Defense Council*, to argue that, as the nation’s securities regulator, the SEC should have the authority to interpret the meaning of any ambiguous terms.\(^\text{131}\)

The court quickly dismissed this argument, writing simply that:

There is no such rule of law. The lack of a statutory definition of a work does not necessarily render the meaning of a work ambiguous, just as the presence of a definition does not necessarily make the meaning clear.\(^\text{132}\) A definition only pushes the problem back to the meaning of the defining terms.

The SEC also failed to convince the court that a change in its interpretation of the meaning of “client” was necessary because of changes in the industry – specifically the rapid growth of hedge funds, increasing retailization and a corresponding increase in fraud.\(^\text{133}\) The court seemed unconvinced of significant change, and thus was unconvinced a new interpretation was appropriate.

The court held that:

[i]the Hedge Fund Rule might be more understandable if, over the years, the advisory relationship between hedge fund advisers and investors had changed . . . but without any evidence that the role of fund advisers with respect to investors had undergone a transformation, there is a disconnect between the factors the Commission cited and the rule it promulgated.”\(^\text{134}\) In the absence of a compelling change in the “nature of investment adviser-client relationships,” the court says the SEC’s choice of definition “appears completely arbitrary.\(^\text{135}\)

It seems the court was probably correct to be skeptical of the SEC claims of dramatic changes in the industry. After the ruling was handed down, SEC chairman Christopher Cox conceded in testimony to Congress that there was, in fact, little indication that the feared “retailization” of hedge funds had occurred.\(^\text{136}\)

The SEC also failed to make a convincing argument for why the court should ignore traditional statutory construction.\(^\text{137}\) The court seemed wholly unmoved by the SEC’s argument that the Hedge Fund Rule amended only the method for

\(^{130}\) *Goldstein*, 451 F.3d at 878.

\(^{131}\) See *Chevron U.S.A. Inc. v. Natural Res. Def. Council*, 467 U.S. 837, 842-43 (1984) (holding that if a statute is ambiguous with respect to a specific issue, the question for the court is whether the agency’s answer is based on a permissible construction of the statute). The court also said that considerable weight should be given to the agency’s construction of the statute that it was entrusted to administer. *Id.*


\(^{133}\) *Id.* at 882.

\(^{134}\) *Id.*

\(^{135}\) *Id.* at 883.


\(^{137}\) *Goldstein*, 451 F.3d at 882.
counting clients and did not alter the obligations owed by an investment adviser to its clients, holding that “we ordinarily presume that the same words used in different parts of a statute have the same meaning.”

The SEC opened itself up to contradiction by promulgating the Safe Harbor Rule, while the language of that revision, theoretically, left open the possibility of counting investors as clients, the SEC in fact, chose to do just the opposite and leave investors out of the definition of “clients.” That decision only seems to support the idea that, for the sake of consistency, the term client elsewhere in the act should also not be extended to include investors.

The holding also emphasized the lack of a clear settled definition of hedge fund, saying that “hedge funds” are notoriously difficult to define. The term appears nowhere in federal securities laws, and even industry participants do not agree upon a single definition.” Although the court never explicitly stated why this is a problem, surely, the fact that the SEC, in the court’s view, never clearly defines a hedge fund contributed to the sense that the new rule was arbitrary.

2. Goldstein’s Argument

In short, the case was not so much won by Goldstein as it was lost by the SEC. Goldstein relied to a large extent on the argument that the Supreme Court’s Lowe decision applied here. The SEC made a strong argument that Lowe could be distinguished because its holding was limited to the issue of when a publisher is considered an investment adviser.

The Lowe ruling quite likely would not have been an impenetrable barrier had the SEC presented a stronger case for why it should be allowed to change its interpretation of “client.” The court said as much when it wrote “because [the Lowe court] was construing an exception to the definition of “investment adviser,” we do not read too much into the Court’s understanding of the meaning of ‘client’.”

The court pointed out that the main thrust of Goldstein’s argument was simply that the commission misinterpreted the Advisers Act. The court is ultimately convinced, as Goldstein argued, that “Congress did not intend ‘shareholders, limited partners, members, or beneficiaries’ of a hedge fund to be counted as ‘clients.’”

Goldstein made this argument largely by appealing to the court’s common sense. In fact, the court went on to articulate what seemed to a common-sense

138 Id. (citing Sullivan v. Stroop, 496 U.S. 478, 484 (1990)).
139 Goldstein, 451 F.3d at 880.
140 Id. at 874.
141 Id. at 874-75.
142 Id. at 874-76.
144 Goldstein, 451 F.3d at 880.
145 Id. at 878.
146 Id. at 879.
interpretation of what Congress must have meant by the term “client” in the act when it writes:

an investor in a private fund may benefit from the adviser’s advice (or he may suffer from it) but he does not receive the advice directly. He invests a portion of his assets in the fund. The fund manager – the adviser – controls the disposition of the pool of capital in the fund. The adviser does not tell the investor how to spend his money; the investor made that decision when he invested in the fund. Having bought into the fund, the investor fades into the background; his role is completely passive. If the person or entity controlling the fund is not an ‘investment adviser’ to each individual investor, then a fortiori each investor cannot be a ‘client’ of that person or entity. These are just two sides of the same coin.147

Goldstein made another kind of appeal to common-sense when he argued that surely Congress could not have intended to create the conflict that naturally would arise if an adviser were deemed to have a fiduciary duty to both his fund and to the investors in that fund.148 Such a conflict, Goldstein argued, would surely result if the SEC interpreted the term client to encompass fund investors. The court again seemed to latch on to this argument when it wrote

if the investors are owed a fiduciary duty and the entity is also owed a fiduciary duty, then the adviser will inevitably face conflicts of interest. Consider an investment adviser to a hedge fund that is about to go bankrupt. His advice to the fund will likely include any and all measures to remain solvent. His advice to an investor in the fund, however, would likely be to sell. For the same reason, we do not ordinarily deem the shareholders in a corporation the ‘clients’ of the corporations lawyers or accountants.149

3. Impact of the Decision

Although, under Chairman Christopher Cox, the SEC decided not to appeal the Goldstein decision, that does not mean the SEC has given up the battle to tighten regulation of hedge funds. Shortly after the ruling was announced, Chairman Cox announced two new proposed changes to the IAA designed to protect hedge fund investors.150 First, the Commissioner said the SEC intended to raise the minimum amount of assets an individual investor would be required to have to invest in hedge funds.151 The SEC would raise the minimum amount to qualify as a so-called accredited investor under Regulation D from one million to 2.5 million in assets.152

The SEC based its recommendation on research that showed that many more U.S. households are eligible to invest in unregistered investment funds today than

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147 Id. at 879-80.
149 Goldstein, 451 F.3d at 881.
152 Id.
were eligible at the time these rules were put in place more than two decades ago. The research found that some 8.47 percent of U.S. households qualified to invest in hedge funds under the current definition of accredited investor, compared to 1.87% at the time the rule was introduced in 1982. Raising the minimum-asset number to $2.5 million would reduce the percentage of households eligible to invest to just 1.3 percent, just below the percentage of households that qualified under the current rule when it was first established.

Second, the SEC has proposed a tougher anti-fraud statute aimed at hedge fund advisers, whether they are registered or not. The SEC seems to believe stronger anti-fraud language will allow it to force advisers to “look through” their funds and count investors as clients—essentially the same thing it tried to do with the Hedge Fund Rule.

IV. RECOMMENDATIONS AND CONCLUSIONS

The first problem the SEC should address, before imposing tougher regulations on hedge funds, is to define exactly what kind of entities it has in mind. As the Goldstein court correctly pointed out, there is no consensus on the meaning of the term hedge fund. And unless the SEC establishes clearly what it means by the term, any attempt to increase regulation is bound to suffer from the same problems identified by the Goldstein court; that is, that any increased regulation targeting hedge funds is arbitrary.

However, any serious consideration of a definition that includes the companies the SEC is concerned about will inevitably not result in any expansion of regulation.

It is generally accepted that the term hedge fund dates from the 1940s and originally referred to investment companies that tried to reduce normal market risk by “hedging” long stock positions by selling some stocks short. However, the term is now used in the financial press to refer to any investment company that is not registered with the SEC. Indexes of hedge funds include everything from companies that invest in risky distressed securities to those that maintain market-neutral positions, so that the term clearly encompasses a wide-range of investment strategies and degrees of risk.

Since the SEC seems most concerned with keeping small investors from becoming exposed to highly-risky hedge funds, an appropriate definition would be

153 Id. at 406.
154 Id.
155 Id. at 401.
156 Id. at 401, fn. 10, fn. 11.
157 Goldstein, 451 F.3d at 874-75.
158 Id. at 882.
160 Id.
161 Id.
one that encompasses unregistered funds that target retail investors with highly-leveraged, or otherwise risky, investments. However, if it were to define hedge funds in such a way, no new firms would be subject to registration, which are not already required to register. The investment company rule, discussed above, which requires registration of any company offering investments to the public already forces firms targeting retail investors to register. Moreover, such a definition is not likely to increase protections for small investors who might become indirectly exposed to hedge funds through their pension funds. Pension fund managers are already required to register and are already regulated by the commission so any further protection for investors in this regard would only be redundant.

On the other hand, the SEC’s proposal to raise the minimum amount of assets needed to be an accredited investor is something the SEC can and probably should do. $1 million is just not what it used to be, particularly given the rapid appreciation in real estate prices over the last decade. In Southern California the price of an average home has more than doubled since 1998 and prices of fairly modest homes in nice neighborhoods easily top $1 million. How unusual, then, would it be for a couple nearing retirement to have $500,000 of equity in their home and another $500,000 in retirement savings. And so it’s not very difficult to envision that a large number of families who might soon qualify as accredited, even if they are not necessarily sophisticated investors.

The SEC proposal to lift the minimum asset requirement to $2.5 million would reduce the percentage of households that qualify to very near the level it was when the regulation was first implemented, and the additional proposal to adjust the number every five years for inflation would insure that the exemption would continue to include only the richest investors who are least likely to need safeguards.

However, it is not clear that the SEC has fully considered other options that may achieve the same goal in a more effective way. Since the main reason that so many more households now qualify as accredited investors was the run-up in real estate prices, another, relatively simple solution would seem to be to exclude the value of one’s primary residence as an asset for the purpose of qualifying. Such a change would eliminate the scenario the SEC seems most concerned with—the household of otherwise modest means, which qualifies to invest in hedge funds simply by virtue of the fact that the value of their home, a property they may have purchases decades ago, has suddenly soared.

The idea underlying the exemption is that millionaires are normally

162 Adopting Release, supra note 38, at 72,057.
163 Goldstein, 451 F.3d at 875.
165 Sexton, supra note 159.
sufficiently sophisticated in financial affairs to watch out for themselves and even if they fail to do so, they can afford to suffer some losses. 169 However, a couple who has $1 million only because the equity in their home has shot up in the last ten years, may not be able to afford much of a loss before they find themselves on the street. Excluding the value of their home, would keep potentially vulnerable investors away from hedge funds.

Commissioner Cox told the senate banking committee last year that he was “concerned that the current definition, which is decades old, is not only out of date, but wholly inadequate to protect unsophisticated investors from the complex risks of investment in most hedge funds.” 170 However, a definition of accredited investor that eliminated the value of one’s primary residence would go a long way toward removing unsophisticated investors from the pool of those eligible to invest in hedge funds.

The SEC has expressed concern that ordinary investors may become exposed to hedge funds through pension funds. 171 However, this problem too seems more speculative than real. Even if pension funds were aggressively moving into hedge funds, which they are not, 172 there is no reason to believe the current regulatory framework would be unable to deal with such a trend. Largely, there is not a problem when ordinary investors are exposed to hedge funds only indirectly through their pension plans because those pension fund managers are required to register and any additional regulation of hedge funds would be duplicative and a waste of SEC resources. 173 Small investors and pensioners are protected by the long-recognized duty of managers of pension funds not to expose their fund’s beneficiaries to excessive risks. 174

The SEC’s proposal to institute tougher anti-fraud measures also seems misguided. 175 While such a change does seem to have a greater chance of withstanding judicial scrutiny, there is, again, little evidence that it is needed. The SEC already has tough anti-fraud tools and is using them. 176 What’s more, while the SEC may have limited tools to regulate hedge funds directly it already maintains close oversight over counterparties to hedge funds, through which it should be able to identify any systemic problems. 177

The commissioners who dissent to the hedge fund rule raised a similar argument, relying on no less an authority than the former Federal Reserve Board chairman, Alan Greenspan, who stated that:

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169 Id.
174 Adopting Release, supra note 38, at 72,093.
175 Id. at 72,092.
176 Id.
177 Id. at 72,091, fn 17.
If there was a public policy reason to monitor hedge fund activity, the best method of doing so without raising liquidity concerns would be indirectly through oversight of those broker-dealers (so-called prime brokers) that clear, settle, and finance trades for hedge funds. Although the use of multiple prime brokers by the largest funds would complicate the monitoring of individual funds by this method, such monitoring could provide much useful information on the hedge funds sector as a whole.\footnote{Greenspan Responses.}

Although the SEC says it is worried about retailization of hedge funds, there’s no evidence, beyond the anecdotal, that this is happening.\footnote{Id.} The SEC chairman himself conceded that the retailization of hedge funds is, so far, just a theoretical problem when he told the Senate banking committee last year “[w]hile some refer to an alleged growing trend toward the ‘retailization’ of hedge funds, the Commission’s staff are not aware of significant numbers of truly retail investors investing directly in hedge funds. In my view, such a development, were it to occur, should be viewed with alarm.”\footnote{Id.}

And while small investors are clearly not buying into hedge funds directly, there is also little indication that they have become indirectly exposed through their pension funds or mutual funds as public and private pension funds have so far not invested heavily in hedge funds.\footnote{Id.}

Citing a study by Greenwich Associates, the SEC conceded that 80% of public pension funds, and 82% of corporate funds, had made little or no investment in hedge funds as of last year.\footnote{Id.} The cited report also stated that that those corporate and public pension funds that did invest in hedge funds allocated an average of only about 5% of their assets to them.\footnote{Id.} Such numbers indicate that even the indirect exposure of most small investors to hedge funds is small to nonexistent.

The SEC expressed greater concern about increasing exposure of endowments to hedge fund, but here too the numbers are far from alarming.\footnote{Id.} The report found that about one-third of endowments did not invest in hedge funds.\footnote{Id.} The nearly two-thirds that did invest in hedge funds, allocated an average of 18% of their assets to them.\footnote{Id.} While this number clearly shows greater exposure to hedge funds by endowments, there is also very little reason to be concerned by it because the financial fate of endowments will rarely have any

\footnote{Written Response to Question from Chairman Shelby in Connection with Testimony Before the Senate Banking, Housing, and Urban Affairs Committee (July 20, 2004) (statement of Alan Greenspan, Chairman, Federal Reserve Board) (hereinafter “Greenspan Responses”)

\footnote{Christopher Cox, Chairman, U.S. Sec. & Exch. Comm’n, Testimony Concerning the Regulation of Hedge Funds Before the U.S. Senate Committee on Banking, Housing and Urban Affairs (July 25, 2006), available at http://www.sec.gov/news/testimony/2006/s072506cc.htm.}

\footnote{Id.}

\footnote{Id.}

\footnote{Id.}

\footnote{Id.}

\footnote{Id.}

\footnote{Id.}

\footnote{Christopher Cox, Chairman, U.S. Sec. & Exch. Comm’n, Testimony Concerning the Regulation of Hedge Funds Before the U.S. Senate Committee on Banking, Housing and Urban Affairs (July 25, 2006), available at http://www.sec.gov/news/testimony/2006/s072506cc.htm.}
impact on small, unsophisticated investors.

Before imposing stringent registration requirements on pension funds, the SEC should consider whether there is not a middle ground approach under which it could get more information about the size and growth of funds, while at the same time allowing hedge funds to keep their trading strategies secret.

Many hedge funds argue that revealing information about investment strategies and techniques would violate their intellectual property rights and put them at a disadvantage. One compromise that has been suggested during 2004 Senate hearings on hedge funds was to allow hedge funds to remain exempt from audits so that they could keep trading strategies confidential, in exchange for funds agreeing to give the SEC any information it needed to track the size and general direction of hedge fund activity. This is a common-sense solution that would allow hedge funds to maintain their trade secrets while at the same time giving the SEC most of what it seeks.

In short, the SEC’s hedge fund rule was a fix for a system that is not broken. The alleged retailization of hedge funds and the rampant fraud that the SEC claimed as the basis for the rule, have not transpired. And in many ways, the common notion that hedge funds are unregulated is also largely a myth.

The fact that hedge fund companies and advisers are exempt from the registration requirements does not mean that they are free to do whatever the please. As SEC Commissioner Cox himself pointed out following the ruling,


notwithstanding the Goldstein decision, hedge funds today remain subject to SEC regulations and enforcement under the antifraud, civil liability, and other provisions of the federal securities laws. We will continue to vigorously enforce the federal securities laws against hedge funds and hedge fund advisers who violate those laws. Hedge funds are not, should not be, and will not be unregulated.


And so, ultimately, the Goldstein decision may represent a victory of the common-sense notion of, don’t fix it if it isn’t broken.

A. Recent Developments

At the time of this writing, Congress was continuing to hold hearings about hedge funds and whether they should be subjected to more stringent regulation. In early March 2007, Senator Charles E. Grassley, Republican of Iowa, tried to slip an amendment requiring registration for hedge funds into a Homeland Security bill, but the idea was rejected before coming up for a vote.

The failure of that bill was part of what appears to be waning enthusiasm for more stringent regulations of hedge funds as the warnings about the risks of


188 Id.


190 Id.

ordinary pensioners losing their life savings to savage hedge funds grow noticeably less dire.\footnote{Id.} A month before Sen. Grassley’s amendment died on the vine, a key advisory group recommended against implementing measures to strengthen regulation of hedge funds.\footnote{Id.}

In what The Wall Street Journal dubbed a welcome call to inaction, the President’s Working Group, made up of the heads of the SEC, the Federal Reserve, the Commodity Futures Trading Commission and the Treasury, concluded that any systemic risk from hedge funds could be best addressed by continuing to closely monitor their counterparties, including banks and brokerages.\footnote{Id.} The long-awaited report also said the SEC’s move to raise minimum asset requirements for hedge fund investors would work well to protect unsophisticated investors.\footnote{Id.} Calls for increased regulation of hedge funds have waned amid a widespread concern that U.S. capital markets are losing their competitive edge over other money centers such as London, Hong Kong and Shanghai due, at least in part, to excessive regulation.\footnote{Id.}

Perhaps another reason the drive to impose tougher regulations on hedge funds is losing steam is that many of the funds themselves are not the high-fliers they once were. Last year, the average hedge fund generated a return of just 12.9%, lower than the market as a whole, according to Hedge Fund Research Inc.\footnote{Id.} Such earthly returns probably raise fewer alarm bells for those worried about what kind of investments hedge funds are making.

This is not to say that voices calling for tougher regulation have been completely drowned out. While anti-regulation sentiment seems to be on the rise in the United States, that is not necessarily true elsewhere. Finance Minister Peer Steinbrück of Germany, which currently holds the presidency of the Group of Seven industrialized nations, has been a vocal critic of weak hedge fund regulation and has urged the Group of Seven to take up the issue.\footnote{Id.}

\footnote{Id.}
\footnote{Id.}
\footnote{Id.}
\footnote{Id.}
\footnote{Id.}
\footnote{Id.}
\footnote{Andy Kessler, Hedge Fund of Funds, WALL ST. J., Feb. 7, 2007. at A15.}
\footnote{Id.}