MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

September 22, 2010

Via Electronic Mail: rule-comments@sec.gov

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: MFA Comments on SEC Regulatory Initiatives Under the Dodd-Frank Act

Dear Ms. Murphy:

Managed Funds Association ("MFA")[1] appreciates the opportunity to comment on the Securities and Exchange Commission's (the "SEC" or the "Commission") Comment Page for SEC Initiatives Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). MFA applauds this initiative for offering interested parties an important opportunity to have input into this unprecedented rulemaking process, even before the Commission and the Commodity Futures Trading Commission (the "CFTC") publish many specific releases for comment. We recognize that the Dodd-Frank Act reframes the overall regulatory landscape, but that the SEC and the CFTC, among other agencies, will be responsible for implementing key details surrounding many of the crucial provisions. We also recognize that many of these areas are complex and new to regulatory oversight, and we pledge our support in helping the agencies address the range of issues in which our members have expertise. Further, we appreciate that the Commission and the CFTC continue to coordinate on regulatory initiatives, toward the shared goal of enhanced oversight that promotes efficiency and leverages cross-agency experience.

MFA endeavored to be an active and constructive participant in the discussions leading up to the passage of the Dodd-Frank Act and intends to be similarly engaged in the rulemaking process. We were supportive of the overall goals of the legislation and are committed to seeing them faithfully implemented. As part of our legislative engagement, for example, we testified nine times before Congress regarding financial

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[1] MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $1.5 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

regulatory reform.[2] As longstanding market participants, we strongly supported the strengthening of our nation's financial regulatory system. The devastation of the financial crisis was felt by all, including hedge funds and, in turn, by institutional investors in our funds. Hedge funds were customers and counterparties of the large banks, and the harm that they encountered, along with investors of every stripe, underscores the need for reform. In the OTC derivatives market, for example, we supported the establishment of mandatory clearing requirements for eligible swaps to mitigate counterparty, systemic, and operational risk and to promote transparency. We also were an early supporter of requiring managers of private investment funds to register with the Commission under the Investment Advisers Act of 1940, as amended (the "Advisers Act").

In keeping with the spirit of the Commission's initiative, we thought it appropriate to offer some general comments on the provisions of the Dodd-Frank Act that would most directly affect our members. For your convenience, we have organized our comments on a section-by-section basis, which does not necessarily reflect the relative importance of the issues. We have not limited our comments to only those items included on the Commission's Comment Page, but have included additional issues of significance to our industry. We also intend to comment on specific rule proposals as they are issued.

As the Commission considers the appropriate regulatory framework for private investment fund advisers, we believe that it is important to be clear about the size, scope and activities of the hedge fund industry in the context of other financial market participants. Although the hedge fund industry is important to capital markets and the financial system, it is relatively small in size and scope when considered in the context of the wider landscape. For example, the hedge fund industry is significantly smaller than both the global mutual fund industry and the U.S. banking industry. The global mutual fund industry managed $23.02 trillion in assets, as of March 31, 2010.[3] The top 50 U.S. bank holding companies alone had $14.4 trillion in assets, as of June 30, 2010.[4] By comparison, the global hedge fund industry had approximately $1.53 trillion in assets under management, as of July 2010, with the entire industry smaller than each of the three largest bank holding companies individually.[5]

Similarly, though private investment funds are often characterized as being highly leveraged financial institutions, the industry is, and has been, significantly less leveraged than other financial market participants. According to a recent study by academics at

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2 Copies of MFA's testimonies are available at www.managedfunds.org.

3 Source: Investment Company Institute, available at: http://www.ici.org/research/stats/worldwide/ww_03_10.

4 Source: Federal Financial Institutions Examination Council, available at: http://www.ffiec.gov/nicpubweb/nicweb/Top50Form.aspx.

5 Available at: http://www.finalternatives.com/node/13723.

Columbia University, the leverage ratio of investment banks during the period from December 2004 to October 2009 was 14.2, with a peak of 69.5 for investment banks in 2009, and the leverage ratio of the entire financial sector during that period was 9.4.[6] By comparison, this study found that the leverage ratio for the hedge fund industry was 1.5 as of October 2009, with an average ratio of 2.1 from December 2004 to October 2009, with a high of 2.6. The findings of this study with respect to the leverage ratio of the hedge fund industry are consistent with other studies, which report leverage ratios below 3.0 for an extended period of time.[7]

As the Commission develops a new regulatory framework for private investment fund advisers, we encourage it to consider the limited size and leverage of private investment funds compared to other financial market participants. In that regard, we support efforts by the Commission to gather information about the private investment fund industry and other financial market participants. We believe that it is important for regulators to have access to market data so that they are able to make decisions based on complete information about markets and market participants.

I. General Comments

MFA supports a renewed regulatory framework that will minimize systemic risk, strengthen investor protection, and promote market discipline and integrity. Recognizing the deficiencies that contributed to the financial crisis and taking focused steps to remedy them in a manner that promotes clear and consistent rules is critical to restoring investor confidence and market stability. Our industry is comprised of investors who rely on markets to be fair, open, and free from manipulation in order to conduct their businesses. We are subject to the same extensive rules and regulations under the federal securities

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6 Hedge Fund Leverage, available at: http://www2.gsb.columbia.edu/faculty/aang/papers/HFleverage.pdf.

7 *See*, BofA Merrill Lynch study, which finds the leverage ratio for the industry was 1.16 as of July, 2010 http://www.reuters.com/article/idUSTRE67G28220100817; *see also*, FSA study, Assessing possible sources of systemic risk from hedge funds, July 2010 (finding a leverage ratio of 272%, as of April, 2010), available at: http://www.fsa.gov.uk/pubs/other/hedge_funds.pdf, and The Turner Review, A regulatory response to the global banking crisis, March 2009 (finding that the leverage ratio of the hedge fund industry since 2000 has been two- or three-to one), available at: http://www.fsa.gov.uk/pubs/other/turner_review.pdf.

The above studies use different formulas for calculating leverage ratios, which explains the slight differences in leverage ratios determined by each study. Our purpose in this letter is not to endorse any particular formula, but to demonstrate that the leverage ratios for the hedge fund industry are significantly less than the ratios for many other types of financial institutions. MFA is preparing a comment letter in response to the SEC's and CFTC's Advance Joint Notice on Definitions Contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, in which we provide thoughts on how the agencies should define "highly leveraged" for purposes of the "major security-based swap participant" definition.

laws as other investors and are longtime advocates of clear guidelines and strong enforcement.

Our members actively deploy risk capital in markets throughout the world and invest heavily in proprietary strategies to identify new opportunities. We recognize the need for regulators to have access to information about our activities in order to have a comprehensive view of the markets and effectively oversee the financial system. At the same time, we note the importance of maintaining utmost confidentiality and conducting inquiries in a judicious manner so as to ensure privacy and manage the costs of compliance. We also note the significance of international coordination in ensuring consistent regulation across borders and promoting competition and innovation in all markets.

II. Title IV

A. Definition of "Client"

Section 406 of the Dodd-Frank Act provides the Commission with broad authority to define, by rule, terms in the Advisers Act. However, it expressly limits the Commission's authority to define the term "client" by prohibiting the Commission from defining the term for purposes of Section 206(1) and (2) to include investors in a private investment fund if the fund has an advisory agreement with the adviser. Section 913 of the Dodd-Frank Act amends Section 211 of the Advisers Act to provide a similar limitation, such that, to the extent the Commission issues rules under the Advisers Act regarding an adviser's fiduciary duty to customers, the Commission may not define "customer" to include investors in a private investment fund if the fund has an advisory agreement with the adviser.

For advisers to private investment funds, the adviser-client relationship is between the adviser and the fund, not between the adviser and specific investors in the fund, which is a key characteristic of pooled vehicles, as distinguished from individual advisory relationships. This distinction is important from an investor protection perspective because as sophisticated investors, investors in private investment funds require, and appreciate the need for, all investors in a pooled investment vehicle to receive consistent and uniform treatment. Moreover, an adviser to a private investment fund would not be able to manage the fund with a separate fiduciary duty to each individual investor in the fund. For example, an adviser would not be able to exercise its proxy voting responsibilities on an investor-by-investor basis, as investors are likely to have different views as to how they would choose to vote on various issues. As such, we believe that maintaining this distinction is consistent with the Commission's current approach to the term "client".[8]

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[8] *See* SEC Release No. IA-3060 (July 28, 2010), in which the Commission adopts amendments to Form ADV and in doing so retains the definition of "client" as the private investment fund and not the fund's investors.

We further believe that there are alternative approaches that would enable the Commission to address any regulatory concerns[9] regarding the protection of investors without disrupting the relationship between an adviser and the funds it advises. Section 206(4) of the Advisers Act, for example, prohibits investment advisers from engaging "in any act, practice, or course of business which is fraudulent, deceptive, or manipulative." Section 206(4) is not limited to the adviser-client relationship and provides the Commission with significant authority to address regulatory concerns regarding the protection of investors without having to modify the definition of "client". As such, we urge the Commission to continue the current approach of defining "client" to mean the fund, and not the investors in the fund.

B. Self-Regulatory Organization and Investment Adviser Examinations

Section 416 of the Dodd-Frank Act requires the Comptroller General of the United States to conduct a study on the feasibility of a self-regulatory organization ("SRO") to oversee private investment funds. Similarly, Section 914 of the Dodd-Frank Act requires the Commission to conduct a study on the need for enhanced examination and enforcement resources for investment advisers, including whether designating an SRO to oversee advisers would improve the frequency of examinations of advisers. We look forward to participating in the research efforts for these studies.

MFA strongly supports ensuring that the Commission has the resources it needs to fulfill its mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation. In order to fulfill this mission, the Commission must have adequate resources to conduct examinations of participants in the capital markets, including investment advisers. During the legislative process, we supported provisions that would augment the Commission's resources.[10] We are pleased that the Dodd-Frank Act provides additional resources to help ensure that the Commission continues to serve this important oversight function. If the Commission were to determine, even after the implementation of the Dodd-Frank Act, that it still does not have adequate resources to permit the Office of Compliance Inspections and Examinations ("OCIE") to conduct examinations of all registered investment advisers with the appropriate frequency, we believe the Commission should work with policy makers to ensure that it receives such resources. In that regard, we would support appropriate fees on investment advisers to help ensure that OCIE has the resources they need to conduct examinations of the investment adviser industry.

Generally, we are concerned that creating a new SRO for investment advisers would not result in any public policy benefit, but would create an additional layer of

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[9] For example, we understand that the Commission may consider broadening the definition of "client" with respect to advisers of private investment funds because of regulatory concerns regarding the application of certain provisions of the Advisers Act, such as Section 206(3).

[10] Testimony of the Honorable Richard Baker, Chairman & CEO, MFA, before the Committee on Financial Services, U.S. House of Representatives, October 6, 2009, at 6-7.

regulation, subjecting advisers to potentially duplicative or inconsistent requirements. We are also concerned, given the significant variation in business models among investment advisers, from small firms that advise private funds to the largest global banks that advise retail clients, that a single SRO for investment advisers would be ill-equipped to handle the diversity of issues without being cost prohibitive.

C. Advisers Act Exemption for Registered Commodity Trading Advisors ("CTAs")

Section 403 of the Dodd-Frank Act retains the exemption for CTAs whose business does not consist primarily of acting as an investment adviser from registering with the Commission if they are registered with the CFTC. Section 4(m)(3) of the Commodity Exchange Act provides an analogous exemption from CFTC registration for CTAs that are registered with the SEC as investment adviser and whose business does not consist primarily of acting as a CTA.[11] The Dodd-Frank Act does not amend this section, but rather adds a new provision in Section 403, which provides that an adviser to a private investment fund that is also a registered CTA is exempt from registration with the Commission, unless the business of the adviser should become predominantly the provision of securities-related advice.

The language in Section 403 of the Dodd-Frank Act reflects Congress's recognition that CTAs to private investment funds, which are primarily engaged in the business of providing advice regarding futures and are already subject to a comprehensive registration and regulatory framework, do not have to be dually registered. It further reflects the view that requiring these CTAs to register with both the Commission and the CFTC would, at best, subject them to a duplicative regulatory framework and, at worst, subject them to potentially inconsistent regulatory requirements.

MFA encourages the Commission and the CFTC to adopt guidance clarifying the criteria relevant to determining whether an investment adviser or a CTA that is registered with one of the agencies can rely on the relevant exemption from registration with the other agency, respectively. In this regard, in September of 2009, MFA filed a comment letter with the Commission and the CFTC recommending that they consider the factors addressed in the *Peavey Commodity Futures Fund* no-action letter.[12] We continue to

[11] We note that CFTC regulations also provide for other exemptions from registration as a CTA or as a commodity pool operator.

[12] *See* Peavey Commodity Futures Fund, SEC No-Action Letter (pub. avail. June 2, 1983), 1983 SEC No-Act. LEXIS 2576 (determining the primary engagement of a fund for purposes of the Investment Company Act of 1940, as amended). *See also,* Tonopah Mining Co. of Nevada, 26 S.E.C. 426 (1947) (adopting a five factor analysis for determining an issuer's primary business for purposes of assessing the issuer's status under the Investment Company Act of 1940, as amended) (the "1940 Act").

A copy of MFA's comment letter is available at http://www.managedfunds.org/downloads/MFA%20response%20to%20SEC.CFTC.9.25.09.pdf.

believe that the factors addressed in the letter provide an appropriate framework for determining the primary (or predominant) business of an investment adviser or a CTA.

With respect to registration, we also note that there are market participants who are or may become registered with both agencies as an investment adviser and CTA and/or commodity pool operator (and quite possibly one day as a "major security-based swap participant" and a "major swap participant"). MFA encourages the Commission and the SEC, in addition to jointly promulgating rules to establish records and reports of private funds pursuant to section 406 of the Dodd-Frank Act, to consider the registration requirements of private funds and their advisors under the CEA and the federal securities laws to simplify the registration process and to avoid potentially inconsistent regulatory requirements.

D. Protection of Confidential Information

Section 404 of the Dodd-Frank Act provides the Commission with broad authority to compel reporting by private investment fund advisers of highly sensitive and proprietary information for systemic risk purposes, among other regulatory purposes. Section 404 also provides for confidential protection of proprietary information reported by private investment fund advisers. We support systemic risk reporting by private investment funds to the Commission as well as public dissemination of aggregated information. At the same time, we are deeply concerned about the prospect of proprietary or confidential information being disclosed to the public. Such information is highly sensitive from a competitive standpoint and advisers to private investment funds employ substantial safeguards to protect the proprietary and confidential information of the funds they manage, including information related to their investment strategies, portfolio holdings and investor base. It is also critical that sensitive investor information that may be reported by an adviser be protected by the SEC. Public disclosure of confidential investor information could cause potential harm to those investors. Moreover, an adviser's strategies typically include multiple components and the disclosure of pieces of data would be incomplete and inherently difficult to understand. As a result, such information could be misleading to the public, including investors, which could have negative consequences should they misguidedly try to act on it. Given the sensitive nature of such information, we believe that it is critical to have strong confidentiality safeguards in place that protect the proprietary interests of private fund advisers and the welfare of the public and capital markets. We further believe that these safeguards should continue to exist when the Commission shares such information with other regulators.

E. Exemption of Venture Capital Fund Advisers and Family Offices

MFA strongly supports a comprehensive registration regime under the Advisers Act. The activities and structures of various kinds of private funds and their advisers differ, but overlap in many meaningful ways. In that light, we encourage the Commission to define the terms "venture capital fund" and "family office" in a way that avoids creating unintended loopholes, regulatory arbitrage, or uncertainty in how or which firms have to comply with registration and regulation.

F. Accredited Investor and Qualified Client Standards

MFA has consistently supported increasing both the "accredited investor" and "qualified client" standards to account for the effects of inflation, as required by Sections 413 and 418 of the Dodd-Frank Act, respectively. As the Commission issues rules to adjust those standards going forward, we encourage it to provide an appropriate implementation period to allow market participants time to adjust.

In addition, as the Commission updates the "accredited investor" standard, we recommend that it define the standard to include "knowledgeable employees" of a private investment fund for the purpose of investing in that fund. We also recommend that the Commission concurrently amend Rule 3c-5 under the 1940 Act to expand the types of employees who can qualify as "knowledgeable employees" under that Rule. We believe that there are many non-executive employees who are familiar with the risk/return and other characteristics of the private investment funds managed by their employer and who possess a sophisticated and knowledgeable understanding of the investment objectives, risks and operations of those funds. This is particularly relevant to large private investment fund advisers, in which senior personnel of the adviser may not qualify as "knowledgeable employees" under the Commission's current interpretation despite having senior level responsibility within the organization. MFA members support aligning the interests of investment fund managers with the interests of the advisers' employees. Permitting a broader category of employees of private investment advisers to invest in their employer's funds, without running afoul of securities law placement provisions, would represent a simple, yet meaningful, policy change that would significantly enhance investors' interests and promote sound risk management of the funds.

G. Transitional Relief

In adopting Rule 203(b)(3)-2 under the Advisers Act in 2004 (the "Registration Rule"), the Commission also adopted several amendments to Advisers Act rules to provide relief to advisers that were required to register as a result of the Registration Rule. Specifically, the Commission issued rules to provide transitional relief regarding books and record keeping requirements in support of performance reports and to grandfather certain existing adviser-client contractual relationships.[13] We are concerned that clients could see their advisory relationships changed or terminated if the Commission does not adopt appropriate transitional and grandfathering provisions for advisers required to register as a result of the Dodd-Frank Act. As such, we encourage the Commission to consider providing relief similar to that provided in 2004 with respect to advisers required to register with the Commission as a result of the Dodd-Frank Act.

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[13] *See* Investment Advisers Act Release 2333 (December 2, 2004).

III. Title VII

We strongly support the goals of OTC derivatives regulation to enhance transparency and reduce systemic risk. We also recognize that these instruments play such a crucial role in our financial markets by allowing companies to effectively manage their financial and business risks, and we therefore, want to ensure that unintended consequences of the regulations do not reduce or restrict the availability of customized risk management tools. Thus, we urge the Commission to gather substantial data on this new area of oversight and tailor its rules and regulations to address identified risks and the intended objectives of the Dodd-Frank Act. In addition, we request that the Commission adopt appropriate grandfathering provisions to ensure that existing derivatives transactions are not adversely affected by rulemakings resulting from the Dodd-Frank Act.

In this letter, we are providing our general thoughts on the various issues from Title VII of the Dodd-Frank Act that are of greatest significance to us. We also fully intend to comment on the specific rule proposals related to Title VII that are relevant to MFA's constituencies, as the Commission issues them.

A. Definition of "Security-Based Swap Dealer"

Section 761 of the Dodd-Frank Act defines "Security-Based Swap Dealer" ("SSD") (in relevant part) as a person who: (i) holds themself [*sic*] out as a dealer in security-based swaps; (ii) makes a market in security-based swaps; (iii) regularly enters into security-based swaps with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing it to be commonly known in the trade as a dealer or market maker in security-based swaps.[14]

We are concerned that because of the breadth of this definition, it may inadvertently capture regulated, non-bank customers. Specifically, prong (iii) of the definition, which relates to "regularly entering into security-based swaps", would capture parties that would traditionally be thought of as investors or hedgers, as opposed to true dealers or market-makers. We note that the Exchange Act already provides a definition of dealer, which has a longstanding role in market parlance and practice, and which specifically excludes those market participants who are not "in the business" of buying and selling securities as well as those who buy and sell for their own account.[15] We respectfully suggest that the Commission should consider this established standard as it further defines SSD.

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[14] Section 761 amends Section 3(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), to add new subsection (71).

[15] Section 3(a)(5) of the Exchange Act provides the following "dealer" definition: "[t]he term 'dealer' means any person engaged in the business of buying and selling securities for such person's own account through a broker or otherwise" and excludes "a person that buys or sells securities for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business."

B. Definition of "Major Security-Based Swap Participant"

Section 761 of the Dodd-Frank Act defines "Major Security-Based Swap Participant" ("MSSP"), in large part, as a non-SSD: (1) who maintains a substantial position in security-based swaps; (2) whose outstanding security-based swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets; or (3) is a financial entity that is highly leveraged relative to the amount of capital that it holds and maintains a substantial position in outstanding security-based swaps.[16]

MFA believes Congress's intent in creating an MSSP designation was to focus regulation on systemically important, non-dealer market participants whose swap positions may adversely affect market stability. One example of such an entity was AIG, which was an exception to normal market practice. Unlike other customers, AIG, given its market presence, enormous size, and AAA-rating was not required to post initial margin on its trades to its dealer counterparties and was only required to post variation margin once rating agencies belatedly downgraded AIG's credit rating. Thus, when AIG was on the brink of default, it exposed its swap counterparties to massive losses and put the broader financial system at risk. In contrast, dealers engage in extensive due diligence with respect to private investment funds before entering into swaps with them. Dealers also insist that private investment funds collateralize their trades by posting initial and variation margin, which protects the dealer counterparty and the financial markets from risk in the event of the fund's default. We strongly support the need for enhanced market standards and consistency to prevent anomalous and dangerous practices, such as AIG's, and which mitigate the excessive build-up of counterparty and systemic risk. In addition, we note that the Dodd-Frank Act will already require our membership to report extensively on its market activities as registered advisers, whether or not private investment funds are designated as MSSPs.

A crucial component of the MSSP categorization is the definition of "substantial position", which Congress instructed the Commission to define in a manner that safeguards against systemic risk. We are supportive of this approach and believe that, in determining whether a market participant has a "substantial position" in security-based swaps, we believe the Commission should consider such market participant's overall position in swaps, accounting for offsetting positions, including cleared contracts and securities that mitigate risk. We also support Congress's direction to the Commission that in defining "substantial position" the Commission must take into account "the person's relative position in uncleared as opposed to cleared swaps and may take into consideration the value and quality of collateral held against counterparty exposures."[17] Such guidance will help capture the actual risk to counterparties and the broader system if

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16 Section 761 amends Section 3(a) of the Exchange Act to add new subsection (67).

17 *See* Section 761. Section 3(a)(67)(B) of the Exchange Act defines "substantial position," which is relevant to the determining who is an MSSP. In considering the value and quality of collateral held against the counterparty exposure, we believe it is important for the Commission to consider the category or type of security-based swap as different types of security-based swaps carry different risk profiles.

the market participant failed, and would recognize the market-disciplining activities of central clearing and increased bilateral reserves as contemplated by the Dodd-Frank Act. Indeed, the Dodd-Frank Act requires central clearing and collateralization because of their risk mitigating effects and because they will cushion counterparties and the financial system in the event of a default. A market participant that makes use of these practices to safeguard its security-based swaps should not fall within the MSSP definition.[18]

We would be happy to discuss the above points in greater detail with the Commission in their effort to develop specific regulatory language.

C. MSSP Registration

Section 764 of the Dodd-Frank Act gives the Commission broad discretion to set the registration requirements for MSSPs. As mentioned herein, whether private investment funds fall within the MSSP definition will depend in large part on the definition of "substantial position". Given that our activities are dynamic, the value and volume of the positions in our swaps portfolios may turnover, increase or decrease on a frequent basis. Accordingly, unlike other market participants, our members have the potential to routinely fall in and out of the MSSP category. To that end, we request that in crafting rules surrounding registration, the Commission have regard for dynamic business models and build flexibility into the construct to ensure that regular deregistration and re-registration are not required.

D. Registration as a Security-Based Swap Dealer

With respect to cleared security-based swaps, Section 763 of the Dodd-Frank Act makes it unlawful for a person to accept any money, securities, or property as margin from a swaps customer, unless the person has registered as an SSD. As customers, we strongly support the protection of the positions and collateral of swap customers. However, we are concerned that this registration requirement does not distinguish between the receipt of initial margin—which is a one-way payment made by a swap customer to a swap dealer at the outset of a trade—and variation margin that both swap counterparties may exchange with each other to reflect a mark-to-market change throughout the life of a trade.

If we, and other swap customers, could not collect variation margin for cleared security-based swaps without being required to register as SSDs, two significant, negative consequences would result. First, counterparty, systemic and liquidity risks would greatly increase because customers would have an incentive to elect to not secure their exposure through the receipt of variation margin in order to avoid becoming SSDs. Second, customers would likely experience significant liquidity risks to the extent that

18 *See* statement from Senator Lincoln in a colloquy between Senator Hagan and Senator Lincoln (Cong. Record, July 15, 2010) on determining whether an entity has a "substantial position": "Entities that fully collateralize swap positions on a bilateral basis with their counterparties, thereby reducing their potential to adversely affect market stability, should be viewed differently from those that do not."

they would be required to pay out cash for variation margin on unprofitable transactions, but would be unable to collect variation margin on transactions that are in their favor.

We believe that Congress did not intend to subject swap customers to SSD registration and regulation with respect to their cleared security-based swaps. Moreover, we believe that Congress did not intend to define SSDs to include a person who accepts variation margin. Accordingly, we believe it would be prudent for the Commission to employ its authority under Section 761 of the Dodd-Frank Bill by further defining the term "margin" for this purpose as initial margin only.

E. MSSPs: Capital and Margin Requirements

Section 764 of the Dodd-Frank Act provides for the registration and regulation of MSSPs and directs the Commission to impose capital and margin requirements on MSSPs. Capital requirements are inconsistent with the business structures and risk profiles of certain non-bank entities that are not already subject to regulatory capital requirements, and imposing capital requirements on such entities could have significant, unintended consequences, including by effectively precluding them from participating in the market. Thus, in establishing capital requirements for non-bank MSSPs, we believe it is important for the Commission to consider the different business structures and risk profiles of the various participants and tailor requirements appropriately.

As the Commission is aware, capital requirements are an established feature of banking regulation designed to protect against unexpected losses without adversely affecting the interests of creditors (such as depositors, policyholders, or the government). Banks set aside capital as a percentage of their overall risk exposure, with permanent Tier 1 capital as the core measure of their financial strength. In contrast, many non-bank financial entities, such as private investment funds, do not have such creditors, only investors, and do not have permanent Tier 1 capital, as these entities serve a different role and purpose in the markets. Specifically, investment advisers manage assets of private investment funds on behalf of such fund's investors, which frequently include pension plans and endowments. The assets are not permanent but rather belong to the investors, which have the right to redeem them subject to the terms of their contractual agreements. In this respect, all of the fund's investments, including security-based swaps, belong to the investors. The funds, in turn, are mandated by their investors[19] to make investments with their capital and the investors assume the risks associated with that arrangement. Ultimately, any losses incurred by the funds are ultimately borne by the investors themselves, with the fund's counterparties protected by the posted collateral.

The posting of collateral by private investment funds serves the same function that capital does for banks and other similarly regulated financial entities (*i.e.*, protecting the counterparty and financial system against such entities' default). In addition, the imposition of capital requirements on non-bank MSSPs would greatly increase the cost of doing business for these entities and could result in other attendant consequences.

[19] Typically, the adviser's employees are significant investors in their own funds.

Accordingly, we believe that in setting capital requirements for non-bank MSSPs, the Commission should count collateral posted by such non-bank MSSPs towards any such non-bank MSSP capital requirements.

F. Mandatory Clearing and Exchange Trading

Section 763 of the Dodd-Frank Act requires market participants to clear any security-based swap that a clearing agency will accept for clearing and that the Commission requires to be cleared. In addition, Section 763 of the Dodd-Frank Act requires swap counterparties to execute all cleared security-based swaps on an exchange or security-based swap execution facility ("SSEF") unless no exchange or SSEF makes the security-based swap available for trading.

MFA supports a regulatory framework that encourages central clearing of OTC derivatives. We believe that central clearing will play an essential role in reducing systemic, operational and counterparty risk, as it does in the equity and futures markets, and that the imposition of clearing and exchange trading to the extent practicable will offer increased regulatory and market efficiencies and greater market transparency and competition. Although we expect a bilateral market to remain for market participants to customize their business and risk management needs, we believe that mandatory clearing and exchange trading to the extent practicable will offer increased regulatory and market efficiencies, greater market transparency and competition.

As customers, we recognize that the success of security-based swap clearing and exchange trading will depend on the structure, governance and financial soundness of central counterparties ("CCPs"), SSEFs and exchanges. Accordingly, we emphasize the need for CCPs, SSEFs and exchanges, wherever applicable, to have transparent and replicable risk models and to enable fair and open access in a manner that incentivizes competition and reduces barriers to entry. In addition, from a customer protection perspective, we believe it is important to have customer representation on the governance and risk committees of CCPs because given the critical decisions such committees will make, they will benefit from the perspective of such significant and longstanding market participants. Finally, we request that the Commission implement rigorous standards for the approval of CCPs, SSEFs and exchanges and require that such entities have appropriately robust internal policies and processes to mitigate their risk to the financial system.

G. Segregation of Collateral

For cleared security-based swaps, Section 763 of the Dodd-Frank Act requires each broker, dealer or SSD to segregate customer margin from its own proprietary assets and prohibits the broker, dealer or SSD from using such customer assets to margin, secure or guarantee any of its trades or contracts with third parties. For uncleared security-based swaps, Section 763 of the Dodd-Frank Act requires the SSD or MSSP to notify its swap counterparty that the counterparty has the right to require segregation of its margin in an account with an independent third-party custodian.

With respect to cleared security-based swaps, MFA strongly supports the segregation of initial margin, including in a segregated account or other form permitted under applicable regulation, from the proprietary assets of a broker or dealer as a critical component to the effective functioning of the mandatory clearing regime.[20] With respect to uncleared security-based swaps, we support the Dodd-Frank Act's requirement that an SSD offer its customer the option to segregate initial margin in a custodial account for the benefit of the customer, separate from the assets and other property of the SSD. Moreover, we believe that the Dodd-Frank Act gives the Commission the authority to establish rules requiring brokers and dealers to individually segregate customer assets for both cleared and uncleared security-based swaps, rather than segregate assets of all customers in an omnibus account. Accordingly, to the extent that an offering of solely individual segregation for cleared and uncleared swaps is practicable from a cost and risk management perspective, MFA supports the Commission implementing rules allowing the customer to choose between an omnibus account or an individual account.

H. Transaction Reporting

Section 766 of the Dodd-Frank Act requires transaction reporting of uncleared security-based swaps. We fully support the need for the Commission to receive timely transaction reporting in order to provide a clear picture and effective oversight of the financial markets. We support the transaction reporting obligations of the Dodd-Frank Act, which require dealers to report when they are a counterparty to a transaction.

In particular, we believe that the most efficient method for the Commission to accomplish the goal of timely transaction reporting is by requiring dealers to report, since dealers already have established robust transaction reporting systems and have customarily provided transaction confirmations or reports to customers. Customers of dealers, on the other hand, generally do not have reporting systems in place and requiring them to establish such systems would be costly and inefficient when there is a dealer alternative.

We would urge the Commission, however, to take into consideration the impact that rules and regulations on public reporting of transactions could have on the market liquidity of security-based swaps.

I. Position Limits

Section 763 of the Dodd-Frank Act requires the Commission to establish limits, as necessary or appropriate in the public interest, on the size of positions in security-based swaps that a person may hold to prevent fraud and manipulation.[21] Position limits

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[20] Although the Security Investor Protection Act of 1970, as amended, provides some bankruptcy protections to collateral posted on security-based swap, it is important that the Commission ensure that rules related to segregation of collateral provide legal and bankruptcy certainty.

[21] Section 3(f) of the Exchange Act provides interpretive guidance on "as necessary or appropriate in the public interest" and specifically states, "[w]henever pursuant to this title the Commission is engaged in rulemaking, or in the review of a rule of a self-regulatory organization, and is required to consider or

on a physically-settled commodity serve the purpose of preventing participants from cornering the market and driving up the price of the commodity or preventing congestion in the physical delivery of the commodity. In the equities world, ownership and control issues have been addressed through Exchange Act Section 13 reporting requirements and the Section 16 short-swing profit regime, not through limitations on corporate ownership.

We believe it would be difficult, if not impossible, to manipulate the price of an underlying security solely by having economic exposure to the security through a security-based swap. For legitimate reasons, such as for hedging purposes, an investor may have both securities and security-based swaps on the same underlying security in his investment portfolio. We believe position limits are the wrong set of tools to use to address fraud and manipulation concerns with respect to an underlying securities market. Price manipulation, such as through pump-and-dump schemes, are better policed through market data and reporting regimes, rather than limitations on ownership or economic exposure. We note that pursuant to the Dodd-Frank Act the Commission will be receiving extensive market data on security-based swaps shortly. We are concerned that a misguided application of position limits could have significant, negative effects on the liquidity of the equities markets, and inhibit capital formation and investors' ability to hedge risks.

We believe that under the Dodd-Frank Act, through the language "as necessary or appropriate", the Commission has the discretion to not set position limits if such limits are not advisable based on the public interest, the needs of the market or consistent with Congressional intent in the Dodd-Frank Act. Moreover, the Dodd-Frank Act does not impose a deadline for the Commission to set position limits. In light of the serious, negative impact position limits could have on the equities markets we recommend that the Commission refrain from imposing position limits on investments in corporate issuers or economic exposure to corporate issuers. We recommend that the Commission first study the size and scope of the security-based swaps market, how these products are legitimately used, and how they potentially could be used to manipulate markets before determining whether position limits regulation is necessary or appropriate to prevent fraud and manipulation.

J. Definition of "Security-Based Swap Execution Facility"

Section 761(a)(6) of the Dodd-Frank Act defines a "security-based swap-based execution facility" (a "SEF") as "a trading system or platform in which multiple participants have the ability to execute or trade security-based swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that—(A) facilitates the execution of security-based swaps between persons; and (B) that is not a national securities exchange." However, in recent statements, regulators have indicated that they may

determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."

further narrow this definition by requiring that to qualify as a SEF "a company must offer a 'many-to-many' platform, or a platform that lets multiple players transact on swap deals."[22]

MFA believes that each swap trading platform needs to be appropriate for the product type it will execute, as the characteristics and corresponding trading needs vary. In addition, we believe that permitting the broadest range of swap trading platforms (subject to the requirements under the Dodd-Frank Act) would benefit investors, promote market-based competition among providers, and enable greater transparency over time and across a variety of products. In promulgating rules surrounding this definition, the Commission should ensure that it does not construe the scope of the SEF definition too narrowly. Rather, the Commission should preserve flexibility and opportunity for variety and organic development among trading platforms to the benefit of all market participants and consistent with the approach in other markets.

IV. Title IX

A. Executive Compensation

Section 956 of the Dodd-Frank Act requires federal regulators to establish rules or guidelines that would require "covered financial institutions" to disclose to regulators any incentive-based compensation arrangements, and would prohibit an institution from enacting any incentive-based compensation arrangements that encourage inappropriate risks. The Dodd-Frank Act defines "covered financial institution" to include, among others, investment advisers and other financial institutions as determined by regulators, but excludes any covered financial institution with less than $1 billion of assets.

Incentive-based compensation arrangements are beneficial to investors in private investment funds because such compensation results in an alignment of the interests between the adviser and its senior employees, and the fund's investors. Typically, an adviser's incentive-based compensation and the incentive-based compensation of an adviser's senior employees are linked to the performance of the fund. Therefore, an adviser and the adviser's senior employees only receive incentive-based compensation when the fund's investors make a profit on their investment. Sophisticated investors choose to invest in private investment funds to diversify their portfolio and because of the alignment of interests that results from the link between the profits of the investor and the compensation of the adviser and its senior employees. As such, any rules prohibiting incentive-based compensation under Section 956 would be inappropriate in the private investment fund context and could harm investors.

We believe that the focus in implementing Section 956 should be to address incentive-based compensation arrangements by firms that could create risk to the financial system or to taxpayers and we believe that this focus is consistent with the

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[22] Sarah N. Lynch, "CFTC's Gensler: Swap Trading Venues Will Face Changes Under New Rules", Dow Jones Newswires, Sept. 9, 2010.

intended scope of Section 956. Investment advisers to private investment funds are distinct from the financial institutions that are the intended focus of Section 956. Investment advisers are typically privately held companies with a small number of owners, with streamlined corporate governance structures that are designed to align compensation with investor interests. In addition, federal securities laws prohibit private investment funds from offering their interests to the public, and any purchaser of an interest in a private investment fund must meet substantial wealth and income requirements. Accordingly, retail investors are not affected by compensation policies at investment advisers to private investment funds. Moreover, investment advisers to private investment funds are not depository institutions, and do not maintain accounts that are federally insured. Private investment funds and their investment advisers neither required, nor sought, federal assistance, and they operate their businesses with no backstop from taxpayers. For private investment fund advisers that do not have public shareholders, federally insured deposits, do not create other taxpayer exposure, and otherwise do not jeopardize the financial system, there would not seem to be any public interest in restricting the compensation structures with respect to such advisers.[23]

B. Disqualifying Felons and Other "Bad Actors" from Regulation D Offerings

Section 926 of the Dodd-Frank Act directs the Commission to issue rules disqualifying issuers from making offerings and sales of securities in reliance on the safe harbor in Rule 506 of Regulation D ("Rule 506") under the Securities Act of 1933, as amended (the "Securities Act"), if the issuer or persons affiliated with the issuer have engaged in conduct that is substantially similar to the provisions of Rule 262 under the Securities Act, or are subject to certain final orders of a state securities commission or other state authority.

MFA strongly supports appropriate penalties and bars for persons in the securities industry who engage in inappropriate conduct. Firms and persons that violate the securities laws harm not only their own investors and clients, but also undermine confidence in the financial services industry and capital markets as a whole.

Rules adopted by the Commission under Section 926 will apply to a broad range of conduct. The wide scope of Section 926 could affect many firms that currently rely on Rule 506 in conducting private offerings. In implementing Section 926, we encourage the Commission to differentiate between technical violations and intentional or other more egregious conduct, similar to the Commission's treatment of insignificant deviations from the requirements of Regulation D pursuant to Rule 508 of Regulation D.[24] We further urge the Commission to give particular consideration to whether, and the extent to which, it would be appropriate to apply the disqualification provisions to firms that entered into settlement agreements with regulators prior to enactment of the Dodd-

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[23] Please see our discussion at Section II.F about aligning the interests of managers' employees and the interests of the funds.

[24] 17 C.F.R. §230.508.

Frank Act. In that regard, we are concerned that retroactively applying the provision to previously negotiated settlements would impose an additional penalty after the fact.

In preparing rules under Section 926, the Commission should also consider providing generally applicable guidance to firms that wish to seek relief from the disqualification provision, as specifically permitted by Section 926. The Commission could, for example, describe conditions that firms generally must meet to be eligible for such relief, thereby assisting firms that would face uncertainty in conducting their private offerings as a result of the rules.

C. Short Sale Disclosure

Section 929X of the Dodd-Frank Act requires the Commission to adopt rules providing for the public disclosure of the name of the issuer and the title, class, CUSIP number, aggregate amount of the number of short sales of each security, and any additional information determined by the Commission after the end of the reporting period. The disclosure must occur at least every month.

We support the approach taken in Section 929X of requiring the public disclosure of the aggregate amount of short sales of securities on a periodic basis, rather than requiring public disclosure of individualized short sale information. Disclosure of the information on an aggregate basis provides markets with additional transparency, while avoiding the harmful effects on markets and investors that would result from disclosure of an individual investor's confidential investment information.

By contrast, there is clear independent evidence that public disclosure of individual short positions would have substantially negative effects on the efficient functioning of capital markets. A recent study of the effect on markets of existing individual position public disclosure rules outside the U.S. concludes that such rules have impeded market liquidity, which is critical to investor confidence, significantly decreased trading volumes, interfered with efficient price discovery in affected stocks, and increased intraday volatility.[25] At the same time, such individual position disclosure has driven up transaction costs for all investors - including pension funds, endowment funds and retail funds - and burdened businesses with higher costs for obtaining capital in a challenging global market. Public disclosure of individual short positions would reduce short selling activity, and as a result lead to similar harmful effects on markets and investors that were caused by the temporary ban on short selling of the shares of financial companies that was adopted in 2008.[26]

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[25] *The effects of short-selling public disclosure regimes on equity markets: a comparative analysis of US and European markets*, Oliver Wyman, dated February 9, 2010. MFA members sponsored the Oliver Wyman research.

[26] *See*, Boehmer, E., Jones, C. M., Zhang, X., *Shackling Short Sellers: The 2008 Shorting Ban*, 2008a, preliminary draft, available at: http://www2.gsb.columbia.edu/faculty/cjones/ShortingBan.pdf.

In addition, public disclosure of individual short position information would harm investors by revealing participants' commercially confidential investment strategies to competitors, and can also provoke herding or copycat behavior in the market. Public disclosure provides no investor protection against, but significantly (and unnecessarily) increases, the risk of economic harm and even increases the potential for short squeezes. Rather than providing accurate information to the relevant market, publication of individual short positions will inevitably mislead the general public, because what is publicly disclosed will often omit critical information and paint an incomplete picture. For example, such disclosure could create the erroneous perception that an investor expects the price of a particular security to decline, when in fact the short position disclosed may simply be a hedge against other individual positions.

Public disclosure of aggregate short information provides useful information to market participants while minimizing the adverse market consequences and the burdens on individual investors that result from disclosure of individual information. Public disclosure of aggregate short information also reduces the burdens on the Commission in gathering and reviewing large amounts of data, such as those it experienced with Form SH. Indeed, its determination to find a more streamlined method for aggregate reporting via brokers and/or exchanges after the discontinuation of Form SH underscores this point. We look forward to providing additional information to the Commission during its rulemaking process.

D. Beneficial Ownership and Short Swing Profit Reporting

Section 929R of the Dodd-Frank Act amends Section 13(d) and Section 16(a) of the Exchange Act, to permit the Commission to shorten the time period during which a beneficial owner of more than 5% or 10%, respectively, of a class of equity securities must report its ownership. Currently, each section requires a beneficial owner to report its ownership within ten days after the acquisition.

The reporting obligations provided in Section 13(d) and Section 16(a) of the Exchange Act are designed to both encourage investment activity and provide shareholders with notice of material changes in ownership. We believe the existing ten-day period strikes the appropriate balance between these two important objectives. Investors, including private investment fund managers, have long relied on this standard in making their investment decisions. The existing reporting period provides for appropriate notice to interested parties while continuing to encourage private investment funds and other investors to invest needed capital in growing and restructuring businesses.

E. Standard of Conduct for Brokers, Dealers, and Investment Advisers

Under Section 913, the Commission may adopt a new standard of conduct for investment advisers providing investment advice to retail clients, and potentially other types of clients. Under that new standard, an investment adviser would be required to act in the best interest of the customer without regard to the financial or other interest of the investment adviser providing the advice. We are concerned that imposing a new standard of conduct on investment advisers would create unnecessary confusion. We strongly support a continuation of the current standard of conduct for investment advisers, which has worked well and is well understood by advisers, investors and the Commission.

For more than forty years, the Commission has brought enforcement actions against investment advisers for violations of their fiduciary duty to clients under Section 206 of the Advisers Act.[27] The Commission has broadly interpreted the scope of an adviser's fiduciary duty to apply to all aspects of an adviser's management of client assets. These and other clear, accepted standards of conduct have created certainty in the markets, have functioned effectively for many years, and are an integral part of how investment advisers conduct their businesses. Implementing the standard in Section 913 by creating new rules for investment advisers would have the effect of either replacing the existing and well-established fiduciary standard with a new and potentially ambiguous standard of conduct unfamiliar to the Commission and investment advisers, or creating an additional standard of conduct that could be duplicative of or inconsistent with the existing standard for advisers. We believe that either result would needlessly uproot a widely accepted standard upon which investors and investment advisers have relied for many years.

Section 913 would also permit the Commission to require brokers and dealers to be subject to the standard of conduct applicable to investment advisers under the Advisers Act. As investors, private investment fund managers rely on liquid, well-functioning capital markets. As such, while we support a fiduciary standard for broker-dealers, we encourage the Commission to consider the effect of such standard on investors and the vibrancy of markets, particularly in the context of broker-dealers' role as market makers. As the SEC considers harmonization of the standards of conduct for these investment professionals, however, it should not alter the existing fiduciary duty for investment advisers.

G. Investor Advisory Committee

Section 911 of the Dodd-Frank Act establishes an Investor Advisory Committee (the "Committee") within the Commission and establishes the scope of members to serve on the Committee, including institutional investors. Private investment funds are important institutional investors in our capital markets and represent the interests of their underlying investors. As such, we believe that it is important for the private investment fund industry to have representation on the Committee. MFA would be happy to work with the Commission to identify appropriate representatives from the industry to serve on the Committee.

[27] *SEC v. Capital Gains Research Bureau, Inc. et al*, 375 U.S. 180 (1963).

V. Other Relevant Regulatory Issues

A. European Alternative Investment Fund Managers Directive (the "AIFMD")

On April 30, 2009, the European Commission ("EC") of the European Union ("EU") published the initial text of the AIFMD regarding a regulatory framework for the oversight of alternative investment fund managers ("AIFMs"), currently the subject of trialogue negotiations between the EC, the European Parliament and the European Council of Finance Ministers. As currently drafted, the AIFMD will apply both to any AIFM established in the EU which provides management and administration services to one or more alternative investment funds ("AIFs"), and to AIFMs which are established outside of the EU, including by AIFMs established in the U.S., to the extent those non-EU AIFMs market their funds to European investors.

MFA supports the establishment of globally coordinated, pragmatic, and robust regulatory frameworks for the oversight of AIFMs. We are concerned, however, that U.S. headquartered AIFMs, many of which have a significant EU presence, will not be able to comply with the AIFMD in its entirety and, as such, will not have equivalent access to EU investors under the AIFMD, as drafted.

Though we have concerns with certain of the provisions in the current drafts of the AIFMD, MFA is committed to continuing to work with policy makers to develop an AIFMD that provides for appropriate regulatory oversight while ensuring a workable framework for U.S.-headquartered AIFMs to access the EU market and the continued ability of European investors to access funds managed by U.S.-headquartered AIFMs.

In order to achieve this goal, we believe it is important for U.S. policy makers and regulators to continue to engage with their European counterparts with respect to the AIFMD. We encourage the Commission to continue working with European policy makers to explain the robust nature of Advisers Act registration and regulation for U.S. private investment fund managers. We also encourage the Commission to explain how the agency has adopted a tailored approach to registration and regulation with respect to certain foreign advisers registered with the Commission and certain foreign sub-advisers of SEC-registered advisers. We believe that it is especially important for European policy makers to understand the Commission's tailored regulation of offshore advisers in light of Treasury Secretary Geithner's letters to European Commissioner for Internal Markets and Services, Michel Barnier, and the U.K. Chancellor of the Exchequer, the Rt. Honorable Alistair Darling,[28] in which Secretary Geithner specifically references the U.S. regulatory approach to registration and regulation of non-U.S. investment advisers.

[28] Secretary Geithner's letters are enclosed with this letter.

B. Determination of Systemically Important Financial Companies

Section 112 of the Dodd-Frank Act provides the newly-created Financial Stability Oversight Council ("FSOC") with the authority to designate non-bank financial companies as systemically important and permits the FSOC, acting through the Office of Financial Research, to collect reports from such non-bank financial companies for the purpose of determining whether the company poses a threat to U.S. financial stability. The Commission will be a member of the FSOC and, as the primary regulator for registered investment advisers, will have a significant role to play in determining if any such adviser or any private investment funds that it manages should be deemed to be systemically important.

We strongly support the goals of the Dodd-Frank Act in establishing the FSOC to address potential systemic risks before they arise and we support enhanced regulation of systemically relevant, non-bank financial companies, such as those entities that pose "AIG-like" risks to their counterparties or the marketplace. MFA also strongly supports efforts by regulators to gather data from different types of market participants, including investment advisers and the funds they manage. We believe that regulators should have access to quantitative data to help them determine which bank and non-bank financial companies are systemically important based on full and complete information.

Section 113 of the Dodd-Frank Act sets out a list of factors to be considered by the FSOC when determining whether a financial institution should be deemed systemically significant. We believe that as these factors are developed into regulation the following items may be appropriate to consider:

(1) whether assets under management are (a) owned funds, as in the case of a bank or insurance company, where all of the risk and residual value of investment portfolios go to managers and their stockholders, or (b) managed funds, as in the case of mutual and hedge funds, where the risk and residual value of investment portfolios go to outside investors and may or may not be shared with the fund adviser;

(2) the size of individual and aggregate investment fund portfolios managed by an investment adviser, in the context of the specific capital market segments in which such funds are active;

(3) the degree of investment funds' portfolio leverage in the context of their asset mixes, including the extent to which their borrowings and other liabilities are secured or unsecured;

(4) the sources of investment fund portfolio leverage, whether they are capital-markets based and require relatively frequent roll-over (*e.g.*, commercial paper) or whether they are committed to the funds under medium- or long-term contracts;

(5) the "stickiness" of investment funds' equity capital underlying that leverage, *i.e.*, whether managers can count on investors being locked-up sufficiently to avoid forced unwind of portfolios during financial stress;

(6) the stability of investment fund portfolios, *i.e.*, the extent to which they are subject to a level of volatility likely to require a forced unwind, given the degree of leverage, sources of leverage, and equity capital "stickiness";

(7) whether individual investment fund portfolios are long, short or market neutral and their resulting correlation to specific capital market segments, which could indicate such portfolios' vulnerability when the respective market segments come under financial stress;

(8) the degree of a firm's interconnectedness to major financial institutions, such as whether the firm in question is a top counterparty to such institutions, measured by such institutions' unsecured credit exposure to the firm in question, indicating the overall vulnerability of other major financial institutions if the firm in question were to fail;

(9) the extent to which the persons managing a firm and its investment funds have substantial stakes in the firm's ownership and/or such investment funds' equity capital, which incentivizes such persons not to take inappropriate investment or operational risks that could contribute to the failure of such firm; and

(10) whether an investment fund or other financial institution has an implicit or explicit government guarantee (*e.g.*, FDIC deposit insurance and debt guarantees), access to government-funded capital (*e.g.*, TARP) or other access to government assistance (*e.g.*, access to the Federal Reserve's discount window) any of which would pose losses to taxpayers from the firm's failure.

The legislative history of the Dodd-Frank Act indicates that Congressional intent was that the FSOC designate as systemically important and regulate only those financial institutions that were previously considered "too big to fail," *i.e.*, those companies that if they failed would threaten U.S. financial stability. As we discussed above, the hedge fund industry is of limited size and leverage relative to other market participants such as mutual funds, bank holding companies and investment banks. Because of the limited size and relatively low leverage of hedge funds, no hedge fund failures during the recent financial crisis had a meaningful impact U.S. financial stability, which we believe demonstrates that it is unlikely that any family of private investment funds is systemically significant. We recognize that the FSOC has an ongoing responsibility to monitor and assess the systemic risk of market participants and we look forward to continuing the dialogue on this subject with the SEC and other regulatory members of FSOC.

C. Disparate Treatment of Creditors in Resolution Framework

MFA supports a resolution authority that unwinds failing firms that pose a threat to the system. Because Title II of the Dodd-Frank Act establishes a new resolution framework that intentionally creates new rules distinct from existing rules and practices under bankruptcy law, investors face a significant amount of uncertainty with respect to the implementation of this new framework. We believe that it is important for regulators to create clear, objective rules regarding the implementation of the resolution framework to reduce the current uncertainty investors and counterparties face. [29]

We are particularly concerned with those provisions in Title II of the Dodd-Frank Act, which enable the FDIC to treat similarly situated creditors (*i.e.*, creditors of the same class) differently. We believe these provisions, if interpreted too broadly, will create enormous uncertainty for investors in the debt of these institutions and for other creditors. This uncertainty – *e.g.*, that the FDIC could potentially pay one bondholder a higher amount for its bonds versus another bondholder holding equivalent bonds – will inhibit investors from staying invested in, providing capital to, or otherwise doing business with, financially weak or weakening firms, at the very time such firms need capital most. Moreover, the potential for politically-based decisions, in which the FDIC and/or other government officials pick "winners" and "losers" in connection with the distribution of assets during the liquidation of a seized firm, will chill investor interest and raise costs. The follow-on effects on the market could be profound, with vulnerable firms failing more rapidly and contagion spreading to other financial firms of questionable health; in effect producing the opposite of the intended goals of reduced and contained risk. In light of the adverse effects these provisions could have for investors and for U.S. capital markets, it is imperative that the Commission, as a member of the FSOC, actively engage the FDIC as that agency promulgates rules on how to implement this new statutory authority and work with the FDIC to ensure that those rules treat similarly situated investors equitably.

D. SEC Data Collection

MFA is supportive of the Commission's need for greater transparency about the business activities of private investment funds and other market participants for purposes of analyzing the risk that such participants pose to the financial system. In connection with efforts by the Commission to collect data from private investment funds, their advisers or other market participants, the Commission may receive data from and about private investment funds and their investors that is proprietary and/or confidential. MFA's members expend significant time and resources to employ safeguards to preserve their trade secrets and protect the proprietary and/or confidential information of their

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[29] We note the relative ease in which the futures and options contracts held by Lehman Brothers on behalf of its customers were safely transferred out of the company within a single week of the bankruptcy filing, and believe regulators should consider aspects of the customer protections afforded futures customers and the futures insolvency regime. *See* Will Acworth, The Lessons of Lehman, Reassessing Customer Protections, Futures Industry Magazine, January/February 2009, *available at:* http://www.futuresindustry.org/fi-magazine-home.asp?a=1297.

investors and their private investments funds. While we respect and support the regulators' legitimate needs to collect such information, we are concerned about the harmful effects to investors and our members if such information were disclosed, reverse engineered or otherwise misappropriated. As a result, it is essential that the Commission protect any such information that it receives in response to such surveys to the fullest extent permitted by law.

In addition, as the Commission knows, various international regulators have requested that advisers complete surveys aimed at gathering information to analyze systemic risk. We also believe that the CFTC and other U.S. regulators are considering engaging in similar data requests. As part of our support of the regulatory and informational needs underlying such surveys, we have willingly participated in these efforts and had provided the requested data in response to regulator requests domestically and internationally. However, we are concerned that each survey requires us to expend significant time and resources to respond to these requests and that the scope and type of information that different regulators are requesting is not uniform and does not reflect the ways in which we currently keep information. As a result, in the event that the Commission decides to engage in a similar survey or data request, we emphasize that it is important that the Commission coordinate with other regulators to ensure that to the extent possible, these surveys are uniform, comparable and consistent; that regulators provide respondents a sufficiently reasonable period of time to comply; and that regulators take into account our current recordkeeping systems and methodologies, so that the information provided to the Commission is consistent and useful.

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Conclusion

MFA appreciates the opportunity to comment on the Commission's Comment Page for SEC Initiatives Under the Dodd-Frank Act. As the Commission works to implement the numerous provisions of the Dodd-Frank Act, we intend to offer what we hope will be seen as pragmatic and constructive comments on the Commission's implementation.

If you have any questions regarding any of these comments, or if we can provide further information with respect to these or other regulatory issues, please do not hesitate to contact Stuart J. Kaswell or me at (202) 367-1140.

Respectfully submitted,

/s/ Richard H. Baker

Richard H. Baker

President and CEO

CC: The Honorable Mary Schapiro
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes
Meredith Cross, Director, Division of Corporation Finance
Andrew Donohue, Director, Division of Investment Management
Robert W. Cook, Director, Division of Trading and Markets
Carlo V. di Florio, Director, Office of Compliance Inspections and Examinations
Henry Hu, Director, Division of Risk, Strategy, and Financial Innovation

Enc.