Managed Funds Association
The Voice of the Global Alternative Investment Industry
Washington, D.C. | New York

March 21, 2022

Via Web Submission

Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Comments on Proposed Amendments to Form PF
File Number S7-01-22

Dear Ms. Countryman:

Managed Funds Association ("**MFA**") [1] appreciates the opportunity to provide comments on the Securities and Exchange Commission's ("**SEC**" or "**Commission**") proposed amendments to Form PF and related rules ("**Proposed Amendments**") under the Investment Advisers Act of 1940.[2] The Proposed Amendments have the potential to have broad-reaching and significant implications for private funds and the markets in general. We believe the Proposed Amendments can be improved to provide the Commission with useful information, while decreasing the likelihood for inaccurate and false positive reports, as well as the burden and potential unintended consequences for registrants. MFA has worked with its members to provide the Commission with detailed comments on the Proposed Amendments, which we hope will be viewed as a continuation of our members' collaboration on matters important to investors and the U.S. securities markets.[3]

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1 MFA represents the global alternative investment industry and its investors by advocating for sound industry practices, regulatory, tax and other public policies that foster efficient, transparent, and fair capital markets. MFA's more than 150 member firms collectively mange nearly $1.6 trillion across a diverse group of investment strategies. MFA is an advocacy, education, and communications organization established to enable investment advisers in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA has a global presence and is active in Washington, D.C. London, Brussels, and Asia.

2 Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers, 87 FR 9106 (Feb. 17, 2022) ("**Proposing Release**"), available at: https://www.govinfo.gov/content/pkg/FR-2022-02-17/pdf/2022-01976.pdf.

3 We note that MFA along with other organizations submitted a request for an extension of time for the submission of Form PF comments. *See* Joint Letter Requesting Extension of Comment Period on File Nos. S7-03-22, S7-01-22 (Mar. 1, 2022), available at: s70122-20118198-271109.pdf. We are disappointed that our

MFA supports the Commission's role in overseeing systemic risk consistent with the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("**Dodd-Frank Act**"), which requires the Commission, Commodity Futures Trading Commission ("**CFTC**"), and Department of Treasury to work together in developing a systemic risk report for private funds.[4] Coming out of the financial crisis, Form PF was adopted 11 years ago jointly by the Commission and the CFTC primarily to assist the Financial Stability Oversight Council ("**FSOC**") in monitoring and assessing systemic risk.[5] In 2018, after seven years of Form PF filings by our members, we sought to assist the Commission in their important work, by offering a proposal to the Commission to streamline Form PF to reduce the regulatory burden for filers, while still accomplishing its policy goals to provide useful information to the Commission and FSOC.[6]

The Commission is instead proposing to amend Form PF to gather significantly more information from private fund advisers. In doing so, the Commission is proposing to change fundamentally the nature of Form PF, which currently is a quarterly or annual report—depending on the size and business of a private fund adviser—to make Form PF effectively a daily report.[7] This is because, under the proposal, private fund advisers will need to monitor and track a wide range of financial and operational metrics and events on a daily basis to determine whether any of the new reporting events has occurred and thereby triggered the one-business day filing requirement.

The Proposed Amendments accordingly represent a sea change from the existing design and focus of Form PF and will impose significant new operational burdens on private fund advisers as they have to build or modify systems to gather the information required by the new reporting regime. While we understand that the Commission is trying to get pre-notification of potential hedge fund distress, there are unintended consequences of the Proposed Amendments that must be considered. For example, certain reporting requirements, as currently proposed, have the potential to exacerbate hedge fund stress and, therefore, market stress. Such consequences stem from the fact that both counterparties and investors may seek access to

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extension was not granted, which would have provided us with time to respond to the Commission's many questions with quantitative feedback.

4 *See* Section 404 of the Dodd-Frank Act, Pub. L 111-203, 124 Stat. 1376 (2010), available at: https://www.govinfo.gov/content/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf.

5 Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, 76 FR 71128 (Nov. 16, 2011), available at: https://www.govinfo.gov/content/pkg/FR-2011-11-16/pdf/2011-28549.pdf.

6 MFA Letter to the Honorable Jay Clayton, Chairman, SEC, "A Streamlined Form PF: Reducing Regulatory Burdens" (Sep. 17, 2018), available at: https://www.managedfunds.org/wp-content/uploads/2018/09/MFA.Form-PF-Recommendations.attachment.final_.9.17.18.pdf.

7 Currently, Form PF is a periodic filing required on a quarterly or annual basis depending on the type of filer. Advisers having at least $1.5 billion in "regulatory assets under management" attributable to hedge funds must file quarterly reports within 60 calendar days of their first, second, and third fiscal quarters. All other advisers (including advisers to private equity funds) must file their annual updates within 120 calendar days after their fiscal year ends.

Section 5 reports, or the reporting information may otherwise be leaked, which could result in, among other things, the occurrence of rapid market sell-offs. Accordingly, in considering our comments below, we urge the Commission to calibrate appropriately the thresholds and number and types of reporting triggers to avoid any unintended consequences of the Proposed Amendments.

As explained in more detail below, our concerns with the Proposed Amendments fall into the following general categories:

- First, we are very concerned that the one-business day filing requirement for current reports is unrealistic, would diminish the accuracy of the data the regulators receive, and would impose significant, and likely, insurmountable burdens on advisers to private funds.

- Second, the breadth and scope of some of the reporting requirements, as well as the fact that some of the reporting requirements lack a materiality threshold, will lead to a large number of "false positive" filings that will diminish the value of the data that the Commission collects.

- Third, some of the new Section 5 reporting requirements are ambiguous, making them confusing and difficult to implement, leading to additional inaccuracies and inconsistencies in reports because advisers in the same position will report differently, diminishing their value as data to the Commission and FSOC.

- Fourth, some of the reporting requirements are unnecessary and duplicative, and we recommend that they be eliminated.

More generally, in addition to the potential unintended consequences discussed above, we believe the Proposed Amendments will impose significant operational burdens on private fund advisers that will be far in excess of any potential benefit. In our view, the Commission has not adequately weighed the real costs of the Proposed Amendments against the potential benefits. Time limitations resulting from the extremely short comment period on the proposal (30 days after publication in the Federal Register) unfortunately prevent us from conducting a full study of the costs associated with the Proposed Amendments, but we have indicated below where we think the principal burdens of the Proposed Amendments will be.[8]

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[8] We note that the Commission has recently proposed several rules imposing new, substantive requirements on private fund advisers, as well as a number of rules that will indirectly affect them. *See, e.g.*, Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, Rel. No. IA-5955 (Feb. 9, 2022), available at: https://www.sec.gov/rules/proposed/2022/ia-5955.pdf; Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies, Rel. No. 33-11028 (Feb. 9, 2022), available at: https://www.sec.gov/rules/proposed/2022/33-11028.pdf. Given the short comment periods on all of these proposals, there is insufficient time to conduct a thorough analysis of the Commission's economic analysis, let alone conduct our own study of the costs and benefits of the proposals when considered as a whole.

I. Executive Summary

MFA appreciates the Commission's interest in seeking pre-notifications of potential hedge fund distress. The Proposed Amendments, however, have the potential for significant unintended consequences for private funds and the markets. As such, MFA respectfully urges the Commission to revise the Proposed Amendments to improve the accuracy of the data it receives, limit the number of reporting items to those that are true indicators for fund distress, and better calibrate the reporting thresholds in order to reduce the likelihood for false positive reports, consistent with the recommendations below. We set forth our views on the Proposed Amendments together with our suggested revisions at the end of each section, which we believe will enhance the data the Commission receives, as well as reduce burden and limit potential unintended consequences for registrants. In summary, MFA's primary recommendations are as follows:

- Amend the timing for filing Section 5 reports from one (1) business day after a "key event" to four (4) business days after a "key event."

- Amend the timing for filing Section 6 reports from one (1) business day after a "key event" to a quarterly Form PF filing, but only when one of the items requires an affirmative response (*i.e.*, private equity advisers would file quarterly but only when there is something to report).

- For reports required under Section 5.B. (Extraordinary Investment Loss), raise the threshold of extraordinary losses to 50%. In addition, we recommend using final month-end NAV to compare to the last reported Form PF NAV as the comparison for the loss calculation. In the alternative, we recommend that any NAV comparison be made on a good faith estimate of NAV (and not a final NAV) and take into account interim subscriptions and redemptions to determine whether a loss trigger has been met to require a filing under Section 5.B.

- Eliminate reporting under Section 5.C. (Margin, Collateral, or an Equivalent) as there are a number of other reports under the new Section 5 that we believe better signal Qualifying Hedge Fund[9] stress. This item has a significant likelihood of generating a large number of "false positives" as well as ambiguity among Large Hedge Fund Advisers[10] in interpreting the filing obligations, thus diminishing the value of the data the Commission collects.

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9 "**Qualifying Hedge Fund**" is defined as any hedge fund that has a net asset value (individually or in combination with any feeder funds, parallel funds and/or dependent parallel managed accounts) of at least $500 million as of the last day of any month in the fiscal quarter immediately preceding the most recently completed fiscal quarter.

10 "**Large Hedge Fund Adviser**" is defined as any private fund adviser that had at least $1.5 billion in hedge fund assets under management as of the last day of any month in the fiscal quarter immediately preceding your most recently completed fiscal quarter.

- Limit the scope of reporting under Section 5.D. (Notice of Margin Default) to written notification to a Qualifying Hedge Fund of a default on a call for margin or collateral where such default equals or exceeds 5% of a Qualifying Hedge Fund's last reported NAV, adjusted for subscriptions and redemptions.

- Limit the scope of reporting under Section 5.E. (Counterparty Default) to counterparty defaults involving only regulated broker-dealers and banks as opposed to arrangements that may occur with a variety of other market participants.

- Narrow the scope of reporting under Section 5.F. (Material Change in Relation with Prime Broker) to situations in which a prime brokerage relationship was terminated by the prime broker for a breach of contract or material default.

- Eliminate the reporting under Section 5.G. (Unencumbered Cash) as it will generate a high false positive rate, some of the concerns generating that reporting are covered in other Section 5 reporting and other triggers of Section 5.G. reporting are unrelated to systemic risk.

- Revise the reporting under Section 5.H. (Operations Events) so that it is only triggered when a Large Hedge Fund Adviser, as a result of a system outage, initiates its firm-wide disaster recovery and/or business continuity plan and such plan is in effect for more than two (2) consecutive business days.

- Revise Section 5.I. (Withdrawals and Redemptions) so that filings are triggered after redemptions have matured as opposed to notified redemptions as this timeframe allows registrants to take into account subscriptions. Furthermore, we strongly recommend that reporting should take into account gates and other liquidity features that are expressly set forth in the redemption terms of a Qualifying Hedge Fund. Finally, while we support the 50% threshold proposed, we recommend that there be a minimum dollar threshold of $1 billion before trigging a filing obligation under Section 5.I.

- Revise Section 5.J. (Unable to Satisfy Redemptions or Suspensions of Redemptions) so that the trigger for reporting a failure to pay redemptions request should be five (5) days following the period specified for payment of redemptions proceeds under a Qualifying Hedge Fund's governing documents.

- With respect to Section 6 reporting of a termination of the investment period and termination of a fund, we recommend that such reporting only be made for terminations that occur "for cause" events under private equity fund's governing documents.

- With respect to additional information under Section 4 of Form PF, we recommend eliminating Question 70 as it does not provide meaningful information about the current market or potential systemic risk. In lieu of eliminating this question, we have proposed a number of alternatives that we believe would be more tailored to investor concerns.

- With respect to additional information under Section 4 of Form PF, we recommend that for Question 71 the Commission adopt a triggering event if the private equity fund held a greater than 10% gross asset value position in its private equity fund and a different fund advised by the same adviser or one of its related persons concurrently held a greater than 10% gross asset value position in a different class, series, or type of securities of the same portfolio company.

- Finally, we urge the Commission, upon adoption of any amendments to Form PF, to provide for a transition period of at least eighteen months to permit advisers to private funds (and fund administrators) to implement changes to software and other systems as well as policies and procedures that will be needed to track data in a very different manner than they currently do.

Throughout our comment letter, we have suggested other alternative recommendations and technical clarifications to the new Proposed Amendments that we believe will provide some clarity to private fund advisers in meeting the new reporting obligations.

II. One Business Day to File Following Reporting Event

The Proposed Amendments would require Large Hedge Fund Advisers, with respect to their Qualifying Hedge Funds, and advisers to private equity funds to file reports within one business day of the occurrence of certain "key events," as described below. We are very concerned that the one-business day filing requirement for current reports is unrealistic, would diminish the accuracy of the data the regulators receive, and would impose unnecessary burdens on advisers to private funds.

As explained further below, MFA urges the Commission to allow private fund advisers to file Section 5 reports at least four (rather than one) business days after a "key event." We also do not believe the Commission has made an adequate case for the need for Section 6 reports to be filed by advisers to private equity funds one business day after a triggering event and recommend that the Commission require Section 6 reports to be filed on a quarterly basis, but only when one of the items requires an affirmative response (*i.e.*, advisers would need to file quarterly but only when there is something to report).

A. Large Hedge Fund Adviser Reporting

We do not believe there is another filing requirement in the federal securities laws that provides for one business day to file a report. As a comparison, the Commission requires current reports by public companies to file Form 8-K four (4) days after a significant corporate event to inform market participants. We respectfully request that the Commission provide Large Hedge Fund Advisers with at least the same amount of time to file Section 5 reports. We believe the additional time will allow for a proper assessment of the event, for a more accurate reporting of information, and, most importantly, permit an adviser to devote the appropriate time and resources to address the event so as to be able to fulfill its fiduciary duties.

Furthermore, given that the purpose of Section 5 is to capture events that may involve market-wide risk and potential serious stress on Qualifying Hedge Funds, it is unreasonable in such an environment to require Large Hedge Fund Advisers to collect and assess information for their Qualifying Hedge Funds one business day after a reporting event given the resources likely involved to manage the events necessitating the filing. We believe such expedited reporting would inadvertently contain a significant amount of misleading and inaccurate information being presented and a high number of "false positives," in either case greatly diminishing the value of the data for monitoring and assessing risk.

Large Hedge Fund Advisers need adequate time to recognize an event, determine with the aid of counsel and outside advisers whether the event is required to be reported, and gather and assemble the information necessary to report accurately a significant event. A report required to be filed in near real time will inevitably contain errors, estimates, and even guesstimates. The one business day reporting will also divert an adviser's executive, legal and compliance resources away from addressing the significant event to protect its investors, which is its first obligation as a fiduciary.

***Recommendation*—**We recommend amending the timing for filing Section 5 reports from one (1) business day after a "key event" to four (4) business days after a "key event."

B. <u>Private Equity Adviser Reporting</u>

As noted above, we do not believe the Commission has made an adequate case for the need for Section 6 reports to be filed by advisers to private equity funds one business day after the event. The triggering events primarily involve potential conflicts, in which arguably the Commission may have an interest in receiving information more than annually, but it is a stretch to argue that they have systemic implications or must be addressed immediately.[11] For example, an adviser led-secondary transaction does not involve an event that raises systemic issues, but rather a reshuffling of ownership of assets in a pooled investment vehicle and changes of the terms under which those assets are held. As further discussed below, a termination of an investment period by investors often has built-in cure periods that can result in false positive reports being filed.

***Recommendation*—**We recommend amending the timing for filing Section 6 reports from one (1) business day after a "key event" to a quarterly Form PF filing, but only when one of

[11] The one business day filing requirement applies to advisers to private equity funds that (i) execute an adviser-led secondary transaction, (ii) implement a general partner or limited partner clawback greater than 10%, (iii) are removed as general partner, or (iv) manage a private equity fund where the fund's investment period is terminated or the fund is terminated.

the items requires an affirmative response (*i.e.*, advisers would file quarterly but only when there is something to report).

III. Comments on Specific Provisions Relating to Qualifying Hedge Funds

The Commission proposes to add a new Section 5 to Form PF requiring that Large Hedge Fund Advisers file current reports with the Commission in the event of certain reporting events. MFA appreciates that the Commission has prepared the Proposed Amendments to permit Section 5 to be submitted to the Commission as a stand-alone filing, without the need to re-file the entire Form PF. However, we believe some of the Section 5 reporting thresholds, without changes, could lead to a large number of false positive filings, have ambiguities that will result in various interpretations as to what is required, and may lead to certain unintended consequences, as discussed throughout this letter.

We submit below our comments and recommendations on the substance of the Section 5 reporting requirements under the Proposed Amendments.

1. <u>Extraordinary Investment Loss</u>

Proposed Section 5.B.—A loss equal to or greater than 20% of a Qualifying Hedge Fund's most recent net asset value ("NAV") over rolling 10 business day period.

MFA urges the Commission to revise Section 5.B. to make the information received by the Commission and FSOC more useful and to make the reporting obligations less burdensome to advisers by raising the reporting threshold to 50% and revising the calculation methodology.

First, we question whether the targeted threshold for filing reports under Section 5.B.—that is, a 20% loss in a Qualifying Hedge Fund over a rolling ten (10) business day period—is the correct starting place to measure hedge fund distress. Consider that, for a \$500 million Qualifying Hedge Fund, a Section 5.B. report would be triggered at a \$100 million loss. When there are market corrections or significant market events (*e.g.*, what recently happened in the markets as a result of Russia invading Ukraine), this is generally known to all market participants, and, accordingly, may result in a large number of filings for temporary events that do not show broader market implications. At a time of temporary market dislocation, we would think that the Commission and FSOC would want Large Hedge Fund Advisers to be focusing on and devoting their resources to their Qualifying Hedge Funds in order to navigate them through the temporary market dislocation and not devoting resources to filing a report resulting from an event that is widely known. A higher reporting threshold will reduce the "noise" of a large number of reports that are based on temporary market events.

In addition, hedge fund strategies vary in asset class, strategy, and volatility. Certain strategies offered by Large Hedge Fund Advisers are more volatile than other strategies and setting the loss threshold too low may create a bias in the marketplace against certain investment strategies. This may result in a filing obligation impacting the investment decisions a Large Hedge Fund Adviser may choose to make for a Qualifying Hedge Fund's portfolio to avoid triggering a reporting obligation and any negative inference resulting from the filing of a Section 5 report. Accordingly, we believe a better measure of hedge fund stress, and the attendant investor protection concerns, is at a level of a 50% or more loss measured against the last filed Form PF NAV.

Second, as proposed, Large Hedge Fund Advisers would be required to perform daily final NAV calculations on their Qualifying Hedge Funds to compare it against the NAV for the fund in the last filed Form PF. While performing daily final NAV calculations for registered investment companies is the norm because they invest in publicly-traded securities and have daily liquidity, it is not the case for hedge funds, and thus the operational systems employed by hedge funds and their administrators are not set-up for daily final NAV calculations. In addition, level 3 assets, by definition, are those that are hard to value, which means that they do not lend themselves to daily valuation.

The industry convention for most hedge funds (since redemptions are generally quarterly or monthly and subscriptions are generally monthly) is to calculate their NAVs on a monthly basis and report out those monthly results to investors (and counterparties) generally 10 business days after each month-end. The monthly NAV of a Qualifying Hedge Fund, while unaudited, is generally an accurate depiction of the value of the fund at month end as the Large Hedge Fund Adviser is able to go through all of its processes and procedures to value all assets and liabilities of the fund in an orderly manner. Trying to condense those processes and procedures down to one business day will be burdensome and costly, and may result in the inadvertent production of inaccurate and misleading information. Accordingly, a movement to a daily final NAV calculation would have a significant adverse impact on the hedge fund industry, including the pricing for administrative services and the time, effort, and personnel that would need to be retained to produce a daily NAV.[12]

Furthermore, Large Hedge Fund Advisers have the ability to invest in instruments with varying liquidity and some of those investments (in particular level 3 investments) are not capable of being valued on a daily basis. For level 3 assets, Qualifying Hedge Funds typically undergo a significant valuation process based on (i) models that are developed by the Large Hedge Fund Adviser, often together with an independent valuation agent, or (ii) values determined and/or reviewed by independent valuation agents. Since Qualifying Hedge Funds typically do not have any limits in the types of investments they may make, the complexity of investments vary greatly from fund-to-fund, with more complex investments utilizing independent valuation agents as part of their valuation process, which differs from the pricing services utilized by registered investments funds. Furthermore, many hedge funds that hold level 3 assets often employ "side pockets" to hold such assets precisely because of the difficulty in valuing such assets on a monthly basis, which is the valuation convention for hedge funds.[13]

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12 Imposing these costs on Large Hedge Fund Advisers also would likely raise the barrier to entry for new hedge fund advisers. This could eliminate new entrants and decrease competition in the marketplace.

13 The Commission came to a similar conclusion to allow the venture capital funds to value assets at cost in determining eligibility for the venture capital exemption. *Exemption for Advisers to Venture Capital Funds,*

In addition, operationally, Qualifying Hedge Funds and their administrators are also not accruing all expenses on a daily basis and a daily final NAV calculation will require a significant increase in costs charged by administrators as well as the need for additional internal resources at Large Hedge Fund Advisers. These additional costs would typically be borne by the investors in the hedge funds.

Moreover, a comparison of a Qualifying Hedge Fund's current NAV to NAV as last filed in Form PF, as envisioned by the Proposed Amendments, fails to account for changes in subscription activity and payment of redemption proceeds that may affect NAV, but is not reflective of losses in the market that may pose systemic risk. This failure will consistently skew the data the Commission and FSOC receive from funds in certain stages of their subscription and redemption cycle, thereby tainting the data received. For the sake of real-time data, the Commission is forgoing the opportunity to get more accurate and, thus, more meaningful data about hedge fund performance.

There are a few formulations that we believe would better assess significant losses in the industry to assist FSOC in monitoring and assessing stress at Qualifying Hedge Funds. If the Commission and FSOC seek to compare NAVs, then we would recommend that the loss calculation be against a Qualifying Hedge Fund's month-end NAV (as opposed to a mid-month calculation) after taking into account subscription and redemption activities. Thus, after adjusting for subscription and redemption activities for the month, a Large Hedge Fund Adviser would compare month-end NAV to the previous Form PF NAV to determine whether there was an investment loss that met the threshold for filing. This would provide the Commission and FSOC with access to more frequent information than the currently filed quarterly reports (which are filed within 60 days after quarter end) and be in line with current calculation practices that are relied upon by Qualifying Hedge Fund counterparties and investors. The information provided would be significantly more accurate than what the Commission and FSOC would receive under the Proposed Amendments and the number of potential false positives would be substantially reduced.

Alternatively, if the Commission and FSOC seek to keep a loss calculation over a rolling 10 business days, we recommend that the Large Hedge Fund Adviser be able to compare their last reported Form PF NAV to its good faith estimate of its current NAV, again after adjusting for subscription and redemption activity. As indicated above, moving to a formal daily final NAV calculation would be very difficult for Large Hedge Fund Advisers, would greatly increase administrative costs and personnel costs, and be difficult to implement under the current valuation processes adopted by Large Hedge Fund Advisers. A good faith estimate of NAV, we believe, is an appropriate substitute to compare against the Form PF NAV.

Private Fund Advisers With Less than $150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers Act Rel. No. 3222 (June 22, 2011) at 32-33 (citing a similar approach to rules under the Employee Retirement Income Security Act of 1974 ("ERISA") for funds qualifying as "venture capital operating companies" (29 CFR 2510.3-101(d)).

Recommendation—For reports required under Section 5.B., as discussed above we recommend raising the threshold of extraordinary losses to 50% as a better indication of hedge fund stress.

Recommendation—We recommend amending the filing obligation of Section 5.B. to compare final month-end NAV to the previous Form PF NAV to determine whether there was an investment loss that met the threshold after taking into account subscriptions and redemptions.

Alternative Recommendation—In the alternative, we recommend that any NAV comparison be made on a good faith estimate of NAV (and not a final NAV) and take into account interim subscriptions and redemptions to determine whether a loss trigger has been met to require a filing under Section 5.B.

2. Margin, Collateral or Equivalent Increases

> *Proposed Section 5.C.—A cumulative increase in the total dollar value of margin, collateral or an equivalent posted by a qualifying hedge fund of more than 20% of the fund's most recent net asset value over a rolling 10 business day period.*

MFA recommends eliminating reporting under Section 5.C. because there are a number of other reports under the new Section 5 that we believe better signal Qualifying Hedge Fund stress and because this item has a significant likelihood of generating a large number of "false positives" as well as creating ambiguity among Large Hedge Fund Advisers in interpreting the filing obligations, all of which will diminish the value of the data the Commission collects.

We understand that it is important in the Commission's and FSOC's roles to collect information where there is the potential for systemic risk to the marketplace and that the stated goal of the reporting pursuant to proposed Section 5.C. is based on the belief that a 20% increase in margin, collateral, or an equivalent relative to the last Form PF NAV for a Qualifying Hedge Fund is "large enough and precipitous enough to signal potential significant stress at the fund, at its counterparties, or the broader market."[14] We believe that collecting data on a Qualifying Hedge Fund's extraordinary investment loss (see Comment 1. above), defaults on margin calls (see Comment 3. below), and material withdrawal/redemption activity or suspensions (see Comment 8. below) is a better gauge for monitoring and assessing Qualifying Hedge Fund stress and potential attendant systemic risk. We do not believe that collecting data on increases in margin, collateral, or an equivalent for other reasons is necessary, instructive, or relevant for monitoring and assessing systemic risk or even fund stress. We believe that doing so would result in a significant number of false positive filings that have nothing to do with systemic risk and will only serve to "cloud the system," perhaps even cause stress to the Qualifying Hedge Fund were the filing to become more widely known to market participants.

Accordingly, we believe the Commission should remove the requirement for a Large Hedge Fund Adviser to file a report under proposed Section 5.C. for a Qualifying Hedge Fund

[14] Proposing Release at 9111.

arising out of the following items enumerated in Section 5.C, as none of them impact systemic risk:

(i) exchange requirements or known regulatory action affecting one or more counterparties,

(ii) establishing a new relationship or new business with one or more counterparties,

(iii) new investment positions, investment approach or strategy and/or portfolio turnover of the hedge fund, or

(iv) other.

If the Commission wants information regarding the foregoing items, it could require they be reported on the next quarterly Form PF filing, which already discloses collateral information in Question 37 and 43 Form PF. Otherwise, many Large Hedge Fund Advisers would be filing Section 5.C. reports on a regular basis as they establish relationships and deploy capital in the ordinary course of business, thereby generating false positives as none of such ordinary course activities are systemically important. In addition, the Commission and FSOC would already be aware of any "exchange requirements or known regulatory action," and therefore requiring a report under Section 5.C. under such circumstances would be redundant.

As stated above, we believe that significant losses in the value of a Qualifying Hedge Fund's assets is an appropriate method to monitor and assess Qualifying Hedge Fund stress, and potential attendant systemic risk, if addressed in the ways we discussed above. For example, where Qualifying Hedge Funds utilize leverage in their trading strategies, a significant loss of portfolio value will result in an increase in margin calls. Capturing the information above in Section 5.B. will signal market participant stress. By contrast, we believe that reporting a 20% increase in the total dollar value of margin, collateral, or an equivalent will result in a significant number of false positive reports filed under Section 5.C. by Large Hedge Fund Advisers that are unrelated to systemic risk. If the Proposed Amendment is adopted as proposed, there are a number of Large Hedge Fund Advisers that would be filing reports under Section 5.C. on a frequent basis even though their Qualifying Hedge Funds are performing well.

We note that if Section 5.C. reporting requirements are maintained, we believe that revisions should be made to this section to remove some of the ambiguity in the reporting requirement.

As an initial matter, we note that without further clarification of the definitions of "margin," "collateral," or the "equivalent," there will be significant inconsistency and confusion as to how these terms are to be applied, which will result in a significant amount of both false positive reporting and inconsistent interpretations among filers. Form PF collects information regarding the collateral posted by a Reporting Fund in Questions 37 and 43. In the context of those questions, collateral clearly refers to, among other categories of assets, the gross market value of securities posted under prime brokerage, reverse repurchase agreements, and other secured borrowings. Collateral would also include the value of short sale proceeds in the context of securities borrowing transactions. Without removing the reference to collateral in Section 5.C. or providing an alternative definition, the calculation in Section 5.C. will include the market value of equities held in prime brokerage accounts, the market value of bonds financed through reverse repurchase agreements, and the value of all other cash and investments identified as collateral under any other financing agreements.

We do not believe it is the intent of the Commission, nor do we believe it serves any legitimate policy goal, to create a Section 5 reporting obligation as a result of an increase in the market value of the positions financed through collateralized lending arrangements. In addition, any definition of margin should be limited to the minimum amount of margin required by a counterparty to be posted and exclude variation margin or any excess margin that a counterparty elects to post to a counterparty. Positions with offsetting risks across tenors, currencies, products, or counterparties may generate increases or decreases of variation margin without any material change in risk or PNL. Furthermore, some Qualifying Hedge Funds may post margin in excess of the mandatory amount in order to reduce financing costs or reduce the frequency of margin movements. Amounts posted in excess of the minimum should not factor into any calculation of increased margin.

Moreover, regardless of how margin and collateral are defined, there are numerous situations where the margin requirements of a Qualifying Hedge Fund may increase significantly without any increase in risk taking or losses. One example is when a manager takes short bond futures into delivery. Many FCMs will require customers to deliver fully paid for bonds as collateral prior to or at the inception of the delivery window and prior to settlement. Such bonds would have been financed on much lower margin prior to delivery as collateral and will result in a temporary increase in margin requirements. Another example is risk-offsetting FX forwards with different value dates (*e.g.*, a market participant bought Euros for April 1 settlement and sold Euros for April 3 settlement). During the period of time between the value dates, the amount of reported "margin" in the account will increase (as the first leg settles and a mark-to-market gain turns into margin) before collapsing (as the second leg settles and mark-to-market loss is netted against the margin in the account).

Similarly, if a Qualifying Hedge Fund borrows more because it received an influx of subscriptions and the strategy is levered, there needs to be a similar adjustment to the last filed Form PF NAV to provide an appropriate comparison as such borrowing will not really be reflective of risk.

***Recommendation*—**We believe that Section 5.C. should be removed as it is redundant, confusing, requests information that is not relevant for the monitoring and assessing of systemic risk, and, if adopted as proposed, would result in a significant number of false positive filings with many Large Hedge Fund Advisers filing on a regular basis even though their Qualifying Hedge Funds are performing well and showing no stress.

***Alternative*—**If the Commission determines to proceed with the framework for Section 5.C. reporting, we suggest that the following clarifications be made: (i) clarify the definitions of "margin", "collateral" or "equivalent" or else eliminate "collateral" or "equivalent" from the trigger, (ii) limit the definition of "margin" to the minimum amount of margin required by a counterparty to be posted and exclude variation margin or any excess margin that a counterparty elects to post to a counterparty, (iii) eliminate reporting under Section 5.C. where there are offsetting transactions and where there are transactions that do not increase risk and loss, and (iv) adjust the NAV comparison to take into account the effect of subscriptions and redemptions.

3. Notice of Margin Default or Determination of Inability to Meet a Call for Margin, Collateral or Equivalent

Proposed Section 5.D.—(1) a Qualifying Hedge Fund receives notification that it is in default on a call for margin, collateral or an equivalent, resulting in a deficit that it will not be able to cover or address by adding additional funds (if there is a cure period, no filing would be due until expiration of the cure period unless the hedge fund is not expected to be able to meet the call during the cure period) or (2) the Large Hedge Fund Adviser determines that the Qualifying Hedge Fund is unable to meet a call for increased margin, collateral or an equivalent, including in situations where there is a dispute regarding the amount or appropriateness of the margin call (no filing required where there is sufficient assets to cover the largest disputed amounts).

MFA urges the Commission to limit reporting under Section 5.D. to situations in which there is a written notification to a Qualifying Hedge Fund of a default on a call for margin or collateral where such default equals or exceeds 5% of a Qualifying Hedge Fund's last reported NAV adjusted for subscriptions and redemptions.

As discussed above, we appreciate the need for FSOC to collect information where there is a potential for systemic risk. However, we believe the proposed reporting under Section 5.D. should be under clearly defined circumstances. There is a significant amount of communication, both oral and electronic, between Large Hedge Fund Advisers and their counterparties, especially surrounding a margin call. In almost all cases, documentation between Qualifying Hedge Funds and their counterparties requires that if the counterparty wants to call a default on a margin call, it must do so in writing.

We believe it is appropriate to seek to capture information in a Section 5.D. report where there is notification in writing of a default on a call for margin or collateral where the Qualifying Hedge Fund will not be able to cover the maximum defaulted amounts under dispute. Having a bright line test for whether a 5.D. report is required is important for the reasons stated above, as well as requiring written notice (or email equivalent) from the counterparty. We also believe that the "or equivalent" language in the Proposed Amendments should be deleted for the reasons stated above.

Furthermore, we believe that since the goal of the Proposed Amendments is to provide the Commission and FSOC with current accurate data so that FSOC can monitor and assess systemic risk, there should be a threshold percent for triggering a report under Section 5.D. Having a threshold will serve to reduce the number of filings regarding margin defaults that are small, immaterial, and have no bearing on systemic risk. It is our view that the threshold should be that the maximum default amount be at or greater than 5% of the Qualifying Hedge Fund's NAV as last reported on Form PF, as adjusted for subscriptions and redemptions. This would also be in parallel with the materiality standard for filings under Section 5.E. discussed below. This would serve the purpose of getting potentially material information to FSOC about margin and collateral defaults, and not unnecessarily inundate FSOC's system with Section 5 reports regarding immaterial defaults.

We also believe that reporting on a determination by a Large Hedge Fund Adviser that a Qualifying Hedge Fund is unable to meet a call, without a clear event of default notice being issued by the counterparty, is not the correct standard for measuring risk as this is likely a disputed situation and there are a number of instances where there are discussions between a Large Hedge Fund Adviser and its counterparty as to the correctness of the margin call that often get sorted between the parties over one or more days. Requiring filings under this standard will again result in a number of "false positive" filings for systemic risk as many of these situations are ultimately resolved. Furthermore, without a bright line test, there will be an increased devotion of internal resources needed to determine filing obligations under Section 5.D.

***Recommendation*—**We recommend limiting reporting under Section 5.D. to situations in which there is a written notification to a Qualifying Hedge Fund of a default on a call for margin or collateral where such default equals or exceeds 5% of a Qualifying Hedge Fund's last reported NAV, adjusted for subscriptions and redemptions. We also recommend removing the requirement to file when the Large Hedge Fund Adviser makes a determination that a Qualifying Hedge Fund is unable to meet a call for increased margin, collateral, or an equivalent. The term "or an equivalent" should also be removed as it is not defined and we do not understand what it means.

4. <u>Counterparty Default</u>

> *Proposed Section 5.E.—If a counterparty to a Qualifying Hedge Fund does not (1) meet a call for margin or failed to make any other payment in the time and form contractually required (taking into account any contractually agreed cure period) and (2) the amount involved is greater than 5% of the Qualifying Hedge Fund's most recent NAV.*

MFA recommends that the Commission revise the reporting obligations under Section 5.E. to limit reporting of counterparty defaults to those counterparties that are regulated broker-dealers and banks as opposed to arrangements that may occur with a variety of other market participants.

We appreciate the need to monitor for systemic risk, but we believe the scope of the potential activities covered by proposed reporting under Section 5.E. is too broad. Qualifying Hedge Funds engage in transactions with a myriad of counterparties from prime brokers to broker-dealers and banks to other funds and private parties. We believe that Section 5.E. as drafted would result in Large Hedge Fund Advisers filing numerous Section 5.E. reports as a result of ordinary course transactions that have nothing to do with systemic risk. For example, for Qualifying Hedge Funds making direct loans as part of their investment strategy, a private borrower default in the payment of interest and/or principal on a loan (assuming the 5% threshold was met) would result in a Large Hedge Fund Adviser needing to file a Section 5.E. report. Defaults on bi-lateral arrangements not involving banks or broker-dealers almost by definition cannot be systemically relevant; thus, we do not believe that this is the type of data that FSOC is seeking.

Rather, the Commission and FSOC should focus on defaults to a Qualifying Hedge Fund by a systemically important entity—namely a regulated broker-dealer or bank.

Recommendation—We recommend that the counterparty defaults be limited to regulated broker-dealers and banks as opposed to other arrangements that may occur with a variety of other market participants. As with the other sections, it is our view that the Qualifying Hedge Fund's Form PF NAV be adjusted by interim subscriptions and redemptions to more accurately capture the risk this reporting is intended to cover.

5. Material Changes in Relationship with Prime Broker

Proposed Section 5.F.—A Qualifying Hedge Fund must report a material change in its relationship with its prime broker.

MFA believes the scope of the potential activities covered by the proposed reporting under Section 5.F. is too broad and would generate a material number of false positives and result in FSOC inadvertently receiving bad data, and we therefore recommend that Section 5.F. be narrowed.

First, there may be many reasons for a temporary limit on trading or investment restrictions that do not result in systemic risk but relate to market events that can happen during a trading day. A good example arises out of the recent Russian invasion of Ukraine, which of course is known to everyone. As a result of the invasion, prime brokers placed limits and other restrictions on certain types of trading and these limits and other restrictions were subsequently ratcheted up. If Section 5.F. as proposed were in place, a significant number of Large Hedge Fund Advisers would have been filing Section 5 reports even though there is no systemic issue and the Commission and FSOC are aware of the events without receiving such reports. Without clear guidance as to materiality, we believe providing a measurement for this activity will be difficult to determine and monitor and are likely already covered by other reporting events requested in the Proposed Amendments.

Second, there may be legitimate disputes between a Qualifying Hedge Fund and its prime brokers where limits on trading or other investment restrictions are imposed while the parties are working out their disputes and, accordingly, false positive reports being filed where, in most of these situations, these disputes are resolved.

Third, requiring a Large Hedge Fund Adviser to file a Section 5.F. report upon it terminating a prime brokerage arrangement for a Qualifying Hedge Fund may have a chilling effect on Large Hedge Fund Advisers seeking to enter into new relationships with new counterparties. Necessitating a filing obligation to the Commission in such a context would falsely indicate a "risk" when such actions are being pursued solely for needed or desired commercial reasons.

Recommendation**—**We believe a better measurement of risk reporting would be requiring a Form PF filing under Section 5.F. if a prime brokerage relationship was terminated by the prime broker for a breach of contract or material default. We believe this narrower approach will allow for monitoring of potential Qualifying Hedge Fund stress, eliminate false positive filings, continue to allow for competition if new prime broker relationships are sought to be entered into, and create a bright line as to when filings would be required.

6. <u>Changes in Unencumbered Cash</u>

Proposed Section 5.G.—If the value of a Qualifying Hedge Fund's unencumbered cash declines by more than 20% of the fund's most recent NAV over a rolling 10 trading day period.

MFA urges the Commission to eliminate the reporting obligation under Section 5.G. as this item is likely to result in a high number of false positive reports. Further, many of the concerns behind the Section 5.G. reporting threshold are captured in other Section 5 reporting requirements or are unrelated to systemic risk.

Many MFA members implement global trading strategies and maintain unencumbered cash in U.S. Treasuries, as well as G7 sovereign debt. Depending upon global trading opportunities, many Large Hedge Fund Advisers throughout the year move their cash equivalents back and forth between U.S. Treasuries and G7 sovereign debt,[15] depending upon the currency denomination of the securities they are trading. We understand that some Large Hedge Fund Advisers would have to file between 30-70 reports a year under Section 5.G. due to the transfer of unencumbered cash between U.S. Treasuries and G7 sovereign debt. In these instances, they may trigger the 20% threshold even though the total value of the unencumbered cash does not change significantly. Section 5.G. is likely to result in a high number of false positive reports, which won't be helpful to the Commission yet will be burdensome on filers.

In addition, we believe the Commission has proposed capturing information under Section 5.G. as it believes that a decline in unencumbered cash of more than 20% within a short time window may indicate potential stress at a Qualifying Hedge Fund and a resulting negative effect on its ability to access cash, access its financing, and affect its relationship with its counterparties, thereby raising potential concerns of investor harm and systemic risk. Proposed Section 5.G. gives four enumerated reasons for a decline in encumbered cash. Two of the reasons relating to a decline in unencumbered cash are: (i) losses at the Qualifying Hedge Fund (which is already covered by Section 5.A.); and (ii) change in margin (which is covered by Section 5.B.

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[15] We are concerned that the definition in question 33 is too narrow as it does not include G7 sovereign debt, which many Large Hedge Fund Advisers use as cash equivalents.

and which is not necessarily a negative event) that is inherent in a loss of value, which Section 5.B. reporting would cover, and therefore duplicative of other information captured in the Proposed Amendments and would increase burden for Large Hedge Fund Advisers.

A third reason given for a decline in unencumbered cash is the initiating of new investment positions, strategy, and/or portfolio turnover. A Qualifying Hedge Fund adding new investment positions, strategy, and/or portfolio turnover is not tied to systemic risk or investment harm as unencumbered cash will decrease during a ramp-up stage for a fund, when new subscriptions made by investors are invested, by hedging activity to deal with market events and portfolio turnover. These events do not involve systemic risk or investor protection and, therefore, should not be tracked and captured in the filings proposed in Section 5.G.

The fourth reason for making a Section 5.G. report relates to a decline in unencumbered cash as a result of redemption activity at the Qualifying Hedge Fund. The processing and payment of redemption requests should not raise concerns of systemic risk or investor harm as investors are exercising their rights and the processing of such redemptions are typically planned for, as Qualifying Hedge Funds have notice requirements typically in the range of 30-90 days to raise cash to satisfy investor requests for liquidity. Large Hedge Fund Advisers also have other measures within the Qualifying Hedge Fund's documents that enable the fund to orderly address redemptions without having to engage in a sell off. In any event, this reason is duplicative of proposed Section 5.I.

Recommendation—Given the high false positive rate, technical difficulties in capturing the information for a report under Section 5.G. and the duplicative nature of the information request, we recommend that proposed Section 5.G. should be removed from the Proposed Amendments.

7. <u>Operations Events</u>

Proposed Section 5.H.—The Qualifying Hedge Fund or Large Hedge Fund Adviser experiences a significant disruption or degradation of the fund's key operations, whether as a result of an event at a service provider to the Qualifying Hedge Fund, the Qualifying Hedge Fund or the Large Hedge Fund Adviser.

A Section 5.H. report would be required upon either a Qualifying Hedge Fund or its Large Hedge Fund Adviser experiencing a significant disruption or degradation of the reporting Qualifying Hedge Fund's key operations. "Key Operations" is defined as "operations necessary for (i) the investment, trading, valuation, reporting, and risk management of the reporting fund; and (ii) the operation of the reporting fund in accordance with the federal securities laws and regulations." In the Proposing Release, the Commission stated that "[w]hen evaluating a …fund's key operations that are reasonably measurable, a "significant disruption or degradation' means a 20% disruption or degradation of normal volume or capacity."[16] The Commission cites cybersecurity events and severe weather events as examples.

For the reasons described below, we believe a bright line test for reporting under Section 5.H. would be a clearer reporting obligation, and we recommend that such reporting should be triggered when a Large Hedge Fund Adviser initiates, as a result of a system outage, its firm-wide disaster recovery and/or business continuity plan and such plan is in effect for more than two (2) consecutive business days.

We do not think a quantitative measure provides a clear measure and would be difficult to implement. If a power outage occurs for 20 minutes because of a weather event resulting in a 100% loss of trading activity, is that what is intended to be captured? Should a loss of power be measured over a 24-hour period and therefore only an outage lasting 4.8 hours (20% of a 24-hour day) be captured? If a power outage is so significant, this will be an event likely known by the Commission and FSOC and, if sustaining, may create an impracticality to file within one business day. In addition, we believe that cybersecurity risks and protocols have been addressed by the Commission in other rulemaking and should not be addressed here.[17]

We also do not believe that "degradation" should be part of Section 5.H. as what we believe the Commission is trying to solve for is an actual disruption. Moreover, we do not believe it is possible to measure degradation in a meaningful way, thereby leaving Large Hedge Fund Advisers to guess at what it means.

Accordingly, we encourage the Commission to adopt a bright line test that would be easy to measure and capture significant operational risk at a Large Hedge Fund Adviser. We do not believe that isolated disruptions or disruptions lasting a short period or a disruption affecting only a segment of a Qualifying Hedge Fund's key operations (*e.g.*, an event at a satellite office resulting in closing the office for a period of time and having the employees of the Large Hedge Fund Adviser work remotely) is something that impacts systemic risk or that requires immediate notification to the Commission for investor protection or systemic risk monitoring. We believe that notice of initiating, as a result of a system outage, a firm-wide disaster recovery and/or business continuity plan and having the plan in effect for more than two business days will allow the Commission to monitor operational risks that may signal more system-wide stress.

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16 Proposing Release at 9114.

17 *See* Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies, 87 FR 13524 (Mar. 9, 2022), available at: https://www.govinfo.gov/content/pkg/FR-2022-03-09/pdf/2022-03145.pdf. We note that, in this rulemaking, the Commission is proposing a new rule that would require investment advisers to report on Form ADV–C within 48 hours after having a reasonable basis to conclude that a significant adviser cybersecurity incident or a significant fund cybersecurity incident occurred or is occurring. In a related rulemaking, the Commission is proposing, among other things, to amend Form 8-K to add Item 1.05 to require registrants to disclose information about a cybersecurity incident within four business days after the registrant determines that it has experienced a material cybersecurity incident. *See* Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure, Release No. 33-11038 (Mar. 9, 2022), available at: https://www.sec.gov/rules/proposed/2022/33-11038.pdf.

***Recommendation*—**We recommend that a Section 5.H. report only be required when a Large Hedge Fund Adviser initiates, as a result of a system outage, its firm-wide disaster recovery and/or business continuity plan and such plan in effect for more than two (2) consecutive business days.

8. <u>Withdrawals and Redemptions</u>

Proposed Section 5.I.—A Qualifying Hedge Fund's receipt of cumulative requests for redemption equal to or more than 50% of the most recent NAV (after netting against subscriptions and other contributions from investors received and contractually committed).

MFA urges the Commission to: (i) limit the triggering of a filing obligation under Section 5.I. to a point in time after redemptions have matured as opposed to notified redemptions; (ii) allow reporting under Section 5.I. to be measured after taking into account gates and other liquidity features that are expressly set forth as the redemption terms of a Qualifying Hedge Fund; and (iii) adding an additional minimum dollar threshold of $1 billion before triggering a filing obligation under Section 5.I.

The proposed reporting under Section 5.I does not address the mismatch in timing between redemption requests, which are normally given anywhere from 30 to 90 days or longer before the applicable redemption date, and subscriptions, which normally occur on the date immediately following the applicable redemption date and are usually contracted for in the 2-5 day period prior to the subscription date. As a result of this mismatch, Large Hedge Fund Advisers would not be able to net subscriptions against redemption requests because there will not be any subscriptions to net as subscription dollars come into the Qualifying Hedge Fund long after the notice period has expired.

In order to address the fact that certain investors make protective redemption elections and to address the mismatch in timing between redemption requests and subscriptions, we believe that the threshold for triggering a filing under Section 5.I. should be after the redemption date matures. We believe tying the trigger of Section 5.I. reporting to matured redemption requests would (i) allow subscriptions to be netted, which was intended in the Proposed Amendments and would give a picture of the liquidity a Qualifying Hedge Fund needs to raise to satisfy investors, (ii) provide a clear picture of the redemptions to be processed without the risk of false positive reporting of redemption activity that may be rescinded, and (iii) avoid unintended consequences, as further discussed below, resulting from both investors and counterparties seeking access to Section 5.I. reporting and creating additional negative pressure within a Qualifying Hedge Fund.

We appreciate the Commission's concerns that large redemption requests, suspensions of redemptions, material restrictions of redemptions and the inability to meet redemption obligations of 50% or more of a Qualifying Hedge Fund's NAV may be a signal of potential stress at the fund. We understand that the reporting objective under proposed Sections 5.I. and 5.J. were intended to provide the Commission and FSOC information indicating the potential for investor harm, forced selling liquidations, or broader systemic risk. The Commission stated in the Proposing Release that the trigger event for filing under Section 5 I. should "disregard any pre-existing gates or limitations." We disagree with this position.

During the period of extreme stress in global financial markets and banking systems between mid-2007 and early 2009 ("**Global Financial Crisis**"), many hedge funds successfully relied on a number of liquidity tools including gates, slow pay provisions, side pocket provisions, in-kind distributions and liquidating trusts to avoid a "fire sale" of assets during the market crisis, which could have further contributed to systemic risk and possibly injure remaining investors.

Since the Global Financial Crisis, many hedge funds have continued to refine their liquidity terms based on the lessons learned from the Global Financial Crisis and have implemented investor level gates (which basically limits investors' right to redeem over multiple redemption dates, generally quarterly) and fund level gates (that provide for a maximum amount of liquidity that may be withdrawn—akin to interval funds) as well as other mechanisms such as fast pay/slow pay provisions that were specifically designed to avoid fire sale scenarios for assets and better match liquidity rights for investors with the underlying hedge funds' assets. Failure to take into account these provisions that are built into the redemption terms of a Qualifying Hedge Fund will significantly distort the risk posed by notified redemptions.

Furthermore, in general, filings of Section 5.I. reports will result in other industry constituents desiring access to that information, including investors and a Qualifying Hedge Fund's counterparties. Without taking investor-level, fund-level, and other built-in redemption mechanisms into account, the result may be a significant increase in false positive reports that do not address the risks that reporting under Section 5.I. is intended to address. This can result in increased risk and investor harm as the negative inferences in making such filings may result in a "pile on" of redemption requests and a counterparty taking actions that may be detrimental to the Qualifying Hedge Fund, its investors, and potentially the market as a whole. Furthermore, as discussed in the Proposing Release, certain investors issue protective redemption requests that may be subsequently rescinded thus creating another scenario for false positive reports.[18]

We believe there should be a threshold dollar amount for reporting as the purpose of reporting is to enable FSOC to monitor and assess systemic risk. A Qualifying Hedge Fund with an NAV of $500 million receiving redemption requests of 50% would necessitate a filing for $250 million of redemptions, a relatively low number for systemic monitoring and assessment purposes. In addition to the 50% trigger, we think there should be an additional threshold of $1 billion in redemptions. Redemption amounts below the threshold would be reflected on regular quarterly reports so as to enable the Commission to use the information in its regulatory programs.

Recommendation—We recommend that a filing under Section 5.I. should be triggered after redemptions have matured as opposed to notified redemptions as this is the only timeframe available to take into account subscriptions. Furthermore, we strongly recommend that reporting

[18] Proposing Release at 9116.

should take into account gates and other liquidity features that are expressly set forth in the redemption terms of a Qualifying Hedge Fund. Finally, while we support the 50% threshold proposed, we recommend that there be a minimum dollar threshold of $1 billion before trigging a filing obligation under Section 5.I.

9. <u>Unable to Satisfy Redemptions or Suspension of Redemptions</u>

Proposed Section 5.J.– A Qualifying Hedge Fund (i) is unable to pay redemption requests for more than 5 consecutive business days or (ii) suspends redemptions and the suspension is in place for more than 5 consecutive business days.

With respect to the reporting requested under Section 5.J., MFA requests the Commission provide a technical clarification and require that a Section 5.J. report be filed based on the inability to pay a redemption request within 5 consecutive days from the date in which payment of such redemption request is due. As discussed above, hedge funds typically have a specified timeframe for paying redemption requests, and we believe that a filing should be triggered under Section 5.J. only after this timeframe has passed if a redemption remains unsatisfied.

***Recommendation*—**The trigger for reporting a failure to pay redemption requests should be five (5) days following the period specified for payment of redemption proceeds under a Qualifying Hedge Fund's governing documents.

III. Comments on Specific Provisions Relating to Advisers to Private Equity Funds

1. <u>Current Reporting for Advisers to Private Equity Funds</u>

Proposed Section 6—A current report would be required to be filed for: (i) Adviser-Led Secondary Transactions (Section 6.B.); (ii) General Partner or Limited Partner Clawback (Section 6.C.); and (iii) General Partner Removal, Termination of Investment Period or Termination of Fund (Section 6.D).

MFA recommends that if the data required in Section 6 is necessary for the Commission's oversight function, the reporting should be made on a quarterly basis for private equity fund advisers, and that filings of Section 6 reports for termination of an investment period or a private equity fund be triggered if the termination is a "for cause" termination.

We have addressed Section 6 reporting all at once rather than section by section as the information request in Section 6 is solely related to the Commission's regulatory programs and does not affect systemic risk. The Proposed Amendments are designed to improve the Commission and FSOC's ability to monitor and assess systemic risk by providing information in a timely manner that could significantly affect both investors and the market more broadly and also enhance investor protection efforts. We understand that the Commission believes that developments set forth in the proposed Section 6 reporting merit more timely risk-based monitoring and oversight by the Commission and FSOC given the potential consequences for an ever-increasing pool of private equity investors as well as the financial markets more broadly.

We do not believe that the reporting items in Section 6 raise systemic risk concerns and we do not see any justification for filing Section 6 reports as proposed. Many of the items reported on are events specifically planned for in private equity fund documentation and often with significant negotiations between investors in those funds and the advisers. We understand that the Commission may want to monitor these activities for oversight, but it is not reasonable to require an adviser to a private equity fund to file a special report on a short time frame. In particular, there is often an ability to elect to terminate an investment period with frequent cure periods or temporary suspensions that may or may not become permanent. In addition, there are other termination events, both for "cause" and not for "cause", that may take some time to determine based upon the agreed upon provisions in the fund documentation governing the relationship between the investors and the private equity fund adviser. Accordingly, with respect to these reporting items, and potentially others, there will likely be some false positive reporting or ambiguity as to when to file if it is required to occur the day after the event.

In addition, we note that a large majority of private equity fund limited partnership agreements contain "no fault" termination provisions, pursuant to which a termination of an investment period or of a fund may be triggered by an agreed-upon percentage-in-interest of the fund's limited partners. Such provisions typically require no finding, or even any allegation, as to any breaches of duty, breaches of contract, or other abusive conduct.[19] Such termination provisions are therefore in contrast to "for cause" termination provisions, which are typically triggered by a determination that the fund's general partner or investment adviser has committed a material breach of its fiduciary duties. We believe that "no fault" terminations do not raise the kinds of concerns discussed in the Proposing Release and, therefore, should not be included in Section 6 Reporting.

Recommendation—If the data required in Section 6 is necessary for the Commission's oversight function, we recommend that the reporting should be made on a quarterly basis for private equity fund advisers. We believe this will give the Commission better information than annual reporting and reduce "false" positive reporting by private equity advisers and ambiguity as to timing.

Recommendation—We recommend that filings of Section 6 reports for termination of an investment period or a private equity fund should only be triggered if the termination is a "for cause" termination.

[19] *See* ILPA Principles 3.0, at p. 42, defining "No Fault GP Removal" as "A clause in the LPA that permits investors, after the final closing date, to remove the GP and either terminate the Partnership or appoint a new general partner, *such as in circumstance where there has been no finding of breach of contract*" (emphasis added) (available at: https://ilpa.org/wp-content/uploads/2019/06/ILPA-Principles-3.0_2019.pdf)

2. Proposed changes to Large Private Equity Adviser Reporting under Section 4 of Form PF

We have only commented below on certain proposed changes to Section 4 of Form PF.

A. Question 70

The Commission has proposed to obtain in Question 70 reporting on restructurings or recapitalizations of a reporting fund's portfolio companies following the reporting fund's investment period.

Recommendation—We recommend that Question 70 be eliminated in that it would not provide the Commission with meaningful information about the current market environment or potential systemic risk.

***Alternative Recommendations*—**If question 70 is not eliminated, we offer the following alternative recommendations:

(i) Similar to other proposals in Section 4, we recommend that reporting under Question 70 be limited to reporting of a reporting fund's controlled portfolio companies. A large private equity adviser to a reporting fund that holds a non-controlling position in a portfolio company would not likely have sufficient influence over a portfolio company's restructuring or recapitalization that could present material conflicts and be relevant to the Commission. Furthermore, limiting the reporting obligation to only controlled portfolio company investments will reduce unnecessary duplication of reporting from minority investors in the portfolio company.

(ii) Limit the obligation to only restructuring or recapitalizations of large, private portfolio companies, *e.g.*, private portfolio companies with valuations in excess of $5 billion. The Commission already receives information about portfolio companies with publicly traded securities. Furthermore, restructuring or recapitalizations of smaller portfolio companies (*e.g.*, earlier stage venture-backed portfolio companies) should not be relevant for purposes of Form PF.

(iii) Exclude restructurings and recapitalizations that have a limited impact on the portfolio company and its third-party investors (*e.g.*, reporting obligation applies only to a restructuring of the portfolio company's debt or equity resulting in greater than 20% of equity interests held by third parties unaffiliated with the portfolio company becoming worthless).

(iv) Clearly define what would be a "restructuring or recapitalization" for purposes of question 70. As proposed, it is not clear what transactions would be in or out of scope for the reporting obligation.

B. Question 71

The Commission has proposed to obtain in Question 71 reporting on investments in different levels of a single portfolio's capital structure by funds advised by an adviser or related person.

We believe a materiality threshold is necessary across all of the implicated funds to reduce the administrative burden this question would impose on the industry. Where the position is material to only one fund's portfolio, or where no such position is material to any of the funds, the conflicts of interest that are the focus of the Commission's concerns would not seem to be present.[20]

Recommendation**—**We recommend that the Commission adopt a triggering event to require reporting under Question 71 and that such triggering event would be if the private equity fund held a greater than a 10% gross asset value position in its private equity fund and a different fund advised by the same adviser or one of its related persons concurrently held a greater than a 10% gross asset value position in a different class, series or type of securities of the same portfolio company.

IV. Comments on Cost/Benefit Analysis

The cost/benefit analysis is inadequate and, in our view, does not sufficiently support the proposed rulemaking. The analysis fails to recognize the substantial costs private funds and their advisers will incur, as we describe above. For example, it fails to identify the costs of completely retooling private fund administrative systems to collect new data in new ways, including determining daily final net asset value of portfolios consisting of level 3 securities as well as tracking margin and collateral over rolling 10-day periods. Moreover, as discussed above, it overstates the benefit of the data that the Commission and FSOC will receive because it assumes that the data are indicative of systemic issues. But as we have shown in our discussion above, the data the Proposed Amendments would yield would be deeply flawed, produce numerous false positives, and paint an inaccurate picture of private fund portfolio risks.

A. Costs

The discussion of the costs assumes that funds could utilize existing capabilities for preparing Form PF, which ignores the dramatically different nature of the information that is currently required to be reported. The "direct costs" referred to in the analysis will not be "limited" by the current reporting system, and as explained above, existing risk management systems are not constructed (nor would they ever be) to collect the data in the way the Proposed Amendments would require.

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[20] *See* Proposing Release at pp. 59-60 ("For example, if a portfolio company suffers financial distress, there may be a conflict between the funds' interests given that the company may not be able to satisfy the claims all of classes of creditors").

We have consulted with our members who have uniformly told us that the new systems the Proposed Amendments would be required would have little utility other than to satisfy a regulatory requirement. Thus, the assertion in the cost/benefit analysis that the Proposed Amendments, if adopted, would provide an incentive for private fund advisers to improve internal controls is groundless and based on the false assumption that new information provided to the Commission on Form PF would be of value to the manager.

The Commission also assumes that some of the events required to be reported would occur infrequently and thus require infrequent costs. While this may be technically correct, it ignores the reality that private fund managers and their administrators will have to bear the costs of building and maintaining systems that would have to monitor aspects of their funds' investments, redemptions, margin and collateral positions, and other aspects of fund operations on a daily basis to determine whether a report is required. Thus, we have fairly characterized the Proposed Amendments as imposing the equivalent of a daily filing obligation on private funds. The actual filing cost is the least of the expenses that concern our members.

Because of the ambiguity of many of the proposed requirements, the costs will include the involvement of investment, operational, and legal and compliance personnel to ascertain how a particular investment arrangement must be treated for purposes, for example, of determining its effect on margin levels. Our members expect more frequent employment of outside counsel to assist them in answering these questions. The staffing costs are real, as are the hourly rates charged by our members' lawyers.

Instead of providing an estimation of these costs, the economic analysis offers generalized assessments of costs. It provides no estimation of the frequency with which current reports will need to be filed. It also fails to provide an estimate of the start-up or maintenance costs associated with building systems to collect data and hiring staff necessary to maintain the system.

B. Alternatives

While the Commission provides alternatives, each appears to be within the construct of the Proposed Amendments. Thus, the Commission examines whether reports should be submitted less frequently or whether stress events should be measured based on the size of hedge fund rather than from only Large Hedge Fund Advisers.

The Commission release does not, however, discuss whether alternative stress test approaches were considered, including, for example, the approach of the National Futures Association ("**NFA**"). NFA Compliance Rule 2-50 requires commodity pool operators ("**CPOs**") to notify the NFA of the occurrence of one or more specified reporting events if the commodity pool (i) is unable to meet a margin call; (ii) is unable to satisfy redemptions in accordance with its subscription agreements; (iii) has halted redemptions and the halt is not associated with a pre-existing gate or lockup, or a planned cessation of operations; or (iv) the CPO receives notice from a swap counterparty that the pool is in default. The Commission will recognize that these reporting events are topically similar to those addressed by the Proposed

Amendments, and thus surely NFA Rule 2050 is a reasonable alternative regulatory approach the Commission could have taken with respect to some of the Proposed Amendments and, under its own guidelines, should have considered.[21]

C. Benefit

MFA agrees that a significant benefit of the Proposed Amendments is that they will give the Commission and FSOC additional data. As proposed, however, we believe that much of the data will have little utility in monitoring actual systemic risks for the reasons we have discussed in detail. The Commission's discussion of such benefits and its ability and the ability of FSOC to employ the data to understand actual systemic risk or develop better regulatory policies is seriously misguided.

The well-known aphorism "garbage in, garbage out" expresses the essence of the Commission and the FSOC's problem with the Proposed Amendments. To the extent that responses to the new current reporting requirements do not yield the data the Commission intends, aggregates of that data will prove a false picture of overall systemic risks to policymakers. MFA and its members are very concerned that such flawed data will lead to flawed policies with perhaps unintended adverse consequences for the financial markets and investors.

V. Implementation

As noted above, rather than updating Form PF to improve the quality of data already being collected, the Commission is instead proposing to amend Form PF to gather significantly more information from private fund advisers. In doing so, the Commission is proposing to change fundamentally the nature of Form PF, which currently is a quarterly or annual report to make Form PF effectively a daily report.

Given this change in scope and purpose of Form PF, MFA urges the Commission, upon adoption of any amendments to Form PF, to provide for a transition period of at least 18 months to permit advisers to private funds (and fund administrators) to implement changes to software and other systems as well as policies and procedures that will be needed to track data in a very different manner than they currently do.

VI. Conclusion

As discussed at the outset, the Proposed Amendments have the potential for negative unintended consequences for registrants and the markets, and as such, we respectfully urge the Commission to take a balanced approach in better calibrating reporting thresholds and limiting the number of reporting items in new Form PF to those that are true indicators for fund distress.

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[21] *See* SEC, "Current Guidance on Economic Analysis in SEC Rulemakings, Memorandum" (March 6, 2012) (identifying the elements as follows: "(1) a statement of the need for the proposed action; (2) the definition of a baseline against which to measure the likely economic consequences of the proposed regulation; (3) the identification of alternative regulatory approaches; and (4) an evaluation of the benefits and costs—both quantitative and qualitative—of the proposed action and the main alternatives identified by the analysis."), available at: https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.

MFA strongly believes that the changes recommended in the comments set forth above will (i) help the Commission and FSOC meet their goals of monitoring systemic risk, (ii) provide better quality data to the Commission and FSOC in achieving their mission by eliminating a number of false positive reporting, (iii) provide clarity to private fund advisers as to their reporting obligations to allow such advisers to modify their systems in a manner needed to meet the requirements of the new reporting obligations, and (iv) allow private fund advisers additional time to make the required reports under times of significant market events or other stress.

MFA appreciates the opportunity to provide these comments in response to the Proposed Amendments. If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact Matthew Daigler, Vice President & Senior Counsel, or the undersigned at [redacted].

Very truly yours,

/s/ Jennifer W. Han

Jennifer W. Han
Executive Vice President
Chief Counsel & Head of Global Regulatory Affairs

cc: The Hon. Gary Gensler, SEC Chairman
The Hon. Hester M. Peirce, SEC Commissioner
The Hon. Allison Herren Lee, SEC Commissioner
The Hon. Caroline A. Crenshaw, SEC Commissioner
Mr. William Birdthistle, Director, Division of Investment Management