COALITION OF PRIVATE INVESTMENT COMPANIES

March 31, 2011

By Mail and Electronic Delivery

The Honorable Mary L. Schapiro
Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File No. S7-05-11; Rel. No. IA-3145
Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF

Dear Chairman Schapiro:

The Coalition of Private Investment Companies (CPIC)[1] is pleased to submit this letter to the Securities and Exchange Commission ("Commission") on the above-referenced proposals on reporting by investment advisers to private funds and certain commodity pool operators and commodity trading advisors.[2] We appreciate the Commission's efforts to implement reforms as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA").

CPIC supports the Commission's rulemaking to implement Section 204(b) of the Investment Advisers Act of 1940 ("Advisers Act"), as amended by Section 404 of the DFA, to require reporting by advisers to private funds of information necessary for the Commission and other regulators to assess systemic risks.[3] In view of the volume of information that will be newly required of the largest private funds, we believe the Commission will need to develop a workable, flexible reporting schedule, particularly for initial reports. We also urge the Commission to take all steps necessary to protect the confidential proprietary information filed by private funds with the Commission under its proposed rules, as Congress clearly intended and required.[4]

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[1] CPIC is a coalition of private investment companies who are diverse in size and in the investment strategies they pursue. Established in 2005, CPIC informs policy-makers, the media and the public about the private fund industry and its role in the capital markets.

[2] *See* Rel. No. IA-3145, *Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF,* 76 Fed. Reg. 8068 (Feb. 11, 2011), *available at* http://www.sec.gov/rules/proposed/2011/ia-3145fr.pdf.

[3] *See* Pub. L. No. 111-203, § 404 (2010).

[4] *See* 15 U.S.C. § 80b-4(b)(7)-(10).

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CPIC Supports Detailed Reporting of Information to Regulators by Registered Investment Advisers to Private Funds.

CPIC strongly supported legislation to require registration of advisers to private investment funds.[5] We also supported legislation to give the Commission authority to obtain, and share with other regulators, information from advisers to private funds necessary and appropriate for the protection of investors and the assessment of systemic risk.[6] We believe relevant information from large private funds, together with information gathered from other institutions and financial regulators, will result in an unprecedented range and depth of data available to the Financial Stability Oversight Council ("Council") and its constituent members to assess risks to the financial system.[7] Indeed, a number of areas for private fund reporting under Section 204(b) of the DFA were identified in the Report of the Asset Managers' Committee to the President's Working Group on Financial Markets as disclosures relevant to fund investors and counterparties, for the purpose of evaluating the risks of investing in a private fund.[8] This information should prove useful to regulators in assessing financial system risks more broadly, and we support the detailed reporting requirements under the proposed rule.

Under the proposal, investment advisers to hedge funds and other private funds that are registered under the Advisers Act and manage one or more private funds would be required to report information on new Form PF on a periodic basis. Private fund advisers that are also registered with the Commodity Futures Trading Commission ("CFTC") as commodity pool operators or commodity trading advisors would file Form PF to satisfy

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[5] *See* Testimony of James Chanos, Chairman, CPIC before the House of Representatives Financial Services Committee: Hearing on Regulating Hedge Funds and Other Private Investment Pools (Oct. 6, 2009) (*available at* http://financialservices.house.gov/media/file/hearings/111/chanos_testimony.pdf).

[6] *See* Testimony of James Chanos, Chairman, CPIC before the House of Representatives Financial Services Committee: Hearing on Regulating Hedge Funds and Other Private Investment Pools (Oct. 6, 2009) (*available at* http://financialservices.house.gov/media/file/hearings/111/chanos_testimony.pdf), noting that "regulators' lack of detailed information about private investment funds — the absence of a registration requirement and the inability of a regulator to subject unregistered private funds to periodic reporting and examination — may handicap the SEC in meeting its investor protection mandate, and may limit financial regulators in addressing potential systemic risks."

[7] *See* CPIC, Comment Letter dated November 5, 2010 in response to *Advance Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies*, Financial Stability Oversight Council Release (Oct. 1, 2020), 75 Fed. Reg. 61653 (Oct. 6, 2010").

[8] *See* Report of the Asset Managers' Committee to the President's Working Group on Financial Markets, *Best Practices for the Hedge Fund Industry*, Jan. 15, 2009, *available at* http://www.amaicmte.org/Public/AMC%20Report%20-%20Final.pdf. For example, the Report recommended disclosures of possible risks associated with an investment fund, such as use of leverage, types of assets held, counterparty credit risk exposure, valuation of investment positions, and restrictions on redemptions (including redemption gates and side pocket investments). CPIC Chairman James Chanos participated as a member of the Asset Managers Committee.

certain systemic reporting requirements under proposed CFTC Rule 4.27(d). The amount of information reported and the frequency of reporting would depend on whether a private fund adviser is classified as a "large private fund adviser" or as a smaller private fund adviser. "Large private fund advisers" would include any adviser with $1 billion or more in hedge fund, "liquidity fund" (i.e., unregistered money market fund), or private equity fund assets under management. All private fund advisers that do not fall within the definition of a "large private fund adviser" would be classified as a smaller private fund adviser.

Smaller private fund advisers would file Form PF only once a year as of 90 days after the end of the adviser's fiscal year, and would only be required to report basic information regarding their operations and the private funds that they advise, including information on leverage, credit providers, investor concentration, and fund performance. Smaller private fund advisers that manage hedge funds also would report information about investment strategies, the percentage of assets managed using computer-driven trading algorithms, significant counterparty credit risk, and trading and clearing practices.

Large private fund advisers would file Form PF on a quarterly basis within 15 days of the end of a calendar quarter and provide more detailed information than smaller private fund advisers. The information required of large private fund advisers would vary, depending on the type of private fund (e.g., hedge fund, liquidity fund, or private equity fund) that the adviser manages. Large hedge fund advisers would report on an aggregated basis information regarding exposures by asset class, geographical concentration, and turnover. In addition, for each managed hedge fund that has net asset value of $500 million or more, these advisers would report certain information relating to that fund's investment, leverage, risk profile, and liquidity. Large liquidity fund advisers would provide information on the types of assets in each of their liquidity fund's portfolios, specified information relevant to the risk profile of the fund, and the extent to which the fund has a policy of complying with certain provisions of Rule 2a-7 under the Investment Company Act. Large private equity fund advisers would provide information about each fund they manage, including the funds' borrowings and guarantees, the extent of leverage incurred by their funds' portfolio companies, the use of bridge financing for portfolio companies, and their funds' investments in portfolio companies in the financial industry.

In contrast to information on Form ADV, information on Form PF would not be made available to the public, would be exempt from disclosure under the Freedom of Information Act, and would be protected under additional confidentiality provisions in new Section 204(b) of the Advisers Act, which was added by the DFA. As Congress recognized, these confidentiality provisions are of critical importance to protect the business sensitive and proprietary information of private funds, as discussed more fully below.

CPIC Supports Detailed Reporting by Large Private Funds on Form PF; however, the Proposed Filing Deadline for Larger Private Fund Advisers May be Unworkable for Initial Reports.

CPIC agrees with the Commission's proposal to differentiate the reporting requirements applicable to larger versus smaller private funds, and we support the confidential reporting of detailed information, on a quarterly basis, by larger private funds. However, we believe the filing deadline for Form PF for larger private fund advisers may be unworkable, at least for the initial set of filings. As noted above, under the proposed rules, larger private fund advisers would be required to provide more disclosures than small advisers on Form PF and would be required to file Form PF on a quarterly basis within 15 days of the end of a calendar quarter. Although many private funds already are working to identify and test how they will meet new reporting requirements, we nonetheless believe that meeting the 15-day post quarter deadline for filing Form PF could be difficult for many large private fund advisers. We suggest that the filing deadline for large private fund advisers be changed to within 45 days of the end of a calendar quarter, at least for the initial filings. Under our suggested modification to the proposed rules, large private fund advisers would be required to make their first Form PF filing as of February 14, rather than as of January 15, 2012, while small private fund advisers with a fiscal year end of December 31 would be required to make their first Form PF filing as of March 31, 2012 as currently proposed. However, the compliance dates and relevant deadlines may need to be further delayed, as discussed below, depending upon the date the Commission adopts these rules in final form and decides related issues, such as the choice of electronic system for filings.

The Commission has not yet decided upon the details of the electronic filing system that will be used for Form PF. As discussed in the proposing release, the filing system will need to have certain features, including special confidentiality protections designed to ensure heightened confidentiality protections for Form PF filing information as required by the DFA. At the same time, the system must allow for secure access by the Council and other regulators as permitted under the DFA. The Commission has not yet selected the system for the electronic filing or the filing fees that advisers would be required to pay the operator of the system. The Commission is considering requiring private fund advisers to eventually tag data filed on Form PF using a refined, future taxonomy to be defined by the Commission, and is soliciting comment regarding whether all filings should be done in eXtensible Markup Language ("XML") or an alternative format, such as eXtensible Business Reporting Language ("XBRL").

These issues, as well as the specific information to be reported, will need to be decided and settled well before the compliance dates, and we recommend that the Commission set a compliance date that is no earlier than one year after the date on which the Commission adopts these rules in final form and decides upon the method of and system for filings. Private fund advisers will be filing highly confidential, proprietary information with the Commission on Form PF, and therefore should first have a complete understanding of the nature of the reporting mechanism, including logistics, fees, filing requirements, and the level of security that will be accorded this information.

The Commission Should Not Create Broad Exemptions for Advisers to Private Equity Firms.

CPIC believes the proposed rules are consistent with legislative direction in the DFA to apply the registration, reporting, and record keeping provisions of the DFA to private funds, including private equity funds, and we believe the Commission should resist requests for broad exemptions for private equity funds.

CPIC previously testified in favor of Commission registration of *all* advisers to private investment funds, no matter how styled, and regardless of class of entity, nature of assets, or strategy. As we stated in testimony before the House Financial Services Committee in October 2009:

> [W]e question whether a category of private funds should be relieved of SEC registration, record-keeping, and inspection solely by virtue of its asset class and operations. Indeed, Ponzi schemes and frauds can be run with any asset class, and the lines between different categories of private funds tend to blur over time. We believe the registration requirement should apply to all private funds, whether they are hedge funds, private equity funds, or venture capital funds.[9]

In the proposing release, the Commission observed that international efforts have not only focused on hedge funds, but also other types of private funds, such as private equity funds, due to their potential systemic considerations. For example, an International Monetary Fund ("IMF") staff paper has focused on "extending the perimeter" of effective regulatory oversight so that it captures all financial activities that may pose systemic risks, regardless of the type of institution in which it occurs.[10] The IMF paper states that "[s]pecifically, entities engaged in financial activities on a leveraged basis should be regulated regardless of the legal status of the institution—to capture all entities that contribute to systemic risk on a significant scale."[11] The proposing release further notes that others recognize the need for monitoring the private equity sector because "having information on its potentially systemically important interactions with the financial system

[9] Testimony of James Chanos, Chairman, CPIC, before the House of Representatives Financial Services Committee: Hearing on Regulating Hedge Funds and Other Private Investment Pools (Oct. 6, 2009), *available at* http://financialservices.house.gov/media/file/hearings/111/chanos_testimony.pdf.

[10] *See* Ana Carvajal et al., *The Perimeter of Financial Regulation,* IMF Staff Position Note SPN/09/07 (Mar. 26, 2009), *available at* http://imf.org/external/pubs/ft/spn/2009/spn0907.pdf (hereinafter "IMF Staff Paper"), *cited in* Rel. No. IA-3145, *supra* note 2, at 76 Fed. Reg. 8068, 8071.

[11] *See* IMF Staff Paper, *supra* note 11, at 8.

are an important part of regulators' obtaining the complete picture of the broader financial system that is so vital to effective systemic risk monitoring."[12]

The Commission also stated that its initial view, after consultation with staff representing the Council's members, is that the "activities of private equity funds, certain of their portfolio companies, or creditors involved in financing private equity transactions may be important to the assessment of systemic risk and, therefore, that large advisers to these funds should provide targeted information on Form PF to allow FSOC to conduct basic systemic risk monitoring."[13] The release enumerates several risks of the private equity business model that may be cause for concern, including the reliance on banks to provide bridge financing for leveraged private equity transactions who could be forced to hold the financing if market conditions worsen, and the prospects for leveraged buyouts of systemically important entities.[14] The Commission also states its view, shared by other Council members, that "private equity transaction financings, and their interconnected impact on the lending institutions" could be a useful area for the Council to monitor so that it may have a more complete picture of the financial services marketplace in order to identify potential threats to the. financial stability of the U.S. financial system.[15] We agree.

We also note that the level of detail required by Form PF varies depending on the type and size of private fund. Large Private Fund Advisers would be required to report more information on Form PF than smaller private fund advisers, and a large hedge fund adviser would report more information about itself and the funds that it advises than would a large liquidity fund adviser, which in turn would report more information than a large private equity fund adviser.[16] The burden imposed on large private equity fund advisers under the proposed rules is less than for other large private fund advisers, and we believe the Commission should not be pressured to scale it back further or provide broad exemptions for private equity funds.

Congress Understood the Critical Importance of Protecting Confidential, Proprietary Information of Private Investment Funds.

Congress recognized the need to protect sensitive, confidential and proprietary information that would reveal private funds' proprietary strategies. Section 204(b) of the Advisers Act sets forth significant protections for confidential, proprietary information that relates to private investment funds and their advisers. The term "proprietary information," as defined in subsection (10)(B) of Section 204(b), includes sensitive, non-public information regarding the investment or trading strategies of the investment adviser,

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[12] *See* Rel. No. IA-3145, *supra* note 2, at 76 Fed. Reg. 8068, 8071.

[13] *See* Rel. No. IA-3145, *supra* note 2, at 76 Fed. Reg. 8068, 8074.

[14] *See* Rel. No. IA-3145, *supra* note 2, at 76 Fed. Reg. 8068, 8074-8075.

[15] *See* Rel. No. IA-3145, *supra* note 2, at 76 Fed. Reg. 8068, 8075.

[16] *See* Rel. No. IA-3145, *supra* note 2, at 76 Fed. Reg. 8068, 8085.

analytical or research methodologies, trading data, computer hardware or software containing intellectual property, and any additional information that the Commission determines to be proprietary.[17]

Under subsections (b)(8) and (9) of Section 204 of the Advisers Act, "[n]otwithstanding any other provision of law," the Commission, other government agencies and self-regulatory organizations may not be compelled to disclose reports or records that are required to be maintained or filed under Section 204(b). In addition, proprietary information obtained from such records and reports, such as trading strategies, research methodologies, software and trading data, must be protected from disclosure under the Freedom of Information Act ("FOIA"). Further, even the transfer of such reports and records to other regulators must be restricted. Such information may be furnished to the FSOC only as necessary for the assessment of systemic risks that are presented by a private fund, and records provided to the FSOC also must be exempt from public disclosure under FOIA.[18]

To provide even greater protection against disclosure of the confidential and proprietary information of private funds and their advisers to unauthorized parties, subsection (10)(A) of Section 204(b) of the Advisers Act provides enhanced protection for proprietary information of a private fund adviser ascertained by the Commission from any report required to be filed with the Commission. This information is subject to the same limitations on public disclosure as any facts ascertained during an investment adviser examination under Section 210(b) of the Advisers Act. Section 210(b) of the Advisers Act generally prohibits the Commission and its staff from disclosing the existence of any examination under the Advisers Act or the results of or any facts ascertained during any such examination.

As both Congress and the Commission recognize, public disclosure of this information could cause substantial harm to investment funds, their investors, their managers and markets in general. If a private fund's trade secrets and proprietary information were subject to public disclosure or were leaked, this would be contrary to the intent of Congress, as well as long-standing market practices, federal law, and the rules of numerous federal agencies that recognize the need to protect businesses from unfair economic and competitive disadvantages that would be the consequence of public disclosure of their confidential, proprietary information.[19]

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[17] *See* 15 U.S.C. § 80b-4(b)(10)(B).

[18] Advisers Act §204(b)(7).

[19] For example, the Federal Trade Secrets Act criminalizes the unauthorized disclosure of "trade secrets" by the federal government. The statute only applies to disclosures that are not authorized by law. *See* 18 U.S.C. § 1905. As noted earlier, Exemption 4 of FOIA (5 U.S.C. § 552(b)(4)) and Rule 80(b)(4) of the Commission's Rules of Practice under FOIA (17 C.F.R. § 200.80(b)(4)) provide that the Commission generally will not publish or make available to any person matters that would "[d]isclose trade secrets and

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Because of the irreparable harm that would inure to private funds if their confidential, proprietary information were to leak into the public domain or the possession of unauthorized users, the Commission must establish procedures and systems to protect information that is filed electronically on Form PF from hacking and any other means by which such information could leak into the hands of unauthorized persons or the public domain.[20]

We appreciate this opportunity to provide our comments, and look forward to working with the Commission as it continues with its important work.

Sincerely,

James S. Chanos
Chairman
Coalition of Private Investment Companies

Footnote continued from previous page
commercial or financial information obtained from a person and privileged and confidential [information]." Also, the legislative history of Section 13(f) of the Exchange Act, which pertains to long position reporting by certain investment managers, recognized that it is generally in the public interest to grant confidential treatment to an ongoing investment strategy of an investment manager, as disclosure of such strategy would impede competition and could cause increased volatility in the market place. Senate Report No. 94-75 states: "[t]he Committee "believes that generally it is in the public interest to grant confidential treatment to an ongoing investment strategy of an investment manager. Disclosure of such strategy would impede competition and could cause increased volatility in the market place." S. Rep. No. 94-75, 94th Cong., 1st Sess.; S. 249 (1975).

[20] Our concern about the government's ability to protect the highly sensitive, proprietary information of hedge funds is not merely theoretical. On February 5, 2011, NASDAQ OMX officials released a statement in response to reports that unidentified hackers had breached the company's computer network on multiple occasions in the past year. Thomas Kellerman, a former cyber security expert at the World Bank, has reportedly stated that the fact that NASDAQ's Directors Desk was targeted suggests that the hacker's goal was "virtual insider trading," *i.e.*, hacking into a publicly traded company's sensitive internal data and making trades on that information before it enters the public domain. *See* Devlin Barrett *et. al*, *Nasdaq Confirms Breach in Network*, Wall St. J, Feb. 7, 2011. Further, the publication of classified information that can harm national security on WikiLeaks shows that it is difficult to protect against leaks. Thus, it is critical that the utmost security be given to proprietary information of private funds submitted to the Commission and shared with other regulators and the courts to the extent permitted by the DFA. As Congress recognized, if confidential, proprietary information of a private fund or its adviser were leaked, it would irreparably harm a private fund and its adviser.

cc: The Honorable Luis A. Aguilar, Commissioner
The Honorable Kathleen L. Casey, Commissioner
The Honorable Troy A. Paredes, Commissioner
The Honorable Elisse B. Walter, Commissioner
Elizabeth M. Murphy, Secretary
Eileen Rominger, Director
Division of Investment Management