Alternative Investment Management Association

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549
USA

Send by email to: rule-comments@sec.gov

File Number S7-05-11

26 July 2011

Dear Sir/Madame,

Private Fund Systemic Risk Reporting Rules

With reference to our meeting on the 8 June 2011 and our discussions regarding the private fund systemic risk reporting rules (the 'Reporting Rules'), I revert with the Alternative Investment Management Association's ('AIMA')[1] additional submission in relation to the Reporting Rules. AIMA's first submission in relation to this topic was filed with the Securities and Exchange Commission (the 'SEC') on the 12 April 2011.

AIMA fully supports the ambition of the regulatory reforms to address potential systemic risks through enhanced regulation. We are therefore supportive of obligations on hedge fund advisers to register and report to the SEC. In terms of reporting, we would urge all regulators to strive for a globally consistent approach, which would not only benefit advisers but would also allow for increased comparability of collected data and cross-border collaboration for regulators. We would also encourage regulators to carefully consider potential costs and benefits of new regulation, both the increase in compliance costs for regulated firms, which is likely to ultimately be borne by investors, and whether this is justified by the potential benefits to regulators, which will be expected to carefully analyse the data submitted to them and take appropriate action.

Under the Reporting Rules, larger advisers managing hedge funds, liquidity funds, and private equity funds would be subject to heightened reporting requirements. Large advisers would include any adviser with $1 billion or more in hedge fund, liquidity fund, or private equity fund assets under management (AUM). We understand that the $1 billion threshold relates to <u>gross</u> assets (balance sheet size of the fund advised) and not <u>net</u> assets (total value of advised funds' assets less accrued liabilities). According to the SEC, this heightened reporting threshold would apply to about 200 registered hedge fund advisers, managing more than 80 percent of the U.S. hedge fund industry AUM.[2] Today, about 248 U.S. hedge fund advisers with <u>net</u> AUM greater than $1 billion reflect around 82 percent of the U.S. based hedge fund sector assets under management.[3]

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[1] AIMA is a trade body for the hedge fund industry globally; our membership represents all constituencies within the sector – including hedge fund managers, fund of hedge funds managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,250 corporate bodies in 45 countries.

[2] Proposed joint rules with CFTC regarding reporting by investment advisers to private funds and certain commodity pool operators and commodity trading advisors (the 'Proposal'), p. 32-33.

[3] By using a reporting threshold of $1 billion of gross assets under management hedge fund managers with between $333 million (leverage of 3 times the net assets) and $667 million (leverage of 1.5 times the net assets) in net AUM will be caught by the reporting threshold.

We are therefore concerned that the reporting threshold of $1 billion of gross AUM is likely to capture significantly more than the 200 largest registered hedge fund advisers. We estimate that the threshold proposed by the SEC could capture between 380 and 630 hedge fund advisers representing between 87% and 92% of total AUM of registered advisers. The reasons for this are as follows:

- We estimate that the leverage level employed in the industry is roughly equivalent to 1.5 to 3 times net assets, with most larger advisers employing leverage somewhere between 2 to 3 times of net assets (see Annex 2 for more detailed discussion).
- A simple division of the $1 billion gross AUM by 1.5 and 3 gives a range of $333 million to $666 million of net AUM.
- We estimate there are between 350 and 500 U.S. based advisers with net assets above $666 million and $333 million respectively.
- We estimate that there are around 262 to 438 non-U.S. based advisers with net assets above $666 million and $333 million respectively.
- Some non-US based advisers are already registered with the SEC while more could be expected to be registered as of April 2012. If some portion (between 10% and 30%[4]) of the larger non-U.S. based advisers register with the SEC, the overall number of advisers potentially subject to the systemic risk reporting obligation could be somewhere between 380 and 630.

The estimates have been prepared by using HedgeFund Intelligence's[5] ('HFI') database of single advisers (see Annex 1 for a more detailed presentation of the data). The database represents approximately 60 percent of the hedge fund adviser universe in the U.S. and globally. The leverage estimates have been prepared using several sources of data, including Hedge Fund Research[6], Deutsche Bank and the UK's Financial Services Authority. The data illustrate that, without setting an appropriate threshold and carefully considering the information requested and its analytical usefulness, a potentially significantly higher number of hedge fund advisers would have to comply with the systemic risk reporting requirements of the SEC than initially envisaged.

A threshold of $3 billion in gross AUM seems to be the threshold that corresponds more closely to SEC's stated policy goal of capturing some 200 of the largest registered hedge fund advisers representing 80% of AUM. We therefore believe that the proposed $1 billion threshold could merit further review. Obliging smaller and midsized hedge fund advisers to report detailed information that is unlikely to be material to the detection and assessment of systemic risk and could impose unjustifiably high compliance costs both on the advisers and on the regulating agencies.

We are, of course, happy to discuss further with you any point or detail that arises from this submission.

Yours sincerely,

Jiří Król
Director of Government and Regulatory Affairs

[4] AIMA does not have any accurate estimates of the number of non-US based advisers likely to be registered with the SEC after April 2012. The 10-30% estimate is a conservative conjecture.

[5] HFI is a provider of hedge fund news and data. HFI supply information on more than 13,000 funds.

[6] Hedge Funds Research, Inc specializes in the areas of indexation and analysis of hedge funds.

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Annex 1

Estimates of the potential number of hedge fund advisers subject to systemic risk reporting under different reporting thresholds

Table 1 –U.S. Hedge Fund Advisers HF net AUM, estimate of total U.S. HF industry universe

Net AUM	Number of U.S. based hedge fund advisers in the HFI database	Estimate of the number of all U.S. based HF in the various brackets*	Proportion of Hedge Fund Advisers as % of Total U.S. advisers in the HFI database	Proportion of AUM as a % total Hedge Fund AUM	U.S. based HF AUM in the HFI database (billion USD)	Estimate of AUM repartition in the various brackets of all USD based AUM* (billion USD)
$1bn and over	149	248	13%	81.5%	680.7	1134.4
Total	1,133	1,888	100%	100%	834.9	1391.5

*This estimate is obtained by a simple extrapolation, assuming the HFI database represents 60 percent of the US hedge fund universe.

Source: HFI, December 2010

Table 2 – Estimates of the number of U.S.-based Hedge Fund Advisers potentially captured by different thresholds

Net AUM	Number of U.S. based hedge fund advisers in the HFI database	Estimate of the number of all U.S. based HF*	Leverage 1.5x-HFI database (net AUM above $666m)	Leverage 3x-HFI database (net AUM above $333m)	Leverage 1.5x-Total HF industry estimate* (net AUM above $666m)	Leverage 3x-Total HF industry estimate* (net AUM above $333m)
$1bn and over	149	248	205	298	342	497
Total	1,133	1,888	1,133	1,133	1,888	1,888

*This estimate is obtained by a simple extrapolation, assuming the HFI database represents 60 percent of the global hedge fund universe.

Source: HFI, December 2010

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Table 3 – Estimate of number of non-U.S. hedge fund advisers potentially captured by different thresholds

Net AUM	Number of non-U.S. based hedge fund advisers in the HFI database	Estimate of the number of all non-U.S. based HF*	Leverage 1.5x-HFI database (net AUM above $666m)	Leverage 3x-HFI database (net AUM above $333m)	Leverage 1.5x-Total non-US based HF industry estimate* (net AUM above $666m)	Leverage 3x-Total non-US based HF industry estimate* (net AUM above $333m)
$1bn and over	109	182	157	263	262	438
Total	1,133	1,888	1,133	1,133	1,888	1,888

*This estimate is obtained by a simple extrapolation, assuming the HFI database represents 60 percent of the global hedge fund universe.

Source: HFI, December 2010

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Annex 2

Leverage in the global hedge fund industry

In general, leverage plays a central role in hedge fund advisers' investment activities. Some hedge fund advisers employ little or no leverage while others employ significant levels of leverage. The leverage levels employed by hedge fund advisers vary depending on, for example, the investment strategy employed and AUM. There are numerous ways in which leverage can be measured, and there is generally no consensus on which method is to be preferred. The level of leverage employed by an individual hedge fund adviser is therefore very difficult to calculate. This is also due to the relative lack of standardised reporting of leverage in the hedge fund industry, the substantial off-balance sheet derivatives and swap transactions in some hedge fund strategies, and the fact that each hedge fund adviser uses leverage in different and unique ways. As a result, the main source of information on hedge fund advisers' levels of leverage is a number of commercially available databases containing data which are voluntarily provided by the hedge fund advisers. The analysis in this submission relies on a dataset compiled by Hedge Funds Research, Inc ('HFR'). In addition, data from the UK Financial Services Authority (the 'UK FSA') and Deutsche Bank is also used as a basis for our analysis. AIMA's analysis in this submission is given in good faith and is based on these data believed to be reliable and accurate.

Hedge funds' levels of leverage have varied significantly over time. Generally, levels have dropped during market turbulence as leverage becomes more difficult and costly to obtain. According to a hedge fund leverage report recently published by HFR[7], hedge fund industry leverage declined in the last 12 months from 1.27 to 1.10 times investment capital.[8] The percentage of funds which do not typically utilize leverage at all rose to approximately one third of all funds, an increase of four percent over the last year, while over half of all funds utilize leverage of between one and two times their investment capital. However, in the current financial environment, larger, well-established hedge fund advisers utilizing a variety of strategies are finding it easier to obtain attractive financing terms. According to HFR, larger hedge funds characteristically employ a significantly higher level of leverage: 23 percent of funds with more than $1 billion in AUM utilize leverage of between two and five times investment capital.

The hedge fund industry leverage is, as evident from table 2 below, much higher when calculating average leverage based on assets (2.16) instead of funds (1.10).[9]

Table 2 – Estimated Average Fund Leverage – Q1 2010 vs. Q1 2011

Standard Leverage	Q1 2010	Q1 2011
All SM Fund Weighted	1.27	1.10
All SM Asset Weighted	2.39	2.16
Fund Size:<=50MM	1.08	1.06
Fund Size: 50-200MM	1.17	1.07
Fund Size: 200-500MM	1.45	1.31
Fund Size: 500M-1B	1.73	1.58
Fund Size: >1B	2.03	1.89

Source: HFR © HFR, 17 May 2011, www.hedgefundresearch.com.

[7] HFR tracks leverage in two forms: *Standard Leverage* and *Margin-to-Equity*. All funds which are not primarily futures trading managers are asked to report Standard Leverage.

[8] HFR Hedge Fund Leverage Report: Inflation Special Edition – First Quarter 2011.

[9] HFR Hedge Fund Leverage Report: Inflation Special Edition – First Quarter 2011.

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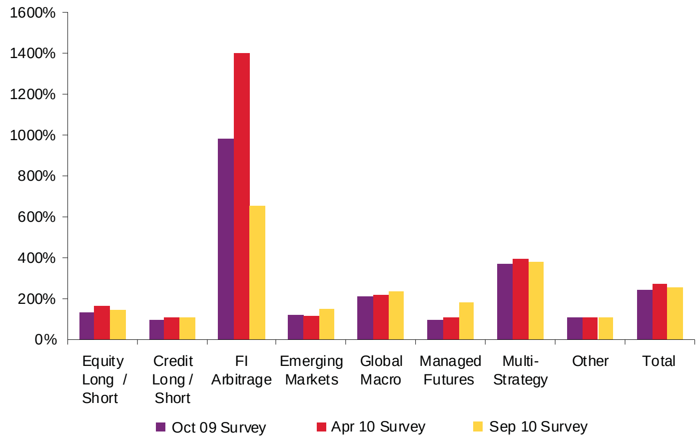
Consequently, the simple arithmetic average leverage ratio in the hedge fund industry is distorted by the high proportion of smaller hedge fund advisers as it is evident that there are significant differences in the use of leverage between small hedge fund advisers and larger hedge fund advisers. The data show that the more representative average asset weighted leverage ratio is nearly double and stands at 2.16 times net assets.

Data from Deutsche Bank also show high leverage ratios for hedge funds, even though Deutsche Bank recently reported that hedge fund leverage has reduced slightly since the beginning of the year. According to data from Deutsche Bank[10], gross leverage has slowly been ticking upwards in Europe (2.5) and Asia (1.79) since January 2011 but has remained stable in the U.S. (approximately 2.5). It should also be noted that the UK FSA in February 2011, as shown in table 3 below, estimated that the average hedge fund managed from the UK was leveraged at 2 or 3 times its net assets.[11]

Table 3 – Qualified Fund Leverage: Cash + Synthetic Borrowing as a percent of NAV



Source: UK FSA, Hedge Fund Survey, February 2011.

We understand from the staff at the Securities and Exchange Commission that the heightened reporting threshold in the Reporting Rules is based on the assumption that the average leverage employed in the hedge fund industry is 1.3 times the net assets. Our view, based on the data presented above, is that leverage for large hedge fund advisers globally is roughly equivalent to 1.5 to 3 times net assets.

Table 4 – Summary of Leverage Data

Source	**Average leverage - Fund weighted**	**Average leverage - Asset weighted**
HFR	1.10	2.16
UK FSA	2-3	N/A
Deutsche Bank	2.3	N/A

[10] This data refers only to the assets held at Deutsche Bank as a prime broker representing approximately 400 hedge funds, and thus, does not reflect hedge fund clients' total leverage which may deviate from this for a variety of reasons.

[11] See the UK FSA paper 'Assessing the possible sources of systemic risk from hedge funds – A report on the findings of the Hedge Fund Survey and Hedge Fund as Counterparty Survey', dated February 2011 (the 'Hedge Fund Survey'), p. 7.

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