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

May 18, 2017

Via Electronic Submission: rule-comments@sec.gov

The Hon. Walter J. Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Managed Funds Association Regulatory Priorities

Dear Chairman Clayton:

Managed Funds Association ("MFA")[1] congratulates you on becoming the new Chairman of the Securities and Exchange Commission (the "SEC" or "Commission"). We also commend the leadership of Commissioner Piwowar and Commissioner Stein during the interim period prior to your arrival. We look forward to continuing a constructive and cooperative relationship with the Commission under your leadership.

As we look forward to working with you and the SEC Staff, we believe it is an appropriate time to outline MFA's priority issues and related requests concerning the Commission's rulemaking that affects the private fund industry. MFA represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA has over 3,000 members from firms engaging in many alternative investment strategies all over the world. We would welcome the opportunity to meet with you, the Commissioners, and Commission Staff in due course to discuss these issues in greater detail.

MFA members favor smart, effective regulation of securities markets generally, and have a strong interest in thoughtful and efficient regulation of hedge fund managers. MFA supported many aspects of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[2] In particular, MFA has consistently supported the provision of the Dodd-Frank Act requiring

[1] The Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms 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 members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

[2] Pub. L. 111-203, 124 Stat. 1376 (July 21, 2010), available at: http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/html/PLAW-111publ203.htm.

the registration of private fund managers with the SEC as investment advisers under the Investment Advisers Act of 1940 (the "Advisers Act"). We believe that the existing framework of SEC regulation of private fund managers has worked well and is effective in fulfilling the SEC's mission to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation.

At the same time, MFA also supports efforts to modernize and simplify the regulatory framework for capital markets and asset managers towards the goals of enhancing investment activity, capital formation and economic growth. In particular, we have taken note of the recent Presidential Executive Orders designed to reduce regulation, control regulatory costs, and establish core principles for regulating the financial system.[3] We support these goals and believe they can be achieved through a sensible approach to regulatory modernization that protects investors, enhances regulatory coordination, promotes market transparency and increases market fairness and efficiency.

To that end, we propose below some specific recommendations that reflect the priority issues of MFA members.

I. Summary of Priority Issues

A. Ensure Data Security and Treatment of Confidential Information

We respectfully urge the SEC to rationalize when and how it requests for highly confidential and commercially valuable intellectual property from registrants, and how it protects such information. The Commission should request for such information only when absolutely necessary; and when it asks for such information, it should be through a Commission issued subpoena. The Commission should also have an information security policy in which the protections and security requirements are heightened or tiered depending upon the level of sensitivity of the data collected. MFA and its members have strong concerns with information security at regulatory agencies. Information security vulnerabilities at a regulator will jeopardize not only market

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[3] *See* President Donald J. Trump, *Presidential Executive Order on Enforcing the Regulatory Reform Agenda*, Exec. Order No. 13777, 82 Fed. Reg. 12285 (Feb. 24, 2017); President Donald J. Trump, *Presidential Executive Order on Core Principles for Regulating the United States Financial System*, Exec. Order No. 13772, 82 Fed. Reg. 9965 (Feb. 3, 2017); and President Donald J. Trump, *Presidential Executive Order on Reducing Regulation and Controlling Regulatory Costs*, Exec. Order No. 13771, 82 Fed. Reg. 9339 (Jan. 30, 2017).

The Core Principles for regulation of the U.S. financial system are to: (a) empower Americans to make independent financial decisions and informed choices in the marketplace, save for retirement, and build individual wealth; (b) prevent taxpayer-funded bailouts; (c) foster economic growth and vibrant financial markets through more rigorous regulatory impact analysis that addresses systemic risk and market failures, such as moral hazard and information asymmetry; (d) enable American companies to be competitive with foreign firms in domestic and foreign markets; (e) advance American interests in international financial regulatory negotiations and meetings; (f) make regulation efficient, effective, and appropriately tailored; and (g) restore public accountability within Federal financial regulatory agencies and rationalize the Federal financial regulatory framework.

In addition, the Treasury Secretary is directed to consult with the heads of the member agencies of the Financial Stability Oversight Council and report within 120 days on the extent to which existing laws, treaties, regulations, guidance, reporting and recordkeeping requirements, and other Government policies promote the Core Principles and what actions are being taken to promote and support the Core Principles.

participants and their investors, but the U.S. economy through the loss of domestic trade secrets and confidence in the integrity of the regulatory framework.

B. Systemic Risk Regulation

The SEC should continue to engage in its role as a member of the Financial Stability Oversight Council ("FSOC") as an advocate for the effectiveness of its capital markets based regulatory framework with respect to asset managers and asset management activities and as an advocate against efforts to impose bank-like regulations on non-bank activities.

C. Withdraw the Proposed Rules on Regulation D, Form D and Rule 156

We recommend that the SEC withdraw the proposed amendments to Regulation D, Form D and Rule 156 to enable firms to raise capital with general solicitation activities pursuant to Rule 506(c) of Regulation D in the manner intended by Congress under the JOBS Act. We believe that in preventing managers from using new Rule 506(c), the proposed amendments have limited capital formation and reduced economic growth, and by withdrawing the amendments the SEC could encourage private firms to raise additional capital.

D. Eliminate SEC Staff Requirements for Individual BD/FCM Margin Methodologies for the CDS Customer Portfolio Margin Program

We suggest that the SEC eliminate the Staff requirements for each clearing member firm that is a registered broker-dealer/FCM to have an individually approved proprietary margin model, and instead use the CCP's approved margin methodology as the baseline, with clearing members able to collect additional margin as they deem appropriate based on their assessment of a clearing customer's credit risk. This approach will enable a viable portfolio margining regime for cleared CDS as mandated by Congress in the Dodd-Frank Act, with expected market benefits for the single-name CDS market.

E. Consolidate Private Fund Systemic Risk Reporting Forms Into a Single Form and Simplify the Information on the Form

The SEC and CFTC should consolidate private fund systemic risk reporting forms into a single form administered by the SEC that a dually registered manager would submit for all of its private funds and commodity pools. Regulators should also reduce and streamline the information submitted on a single form to more effectively fulfill the purpose of systemic risk assessment and minimize the significant regulatory costs imposed on private fund managers.

F. Simplify SEC and CFTC Registration for Private Fund Managers

The SEC and CFTC should adopt a rule or issue guidance that would subject firms to registration with either the SEC or CFTC, depending on whether it is primarily engaged in the business of advising on trading in securities or futures, options, and/or swaps.

This framework would promote efficiency, reduce overlap, help prioritize regulatory resources, and reduce regulatory costs. Under current SEC and CFTC rules, many private fund managers are required to register with both agencies due to their providing investment advice to clients with respect to securities and commodity interests. Such dual registration results in overlapping and duplicative regulatory requirements that impose unnecessary additional costs on managers and their investors with little additional benefit.

G. Eliminate SEC Capital Charge on Electing Tri-Party Custody Arrangements

Consistent with Congressional intent and the customer protection goals of the Dodd-Frank Act, the SEC should eliminate its proposed 100% capital charge on security-based swap dealers for any initial margin for uncleared security-based swaps held by a third-party custodian in a segregated account, subject to the inclusion of recommended required contractual terms in the tri-party custody agreement.

H. Hart-Scott-Rodino Investment-Only Exemption

MFA seeks the SEC's support in encouraging the FTC to abandon an extreme reading of the HSR notification requirements that interfere with SEC's public policy of investor engagement. The SEC's public policy encourages investors to engage with issuers as a critical part of due diligence and good corporate governance. However, the Federal Trade Commission ("FTC") and the Department of Justice have changed public policy by adopting a narrow view on the appropriate engagement between investors and public company boards and management in recent enforcement proceedings against hedge funds in the *Third Point* and *ValueAct* cases for failures to file premerger notification filings under the Hart-Scott-Rodino ("HSR") Antitrust Improvements Act. For years, MFA members relied on the "investment-only" exemption ("Exemption") to the HSR filing requirements. Without any formal change in its rules and regulations, the FTC has taken a much narrower reading of the Exemption than in the past, creating policy tensions with the federal securities laws' policy of encouraging investors to engage with issuers. We urge the SEC to encourage the FTC to take a more balanced approach.

I. Stress Test Requirements For Non-Bank Entities

To the extent the SEC determines to move forward with rulemaking under Section 165(i) of the Dodd-Frank Act, which requires the SEC to issue rules requiring certain financial companies to perform an annual stress test, the SEC should provide that a private investment fund and/or its adviser will be deemed to have met any stress test requirement by submitting Form PF. Such an approach would make regulation more efficient, effective, and appropriately tailored.

J. Incentive Compensation Rule

We encourage the Commission to make further amendments to its re-proposed rule implementing Section 956 of the Dodd-Frank Act, which requires the SEC and banking regulators to issue rules or guidelines that prohibit incentive-based compensation arrangements that encourage inappropriate risk taking by covered financial institutions, so that it does not impose restraints on incentive-based compensation arrangements that exceed the intent of Section 956. Investment advisers engage in a fundamentally different business than banks, as they invest client money rather than investing proprietary capital, and compensation rules designed for banks are not appropriately tailed for investment advisers.

K. Maintain SEC Examinations of SEC-Registered Investment Advisers to Private Funds

The SEC should maintain its existing inspections and examinations of SEC-registered investment advisers to private funds. A system of third-party compliance reviews would be exceedingly difficult to implement in a workable, cost-effective manner that improves upon the existing system of SEC oversight and examination. Such third-party reviews would lead to less efficient and effective regulation that would impose additional regulatory costs on private fund managers.

L. Withdraw the Proposal for Notional-Based Leverage Limits to Regulate the Use of Derivatives by Registered Funds

MFA and AIMA strongly oppose the proposed rule that would limit a registered fund's use of derivatives. We oppose the rule's alternative notional-based leverage limits, among other concerns. As noted in our comment letter of March 28, 2016, we believe such an overall leverage limit is both unnecessary and inappropriate because it lacks sufficient justification, given the practical effect of the SEC's proposed asset segregation requirements and the potential reinforcing effect of the Commission's other related regulations after their adoption. The proposed rule will have the potential unintended effects of limiting investor choice and undermining investor protection by depriving investors of opportunities to invest in alternative mutual fund strategies and their potential benefits.

M. Withdraw the Proposed Rule on Business Continuity and Transition Plans for Investment Advisers

The SEC should withdraw its proposed rule on business continuity and transition plans for investment advisers. While we appreciate the goals underlying the SEC's proposed rule, a new rule is not necessary because existing SEC guidance has already caused most investment advisers to implement business continuity plans. The SEC should instead continue its practice of issuing timely, useful guidance to investment advisers as needed in response to changing market conditions and events.

N. Amend Proposed Rule 18-4(d)(2) to Clarify the Application of Required Subordination of Segregated Customer Margin for Uncleared Security-Based Swaps

The SEC should amend proposed Rule 18a-4(d)(2) to make clear that in the event a counterparty elects to segregate initial margin with an independent third-party custodian, required subordination applies only to segregated initial margin that is kept out of the security-based swap dealer's bankruptcy estate.

O. Ensure that Equity Market Structure Reforms Serve the Needs of Investors

While MFA believes that currently the markets serve investors reasonably well, we suggest that regulators should take additional measures towards: (1) enhancing the resilience of critical infrastructure and the robustness of the market framework; (2) ensuring that any changes to market structure will ultimately benefit investors; and (3) increasing transparency to investors through greater order handling disclosures. We believe such measures will enhance our regulatory framework that has fostered innovations in technology that have revolutionized investing in our equity markets and promoted greater competition among marketplaces, all to the benefit of retail and institutional investors.

P. Update Rule 105 of Regulation M under the Exchange Act

In light of market changes, including changes for secondary and follow-on offering that have occurred since 2007, in particular, the prevalence of overnight shelf offerings, we believe the Commission should amend Rule 105 to provide investors a meaningful opportunity to participate in overnight offerings and to minimize unintended violations of the Rule for investors making a good faith effort to comply with the Rule. Such an amendment would enhance capital formation and economic growth by allowing institutional investors to participate in additional offerings.

Q. Modernize the Advisers Act Advertising Rules

MFA requests that the SEC rethink the restrictions on adviser advertisements and consider providing private fund advisers with greater flexibility in the type of information that they can provide to existing or potential investors in advertising materials. Although the SEC and its Staff have provided guidance on various advertising limitations under the Advisers Act, uncertainty remains as to the scope and application of these limitations to private fund advisers.

R. Update Rule 102 of Regulation M under the Exchange Act for Consistency With Rule 506(c) of Regulation D

The SEC should provide relief under Rule 102 of Regulation M to private fund managers seeking to conduct private offerings pursuant to Rule 506(c), consistent with the intent of Congress in enacting the JOBS Act. Such relief would promote capital formation and economic growth through the raising of additional investor capital.

S. Adopt an Amendment to the SEC Rules of Practice Requiring the Automatic Withdrawal of Long-Delayed Rule Proposals

The SEC should adopt an amendment to its Rules of Practice that would provide by operation of law that any proposed rule that it has not adopted within a certain time period, such as three years, after publication in the Federal Register is automatically withdrawn. We believe such a Rule of Practice would enhance the effectiveness of the SEC's rulemaking process and avoid unintended impacts on market participants.

T. Adopt the Proposed Rule Permitting Additional Investments by Investment Companies and Private Funds in ETFs

The SEC should re-propose and adopt its proposed rule that would permit investment companies to invest in ETFs in excess of the limits of the Investment Company Act of 1940 (the "Investment Company Act"), subject to certain conditions, and ensure that the exemption afforded by the proposed rule includes private funds. The proposed rule would modernize regulation in light of current markets while continuing to address the concerns that led Congress to enact the limitations.

U. Maintain Objective Standards in the Definition of Accredited Investor

We believe the SEC should maintain in the definition of accredited investor clear, objective standards based on the income and net worth of an investor. These objective standards provide certainty to issuers that lead to an efficient process for identifying qualified investors and reduce their regulatory costs.

V. Amend Rule 206(4)-5 under the Advisers Act (the Pay-to-Play Rule) to Minimize Intrusion into the Personal Political Activities of an Adviser's Employees

The SEC should amend the pay-to-play rule so as not to preclude a significant portion of employees in the investment management industry from making political contributions to state, local, and in some cases, federal, candidates. While we support efforts by both the SEC and state enforcement authorities to punish individuals and entities that engage in improper activities in connection with the selection of firms to manage government assets, the rule effectively requires investment managers to prohibit most political contributions by their employees or significantly limit the contribution amounts. The rule should be amended to more narrowly tailor its application to prevent those activities that are more likely to involve pay-to-play practices.

W. Expand the Definition of "Knowledgeable Employee"

We encourage the Commission to revise the definition of knowledgeable employee in Rule 3c-5 so that it does not unnecessarily limit the scope of adviser employees who may qualify as knowledgeable employees, particularly with respect to senior employees. Permitting "knowledgeable employees" of an investment adviser, as defined in Rule 3c-5 under the Investment Company Act, to invest in that adviser's private funds promotes an alignment of interest between the adviser's employees and the fund's investors.

II. Discussion of Issues

In the Sections below are more detailed discussions of the potential impact of these rule proposals and actions on the private fund industry, and our specific recommendations with respect to these issues. Please note that MFA has also previously submitted comment letters describing our recommendations in response to the SEC's formal requests for comment. We would encourage you and the Staff to also refer to these letters, links to which are provided in the discussions.

A. Ensure Data Security and Treatment of Confidential Information

MFA respectfully urges the SEC to rationalize when and how it requests for highly confidential and commercially-valuable intellectual property from registrants, and how it protects such information. The Commission should request for such information only when absolutely necessary; and when it asks for such information, it should be through a Commission issued subpoena. The Commission should also have an information security policy in which the protections and security requirements are heightened or tiered depending upon the level of sensitivity of the data collected; thus, providing heightened confidentiality and security protections for certain information, such as confidential, commercially valuable intellectual property. MFA and its members have strong concerns with information security at regulatory agencies. Information security vulnerabilities at a regulator will jeopardize not only market participants and their investors, but the U.S. economy through the loss of domestic trade secrets and confidence in the integrity of the regulatory framework.[4] Over the last several years, due to both statutory mandates and regulatory discretion, the Commission has expanded the scope and breadth of the types of information that it requests of registrants. It has, however, generally continued to rely on the same framework for information collection and protection. MFA believes that the Commission needs to reexamine and rethink its policies and processes for accessing, collecting and protecting non-public and confidential information.

Currently, the Commission collects an inordinate amount of information from registrants—both directly and indirectly. The SEC's Form PF requires registrants to disclose substantial amounts of highly confidential, commercially sensitive, and proprietary information, which is subject to heightened confidentiality protections.[5] In addition, the Commission in routine exams demands that

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[4] *See* Gregory C. Wilshusen, Director, Information Security Issues, Testimony before the Subcommittee on Research and Technology Oversight, Committee on Science, Space, and Technology, House of Representatives, 7 (July 8, 2015), (GAO reporting that federal agencies had 77,183 cybersecurity incidents in 2015 along—a 1,300% increase since 2006) available at: http://www.gao.gov/assets/680/670935.pdf. In addition, the list of recent federal government cyber breaches is long and growing, including the Central Intelligence Agency, White House, Department of State, Federal Deposit Insurance Corporation, Federal Aviation Administration, Department of Defense, Internal Revenue Service, Office of Personnel Management, the Pentagon, the Federal Reserve, Department of Homeland Security, Federal Bureau of Investigation and Department of Treasury. *See* Continued Federal Cyber Breaches in 2015, Riley Walters, Nov. 19, 2015, available at: http://www.heritage.org/research/reports/2015/11/continued-federal-cyber-breaches-in-2015; The IRS Says Identity Thieves Hacked Its Systems Again, Fortune, Feb. 10, 2016, available at: http://fortune.com/2016/02/10/irs-hack-refunds/; Federal Reserve Hacked More than 50 Times in 4 Years, The Huffington Post, June 1, 2016, available at: http://www.huffingtonpost.com/entry/hackers-breach-federal-reserve-50-times_us_574ee0d5e4b0757eaeb1194c; Republican Staff Memorandum to Republican Members, Committee on Science, Space and Technology, July 12, 2016 available at: https://www.documentcloud.org/documents/2992789-Final-GOP-Interim-Staff-Report-7-12-16.html; Lorenzo Franceschi-Bicchierai, "Hacker Publishes Personal Info of 20,000 FBI Agents," Motherboard, February 8, 2016, available at: https://motherboard.vice.com/read/hacker-publishes-personal-info-of-20000-fbi-agents; and News release, "OCC Notifies Congress of Incident Involving Unauthorized Removal of Information," U.S. Department of the Treasury, Office of the Comptroller of the Currency, October 28, 2016, available at: http://www2.occ.gov/news-issuances/news-releases/2016/nr-occ-2016-138.html.

[5] *See* Section 404 of the Dodd-Frank Act.

investment managers disclose confidential, proprietary research papers and other intellectual property, and related trade secrets concerning investment strategies. We are troubled that information the Commission collects through an exam that may be even more sensitive than information collected on Form PF may not be subject to heightened information security protections, and that the Commission provides different levels of protection to Form PF data depending upon how it is collected. For example, we learned from Commission Staff that an adviser's Form PF is subject to heightened confidentiality procedures if the Commission receives it through the Form PF portal, however, if the Commission Staff subsequently receive a copy through the examination process such copy of Form PF is not provided the same confidentiality treatment. We are aware of statutory provisions designed to protect the confidential and proprietary information of registrants, but without robust, updated policies and procedures at the SEC, we are concerned that the Commission is unable to adequately protect such information.[6]

We are also strongly concerned that Commission Staff, at times, unnecessarily request access to highly confidential and commercially-valuable intellectual property, without exhausting other less sensitive means of understanding a firm's activities, and then do not have robust procedures for protecting such information if it is collected by the Commission. We support the Commission having the information it needs to oversee registrants and to surveil markets, however, this authority needs to be balanced with the potential risk of irrevocable harm (*e.g.*, unauthorized disclosure or misappropriation of trade secrets) to registrants and their due process rights.[7] To be clear, MFA has never disputed the authority of the Commission to obtain confidential materials that it needs to enforce the law. However, the Commission should have a policy to request highly confidential, commercially-valuable intellectual property only when absolutely necessary and through the subpoena process.

In addition, we think the Commission should have an information security policy in which the protections and security requirements are heightened or tiered depending upon the level of

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[6] *See*, Federal Information Security Modernization Act of 2014, 44 U.S.C. § 3551 (2014); Section 404 of the Dodd-Frank Act; 18 U.S.C. § 654 (1996) (prohibiting an officer of employee of United States converting property of another); *and* 18 U.S.C. § 1905 (2008) (prohibiting public officers and employees of disclosure of confidential information generally). *See also* Office of Management and Budget, Annual Report to Congress on the Federal Information Security Modernization Act of 2014, Fiscal Year 2016 (reporting that the SEC's information security program was <u>ineffective</u> under the FY 2016 Inspector General FISMA Reporting Metrics) available at: https://www.whitehouse.gov/sites/whitehouse.gov/files/briefing-room/presidential-actions/related-omb-material/fy_2016_fisma_report%20to_congress_official_release_march_10_2017.pdf; Office of Inspector General, SEC, Audit of the SEC's Compliance with the Federal Information Security Modernization Act for Fiscal Year 2015, June 2, 2016, Rep. No. 535, (urging SEC management to take certain actions to address potential risk with respect to the SEC's information security program) available at: https://www.sec.gov/oig/reportspubs/Audit-of-the-SECs-Compliance-with-the-Federal-Information-Security-Modernization-Act-for-Fiscal-Year-2015.pdf; *and* U.S. GAO Report to the Chair, U.S. SEC, on Information Security "Opportunities Exist for SEC to Improve its Controls over Financial Systems and Data," April 2016, (finding that the SEC needs to improve its controls over financial systems and data as weaknesses continue to limit the effectiveness of security controls) available at: http://www.gao.gov/assets/680/676876.pdf.

[7] *See* Statement of Dissent by Commissioner J. Christopher Giancarlo Regarding Supplemental Notice of Proposed Rulemaking on Regulation Automated Trading, November 4, 2016, (expressing that allowing the CFTC to inspect algorithmic source code "would strip owners of intellectual property of due process of law" and that the "subpoena process provides property owners with due process of law before the government can seize their property."), available at: http://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement110416.

sensitivity of the data collected, including how to dispose of or return the data, if no wrongdoing is found, at the end of the examination, investigation or query. While the Dodd-Frank Act imposed heightened confidentiality protections with respect to systemic risk information that the SEC collects from managers of private funds,[8] we think regulators should impose heightened procedures and standards with respect to all highly sensitive and confidential information that they receive regardless of how it is collected. If the Commission collects highly confidential and commercially-valuable intellectual property from registrants, we think it should consider industry practices and standards with respect to protecting confidential intellectual property. Market participants go to great lengths to protect sensitive intellectual property, implementing practices shaped by case law from intellectual property cases. We think it is only appropriate for the Commission to apply consistent protections.

Accordingly, MFA respectfully urges the SEC to rationalize when and how it requests for highly confidential and commercially-valuable intellectual property from registrants, and how it protects such information. The Commission should request highly confidential and commercially-valuable intellectual property only when absolutely necessary; and when it asks for such information, it should be through a Commission issued subpoena. The Commission should also have an information security policy in which the protections and security requirements are heightened or tiered depending upon the level of sensitivity of the data collected; thus, providing heightened confidentiality and security protections for certain information, such as confidential, commercially-valuable intellectual property. MFA would be pleased to discuss with the Commission common industry practices for protecting confidential intellectual property.

B. Systemic Risk Regulation

The SEC should continue to engage in its role as a member of FSOC as an advocate for the effectiveness of its capital markets based regulatory framework with respect to asset managers and asset management activities and as an advocate against efforts to impose bank-like regulations on non-bank activities. MFA supports activities and markets-based regulation to address identified systemic risk concerns, as opposed to designation of non-bank entities as systemically important financial institutions ("SIFIs") by FSOC and SIFI-based regulation. Further, while MFA supports appropriate regulation of activities, we have consistently expressed concern with applying rules designed for banks to non-banks and non-bank activities such as capital markets activities. We also believe that regulation of asset management activities should be carried out by the primary financial regulators (*e.g.*, the SEC and CFTC) rather than banking regulators.

We recognize that SEC rulemaking is primarily focused on investor protection, and promoting efficiency, competition, and capital formation, consistent with Section 3 of the Securities Exchange Act of 1934 (the "Exchange Act"). We believe, however, that SEC rules that promote these goals also are best suited to address potential systemic risk concerns arising from capital markets activities. With its extensive experience regulating capital markets and capital markets participants, the Commission is better situated to address any regulatory gaps with respect to capital markets activities as part of its overall regulatory framework.

[8] *See* Section 404 of the Dodd-Frank Act.

C. Withdraw Proposed Rules on Regulation D, Form D and Rule 156

We recommend that the SEC withdraw the proposed amendments to Regulation D, Form D and Rule 156 under the Securities Act of 1933 (the "Securities Act") to enable firms to raise capital in the manner intended by Congress.[9]

In 2013, the SEC adopted new Rule 506(c) of Regulation D, as mandated by the Jumpstart Our Business Startups Act (the "JOBS Act"), to repeal the ban on "general solicitation" in certain private placements. MFA believes these amendments have the potential to significantly benefit investors and businesses seeking capital, including private funds. MFA has supported these amendments and the Commission's efforts to maintain appropriate oversight of market practices and achieve its mandate of promoting capital formation and protecting investors.

The objectives of these amendments, however, have not been realized by private fund managers seeking to raise capital, in part due to the SEC's issuance of additional proposed amendments to Regulation D, Form D and Rule 156 under the Securities Act at the same time it adopted the required amendments to Regulation D. These proposed amendments were not required by the JOBS Act, and for over three years have served to thwart the potential benefits of the JOBS Act for private fund managers.

Since the amendments were proposed, very few private fund managers have conducted a private offering under new Rule 506(c) of Regulation D. In considering whether to utilize new Rule 506(c), private fund managers have focused on the legal uncertainty and costs the proposed amendments would impose on managers, in particular due to the continuing difficulty of determining whether certain common practices constitute general solicitation. In preventing managers from using new Rule 506(c), the proposed amendments have limited capital formation and harmed prospective investors by reducing or eliminating the increased transparency and public availability of information that the JOBS Act was intended to promote. Below is a brief discussion of the specific proposals and their potential impact on private fund managers seeking to raise capital.

Advance Form D

The Commission has proposed to amend Rule 503 to require issuers that intend to engage in a general solicitation to file a Form D fifteen calendar days in advance of commencing a general solicitation (an "Advance Form D"). While we support the Commission's effort to study the impact of general solicitation on the Regulation D market, it is unclear to us how a pre-filing requirement facilitates this objective. Form D is an information-gathering tool for the Commission whether filed before or after the initiation of an offering. If Form D, as proposed to be modified by the Commission, were filed within 15 days after the date of first sale, in accordance with the longstanding requirements of Regulation D, the Commission would have access to the same market information.

Requiring an Advance Form D would impose a 15-day waiting period for issuers that want to avail themselves of the benefits of the JOBS Act (*i.e.*, engaging in a general solicitation). This is inconsistent with the JOBS Act's intent of making it easier for companies to access the private

[9] *See* Letter from Stuart J. Kaswell, Executive Vice President and Managing Director, General Counsel, MFA to Elizabeth M. Murphy, Secretary, SEC (Sept. 23, 2013), available at: https://www.managedfunds.org/wp-content/uploads/2013/09/MFA-Letter-to-SEC-on-JOBS-Act-Proposals-Sept-2013.pdf.

capital markets, and may impair the ability of issuers to raise capital when market conditions are most advantageous. We believe the costs to issuers and the markets outweigh the benefits of requiring an Advance Form D and respectfully suggest that the Advance Form D filing requirement also will not promote efficiency, competition and capital formation as required by Section 2(b) of the Securities Act.

In addition, uncertainty often remains regarding what activities do and do not constitute general solicitation. In our experience, reasonable minds may differ on what constitutes a general solicitation – even in certain relatively common circumstances. Requiring an Advance Form D filing in connection with a general solicitation adds further consequences to the uncertainty regarding general solicitation given that, as proposed, an inadvertent failure to file the Advance Form D can prevent an issuer from conducting new private offerings under Rule 506 (and not just 506(c)) for a one-year period. We note also the Commission's acknowledgement in the proposing release that issuers may choose to file an Advance Form D as a protective measure before deciding whether to engage in a general solicitation. We suggest this will result in a substantial amount of premature and possibly meaningless Advance Form D filings, which will lessen the efficacy to the Commission of this information gathering tool.

Form D Amendments

We similarly do not believe the proposal to require filing of a closing Form D amendment within 30 calendar days after termination of a Rule 506 offering makes sense in the context of hedge fund offerings. Hedge funds often engage in continuous – but not necessarily regular – offerings. Because of the nature of this capital raising, there may be uncertainty regarding when an offering terminates. For example, when an issuer's fund raising activities have slowed or are on hiatus but the issuer intends to continue to seek to raise capital, we believe the issuer has not terminated its offering. Similarly, if an issuer intends to solicit or accept new investments only to replace capital as it is redeemed – on a timeline that is thus effectively controlled by investors rather than the issuer – we believe the offering should be deemed ongoing. As a result, this requirement is likely to create substantial uncertainty for hedge fund managers.

Consequences of Non-Compliance with Form D Filing Requirements

The proposed automatic one-year disqualification from relying on Rule 506 for future offerings is a disproportionate penalty for an issuer that fails to file a Form D or an amendment on time (or for other errors in its Form D filings) and would expose issuers, particularly private funds, and investors to significant legal and financial risk that would harm capital-raising and undermine the purpose of the JOBS Act. In this regard, we note that when the Commission amended Regulation D in 1988 to eliminate Form D filings as a condition of Rules 504, 505, and 506, the Commission noted the significant cost savings for issuers that would be achieved without compromising investor protection.[10] The Commission also noted the inequitable result of a minor, technical deviation from the Form D requirements resulting in a loss of a Regulation D exemption and creating a rescission right for all investors. We believe the proposed loss of an issuer's (and its affiliates') access to the private capital markets would be a similarly inequitable result.

[10] *See* SEC Release No. 33-6812 (Dec. 20, 1988).

Moreover, the proposed automatic one-year disqualification would impose greater costs on private funds which, unlike other issuers, do not have the option of turning to the public markets for capital. It is common practice for funds faced with the prospect of investor withdrawals to seek additional capital so that they are not forced to sell their holdings on a compressed timeframe and/or at distressed prices, thus avoiding harm to all investors in the fund. Depriving a private fund of the ability to replace departing capital would result in potentially severe consequences for fund investors.

Required Legends on Written General Solicitation Materials

The proposed legends on written general solicitation materials would not provide meaningful additional protection to investors, but rather would introduce an additional burden on issuers, given the wide range of written communication that may be used by an issuer and the uncertainty as to whether certain types of written communications would be deemed a general solicitation. Investors in private fund generally must be sophisticated individuals or institutions, and these investors typically perform due diligence prior to investing with a particular manager, either themselves or through a consultant or other adviser, which includes reviewing and evaluating the information about a fund and its manager contained in the fund's offering materials. In addition, any performance claims are subject to anti-fraud provisions of the federal securities laws, including the Advisers Act and rules thereunder, that ensure they are appropriate and not misleading to investors.

Submission of Written General Solicitation Materials to the SEC

Requiring private fund managers to regularly submit materials to the SEC in connection with a general solicitation is unnecessary in light of existing oversight and examination methods. Large hedge fund managers must register with the SEC under the Advisers Act, and as SEC-registered investment advisers, managers are subject to the SEC's books and records rule, Rule 204-2 under the Advisers Act. Solicitation materials used by a registered private fund manager would be subject to Rule 204-2, so that a manager would need to maintain the materials for at least five years and make them available to the SEC upon request.[11] Also, registered hedge fund managers are subject to periodic inspections and examinations by OCIE Staff, during which the Staff has access to substantial amounts of information about the adviser and private funds it manages.

Application of Interpretative Guidance of Rule 156 to Private Funds

The Commission has provided no basis for, and asserted no benefits that would flow from, attempting to regulate both mutual funds and private funds in the same way with a single rule, nor has it explained why sales literature directed to sophisticated investors should now be included within the scope of Rule 156. Rule 156 is an interpretative rule that identifies considerations for determining whether sales literature used by registered investment companies is materially misleading in violation of the anti-fraud provisions of the Securities Act and the Exchange Act.[12]

[11] *See* Rule 204-2(a)(11), which applies to copies of each notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons (other than persons connected with such investment adviser).

[12] The SEC adopted Rule 156 for registered investment companies, and the Staff has strictly limited interpretive guidance under Rule 156 to investment companies that target retail investors *See e.g*., SEC No Action Letter, T. Rowe Price Investment Services, Inc. (Sept. 8, 1995) (discussing Rule 156 in the context of variable annuity contract sales materials), SEC No Action Letter, Pacific Mutual Life Insurance Company (Aug. 31, 1990) (discussing Rule

The proposal is unnecessary because, as noted above, any performance claims are subject to anti-fraud provisions of the federal securities laws, including the Advisers Act and rules thereunder.

D. Eliminate SEC Staff Requirements for Individual BD/FCM Margin Methodologies for the CDS Customer Portfolio Margin Program

MFA has opposed, and continues to oppose, the SEC Staff requirements for each clearing member firm that is a registered broker-dealer/FCM ("BD/FCM") to have an individually approved proprietary margin model; and advocate for the use of the CCP's approved margin methodology as the baseline, with clearing members able to collect additional margin as they deem appropriate based on their assessment of a clearing customer's credit risk.

In accordance with the SEC's order of December 19, 2012 (the "Order"), the Staff requires each BD/FCM to adopt its own unique margin regime for the credit default swap ("CDS") customer portfolio margin program. As explained in MFA's previous letters, we believe that such an approach is ill-advised.[13] Although MFA supported certain aspects of the Order because it permitted commingling and portfolio margining of customers' positions in cleared single-name CDS and CDS indices in a Section 4d(f) account under the Commodity Exchange Act, we do not believe that requiring each BD/FCM to adopt individual margin models is either required under the Dodd-Frank Act or appropriate.

The SEC approved ICE Clear Credit's ("ICE") margin methodology for the CDS customer portfolio margin program five years ago. ICE's methodology reflects robust margin analytics derived from a comprehensive data set, including both actual transaction data and market-wide data drawn from its clearing members and the CDS data repository. Individual BD/FCMs' margin methodologies are based on data sets that are much more limited, and accordingly are unlikely to be as robust and accurate as the methodology developed by ICE or any other clearing agency that may offer a CDS portfolio margin program. The ICE margin methodology sets a level playing field regardless of the variations in the robustness of margin analytics across individual BD/FCMs. Despite the SEC's approval of the ICE margin methodology, the Staff continues to require each BD/FCM to adopt individual margin models for the CDS customer portfolio margin program.

Rather than enabling customers to clear at the same or similar initial margin levels already established for dealers under the approved ICE margin methodology, and providing customers with certainty about, and transparency into, the margin models applicable to them, the Staff continues to require an untested approach that will lead to arbitrarily higher initial margin levels for investors.

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156 in the context of variable life illustrations), SEC No Action Letter, Variable Annuity and Variable Life Registrants (discussing Rule 156 in the context of variable life annuity registration statements); SEC No Action Letter, General Guidance to Variable Annuity, Variable Life (Nov. 3, 1995) (discussing Rule 156 in the context of variable life annuity registration statements); SEC No Action Letter, Franklin Group of Funds (Jan. 27, 1987) (discussing Rule 156 in the context of materials filed under the Investment Company Act).

[13] *See e.g.*, Letter from Stuart J. Kaswell, Executive Vice President and Managing Director, General Counsel, MFA, Carl B. Wilkerson, Vice President and Chief Counsel, Securities and Litigation, America Council of Life Insurers, and Jiri Krol, Director of Government and Regulatory Affairs, AIMA, to The Hon. Mary Jo White, Chair, SEC (Dec. 27, 2013), available at: https://www.sec.gov/comments/s7-13-12/s71312-4.pdf.

Such an approach will continue to undermine investors' ability to manage their cleared CDS portfolios, which is contrary to the Dodd-Frank Act's policy goals.

After the issuance of the Order, the Staff further issued a series of temporary approval letters to ICE's clearing members that also set forth conditions and customer initial margin requirements that have a direct and significant impact on investors. The temporary conditional approval letter process precluded buy-side engagement, as the Staff issued letters to, and held private discussions with, individual BD/FCMs to define customer initial margin model requirements without any buy-side participation or input.

In MFA's view, the requirements imposed by the SEC have delayed voluntary buy-side clearing of single-name CDS, with resulting adverse effects on trading volume and liquidity. We respectfully suggest that the SEC eliminate these unnecessary Staff requirements that have created regulatory inefficiencies that are not tailored to address the risks presented by the cleared CDS customer portfolio margin program. The SEC should coordinate with the CFTC and authorize the CCP's vetted and approved margin methodology as the baseline, with clearing members able to collect additional margin as they deem appropriate according to their assessment of a clearing customer's credit risk. This approach will enable a viable portfolio margining regime for cleared CDS as mandated by Congress in the Dodd-Frank Act, with expected market benefits for the single-name CDS market.

E. Consolidate Private Fund Systemic Risk Reporting Forms Into a Single Form and Simplify the Information on the Form

The SEC and CFTC should consolidate private fund systemic risk reporting forms into a single form administered by the SEC that a dually registered manager would submit for all of its private funds and commodity pools. Regulators should also reduce and streamline the information submitted on a single form to more effectively fulfill the purpose of systemic risk assessment of systemic risk and minimize the significant regulatory costs imposed on private fund managers.

Since the enactment and implementation of the Dodd-Frank Act, private fund managers have reported extensive information to regulators on a quarterly or annual basis for the assessment of systemic risk and other purposes on SEC Form PF and CFTC Forms CPO-PQR and CTA-PR (the "Forms"). Under this reporting framework, a private fund manager registered with both the SEC and CFTC is required to submit multiple Forms, despite the fact that the Forms are intended for the same purposes and generally designed to collect the same type of information. The Forms are similar but are not identical, creating a situation where managers that advise both private funds and commodity pools must separately track and calculate for each filing schedules of investments using different methodologies. For each Form, a manager must collect and report a vast amount of highly detailed information about its various portfolio holdings, and the length and complexity of the Forms demand that firms commit significant resources across various business units to complete them.

While MFA has supported the collection of systemic risk information from private fund managers through periodic, confidential reports, we have also consistently recommended that regulators consolidate and simplify the Forms, which would enhance their usefulness, promote systemic risk assessment, and reduce complexity. The current approach is highly inefficient from the perspectives of both regulators and managers.

In this respect, we believe it is an appropriate time for the SEC and CFTC to consolidate the Forms into a single form administered by the SEC that a dually registered manager would submit for all of its private funds and commodity pools.[14] A single form would reduce duplication of reporting and inconsistency among definitions and instructions, allow regulators to monitor systemic risk using data reported in a consistent manner, improve the quality of systemic risk analysis, and lower regulatory expense associated with that analysis. At the same time, it would substantially reduce the compliance burden for private fund managers that currently submit multiple forms designed to achieve a similar purpose.

Simplification of Reporting on a Single Form PF

In addition to consolidating the Forms into a single form, we strongly encourage the SEC to review the amount and type of information required on Form PF in light of its experience with the data that filers have submitted over the last five years. In our view, the scope of information submitted on the Form could be substantially reduced and streamlined in order to more effectively fulfill the purpose for which it was primarily intended, the assessment of systemic risk, and to minimize the significant burden imposed on private fund managers.

After approximately five years of data collection, it would be an appropriate time for the SEC to begin an assessment of the value of the information that it has received on Form PF.[15] In its review, the SEC should consider the effectiveness of the Form for systemic risk assessment, its impact on private fund managers, and its overall costs and benefits to regulators, markets and investors. The SEC should identify any information that does not serve to materially enhance the evaluation of systemic risk or oversight of the hedge fund industry. In the experience of our members, the Form requires them to collect a significant amount of information that they do not regularly calculate as part of their ordinary operations, and neither they nor their investors regard much of the Form PF data as relevant metrics in evaluating their business. We believe that this type of information would likewise not provide substantial value to the SEC in their oversight of the industry.

We recommend that the SEC redesign Form PF from its current format to take a balanced approach that obtains relevant information on a periodic basis and avoids inundating regulators with the significant market "noise" that result from receiving overly frequent data about hedge fund portfolio movements. Like other money management firms and financial companies, a private fund's investment positions, exposures to counterparties, performance and other metrics are subject to short-term market fluctuations that are not useful for the assessment of systemic risk. For example, reporting templates developed by other regulators that seek more targeted information could serve as a useful starting point for an updated Form PF.[16] In addition, we would suggest that the SEC

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[14] By including an additional schedule, the CFTC could request information that is unique to commodity pools.

[15] We have previously recommended that, since Form PF created an entirely new reporting framework for private fund managers, regulators should revisit and potentially amend the Form as they gain experience with the information. In particular, at the time of the adoption of Form PF, we encouraged the Commission to review the Form within two years. *See* Letter from Richard H. Baker, President and CEO, MFA to Elizabeth M. Murphy, Secretary, SEC and David A. Stawick, Secretary, CFTC (Apr. 8, 2011), available at: http://www.managedfunds.org/wp-content/uploads/2011/06/4.8.11-MFA.Form_.PF_.Comments.4.8.11.pdf.

[16] *See e.g.*, UK FCA Hedge Fund Survey and the IOSCO Hedge Fund Survey.

consider reducing the frequency of reporting for large hedge fund managers. We would be pleased to work with Staff to provide our further thoughts on specific information collected in the Form and changes that would enhance its usefulness.

F. Simplify SEC and CFTC Registration for Private Fund Managers

The SEC and CFTC should adopt a rule or issue guidance that would subject firms to registration with either the SEC or CFTC, depending on whether it is primarily engaged in the business of advising on trading in: (1) securities; or (2) futures, options, and/or swaps ("commodity interests"). This framework would promote efficiency, reduce overlap, help prioritize regulatory resources, and reduce compliance costs to managers and their customers.

Under current SEC and CFTC rules, many private fund managers are required to register with both agencies due to their providing investment advice to clients with respect to securities and commodity interests. Such dual registration results in overlapping and duplicative regulatory requirements that impose unnecessary additional costs on managers and their investors with little additional benefit.

The current statutory framework is, in fact, designed for regulators to take such an approach to registration. Section 203 of the Advisers Act provides an exemption from SEC registration for a CFTC-registered commodity trading advisor ("CTA") whose business does not consist primarily of acting as an investment adviser.[17] Section 4(m)(3) of the Commodity Exchange Act (the "CEA") provides an analogous exemption from CFTC registration for a CTA that is registered with the SEC as an investment adviser and whose business does not consist primarily of acting as a CTA.

In addition, Section 403 of the Dodd-Frank Act provided a new exemption from SEC registration for a CFTC-registered CTA that advises a private fund, unless the business of the CTA should become predominantly the provision of securities-related advice.[18] This exemption reflects Congress's recognition that CTAs to private funds, which are primarily engaged in the business of providing advice regarding futures and are already subject to a comprehensive registration and regulatory framework, do not have to be dually registered.

Despite this clear statutory framework, however, the SEC and CFTC have not yet adopted rules or issued guidance to allow firms to avail themselves of these statutory exemptions. MFA encourages the Commission and the CFTC to adopt rules or guidance clarifying these exemptions and the criteria relevant to determining whether a registered investment adviser or CTA can rely on them.[19]

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[17] Advisers Act Section 203(b)(6)(A).

[18] Advisers Act Section 203(b)(6)(B).

[19] In advocating for the simplification of SEC and CFTC registration for private fund managers, MFA will also seek to engage the CFTC with respect to commodity pool operator registration.

In this regard, we recommend that the agencies consider the factors addressed in the Peavey Commodity Futures Fund No-Action letter ("Peavey").[20] We believe the standard set in Peavey to determine the primary business engagement of a fund for purposes of determining whether it is an investment company under Section 3(b)(1) of the Investment Company Act is a fair and flexible standard for determining whether an adviser registered with the CFTC is primarily acting as an investment adviser or its business has become predominantly the provision of securities-related advice. In addition, we believe the same analysis may be applied for purposes of determining whether an adviser registered with the SEC is primarily acting as a CTA pursuant to Section 4(m)(3) of the CEA.

Section 3(b)(1) of the Investment Company Act excludes from the definition of investment company any issuer engaged primarily in a business or businesses other than investing, reinvesting, owning, holding or trading in securities, either directly or through wholly-owned subsidiaries. Under the Peavey analysis, in determining whether an entity investing in futures was otherwise primarily engaged in the business of investing in securities so as to be an investment company, the SEC considered the composition of the entity's assets, the sources of its income, the area of business in which it anticipated realization of the greatest gains and exposure to the largest risks of loss, the activities of its officers and employees, its representations, its intentions as revealed by its operations, and its historical development. The SEC stated that of greatest importance in its analysis was the area of business in which the entity anticipated realization of the greatest gains and exposure to the largest risks of loss as revealed by its operations on an annual or other suitable basis.[21]

We believe the factors under the Peavey analysis are appropriate for determining the primary business activity of an adviser and whether it should be registered with the CFTC or SEC. Accordingly, we recommend that the SEC and CFTC, through rulemaking or guidance, indicate how a firm would be able to determine whether it is acting primarily as an investment adviser or a CTA, based on the Peavey analysis – the composition of the adviser's assets, the sources of its income, the area of business in which the adviser anticipates realization of the greatest gains and exposure to the largest risks of loss, the activities of its officers and employees, its representations, its intentions as revealed by its operations, and its historical development.[22]

G. Eliminate SEC Capital Charge on Electing Tri-Party Custody Arrangements

MFA has opposed, and continues to oppose, the SEC's proposed 100% capital charge on security-based swap dealers ("SBSDs") for any initial margin ("IM") for uncleared security-based swaps ("SBS") held by a third-party custodian in a segregated account.

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

[21] For example, a company's anticipated gains and losses in futures trading as compared to its anticipated gains and losses on its government securities and other securities.

[22] *See also* Managed Futures Association, SEC No-Action Letter (July 15, 1996) (applying a "look through" analysis in determining the primary business of a commodity pool that invests in other commodity pools). Managed Futures Association subsequently changed its name to Managed Funds Association.

The SEC's proposed rules on capital, margin and segregation requirements for security-based swap dealers and major security-based swap participants would impose a 100% capital charge on SBSDs for any IM for uncleared security-based swaps held by a third-party custodian in a segregated account. Given the structure and safeguards included in typical tri-party segregation arrangements, MFA believes that this capital charge is unnecessary.

The SEC has stated that its concern is that tri-party segregation arrangements would likely delay the dealer from taking possession of the collateral when necessary. We understand that the SEC may wish to ensure that certain contractual terms be included in each agreement to protect the dealer's rights to take possession of the collateral when required. In addition, we believe the SEC should allow for certain provisions protective of the pledgor to be included in an agreement without attracting a 100% capital charge.

In addition to being unnecessary, the capital charge is inconsistent with the goal of customer protection articulated and enacted by Congress through statutory provisions encouraging tri-party segregation on IM under the Dodd-Frank Act. Our position on this matter is shared by a wide range of financial market participants, including the International Swaps and Derivatives Association, the Securities Industry and Financial Markets Association, the Asset Management Group of SIFMA, the Investment Company Institute and the Alternative Investment Management Association.[23]

Moreover, we note that other regulators that have finalized or proposed swap capital rules have not included a special capital charge for IM held in a tri-party segregated account.[24]

Tri-party segregation of IM should result in counterparties having credit exposure to the dealer that is limited to changes in daily mark-to-market values. This may make it less likely that counterparties precipitously move their collateral and related positions based on negative news relating to a particular dealer's financial condition. To this end, MFA has discussed with SEC Staff a recommendation for required and permitted contractual terms for tri-party segregation arrangements that will be protective of the dealer, the pledgor and the structure generally.[25]

As a result, consistent with Congressional intent and the customer protection goals of the Dodd-Frank Act, we believe the SEC should eliminate this proposed capital charge in its final rules,

[23] *See* SEC public comment file at: https://www.sec.gov/comments/s7-08-12/s70812.shtml.

[24] *See* CFTC Final Rulemaking on "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants", 81 Fed. Reg. 636 (Jan. 6, 2016), and Notice of Proposed Rulemaking on "Capital Requirements of Swap Dealers and Major Swap Participants", 81 Fed. Reg. 91252 (Dec. 16, 2016), and prior Notice of Proposed Rulemaking on "Capital Requirements of Swap Dealers and Major Swap Participants", 76 Fed. Reg. 27802 (May 12, 2011); and Prudential Regulators' Final Rulemaking on "Margin and Capital Requirements for Covered Swap Entities", 80 Fed. Reg. 74840 (Nov. 30, 2015). The Prudential Regulators are collectively, the Office of the Comptroller of the Currency, Treasury; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; Farm Credit Administration and the Federal Housing Finance Agency. The Prudential Regulators also adopted amendments to the capital rules for banks and bank holding companies to incorporate certain requirements set forth in the Dodd-Frank Act. *See* 78 Fed. Reg. 62018 (Oct. 11, 2013).

[25] Letter from Stuart J. Kaswell, Executive Vice President and Managing Director, General Counsel, MFA, to Elizabeth M. Murphy, Secretary, SEC (Feb. 24, 2014), available at: https://www.sec.gov/comments/s7-08-12/s70812-57.pdf.

subject to the inclusion of our recommended required contractual terms in the tri-party custody agreement.

H. Hart-Scott-Rodino Investment-Only Exemption

MFA seeks the SEC's help to address an increasing regulatory burden imposed by the Federal Trade Commission ("FTC"), regarding Hart-Scott-Rodino Antitrust Improvements Act's ("HSR Act") federal premerger notification program, which provides the FTC and the Department of Justice ("DOJ") with information about large mergers and acquisitions before they occur. Although for years, MFA members relied on the "investment-only" exemption ("Exemption") to the HSR Act filing requirements, the FTC's Bureau of Competition ("Bureau") is applying language from a specific enforcement proceeding under the HSR Act to discourage investor engagement with public companies. Bureau Staff have asserted that sharing of information, discussions about strategy, risk management, and other important issues, even when initiated by the company, would require a cumbersome and expensive public filing. As Acting Chairman Ohlhausen stated in a dissent from the proceeding last year: a "*narrow* interpretation of the investment-only exemption is not in the public interest" and "is likely to chill valuable shareholder advocacy."[26] Discussions with company management are critical to investment managers' oversight duties, and are encouraged by boards of directors, the SEC, and management teams of public companies. The FTC Staff's position discourages vital communication and engagement, and allowing an individual settlement agreement to curtail appropriate investment activity for the entire investment community with no formal FTC rulemaking is inappropriate.

As a policy matter, prophylactic compliance with the HSR Act would be ill-advised for the following reasons:

- SEC regulation should address any public policy concerns. Section 13(d), (g), and (f) provide for appropriate public disclosure and reporting of beneficial ownership and control of public issuers.
- The HSR filings themselves are expensive (a cost borne by underlying mutual fund and hedge fund investors).
- Filing communicates the manager's intent to the market, and may send misleading messages to issuers.
- FTC recently raised the penalties to $40,000 per day, so failure to file is very expensive.

The *ValueAct* case settled on July 12, 2016 for a record fine and injunctive relief that specifies restrictive, prohibited conduct designed to prevent ValueAct's future violations. The *ValueAct* settlement has further increased MFA members' concerns that MFA should engage with the antitrust agencies as quickly as possible to address the highly restrictive scope of the investment-only exemption ahead of any forthcoming FTC guidance.

The DOJ's *ValueAct* complaint refers to discussions, meetings, emails and phone calls between ValueAct and the executive officers of the relevant issuers, implying that such contact, or the volume of such contact, is inconsistent with the Exemption. The lack of guidance from the FTC,

[26] Dissenting Statement of Commissioners Maureen K. Ohlhausen and Joshua D. Wright, *In the Matter of Third Point*, File No. 121-0019 (August 24, 2015) ("Dissenting Statement") at 1 (emphasis added).

combined with the DOJ statements in connection with the *ValueAc*t and *Third Point* enforcement cases, unduly limit hedge fund investors that intend to be passive investors for HSR Act purposes, but want to interact with management or boards of directors of issuers in the ordinary course of monitoring their investments.

Public policy supports shareholders monitoring and influencing corporate governance and corporate strategy decisions. Institutional investors have come to view shareholder engagement and consultation with operational and board management as a central part of sound investment and believe, in the ordinary case, such engagement is not inconsistent with reliance on the Exemption.

More generally, MFA and its members are concerned that the recent enforcement actions suggest the antitrust agencies view frequent contact with management; a request for and receipt of information (consistent with SEC rules) on current and future operations of the issuer, or the strategic direction of the issuer, including commenting or offering suggestions on executive compensation, corporate governance practices, operational execution and business strategies; investor responsiveness to questions raised by management on such topics; identifying and discussing concerns with management or third parties on such topics; and other conduct consistent with investors' fiduciary duties to monitor their investments may be – in isolation, in totality, or in hindsight – inconsistent with the Exemption or evidence of an intention inconsistent with the Exemption, rather than as consistent with the investor's fiduciary duty to its clients and an "investment only" purpose.

MFA is coordinating with the Council of Institutional Investors ("CII") to address the interpretation of the Exemption with senior Staff in the FTC and DOJ. In meetings at the FTC in November 2016, Commissioners Maureen Ohlhausen and Terrell McSweeny were receptive to our engagement with FTC Staff to consider our proposed alternatives to the current interpretation of the Exemption.

In early April 2017, MFA and CII submitted a letter to the Acting Director of the Bureau to propose an alternative to the Bureau's current position, which we believe would better align the Bureau's position with public policies that support shareholder-management communication and engagement. Specifically, we believe, consistent with Acting Chairman Ohlhausen, that reliance on the Exemption be precluded only where the acquirer has engaged in the specific types of conduct identified in the Statement of Basis and Purpose[27] – that is, where the acquiring person is investing in a competitor or is invoking formal corporate governance mechanisms of the issuer (including where the acquiring person is an officer or director of the issuer). Acting Chairman Ohlhausen adopted this position in her statement, with then-Commissioner Joshua Wright, dissenting from the FTC's decision to initiate a "failure-to-file" enforcement action against Third Point.[28] Such a revision to the Bureau's application of the Exemption would be responsive to President Trump's call for

[27] Premerger Notification; Reporting and Waiting Period Requirements, 43 Fed. Reg. 33,450, 33,465 (July 31, 1978) (to be codified at 16 C.F.R. pts. 801–803) ("Statement of Basis and Purpose").

[28] Dissenting Statement at 3; Complaint, United States v. Third Point Offshore Fund, Case No. 1:15-cv-01366 (D.D.C., Aug. 24, 2015); Final Judgement, United States v. Third Point Offshore Fund, Case No. 1:15-cv-01366 (D.D.C., Dec. 18, 2015). In *Third Point* the respondent was enjoined from claiming the Exemption when it engaged in certain acts; Third Point did not pay a civil penalty.

government to "alleviate unnecessary regulatory burdens."[29] We urge the SEC to encourage the FTC to take a more balanced approach to the HSR filing requirements and return to an interpretation that does not undermine investors' interaction with issuers .

I. Stress Test Requirements For Non-Bank Entities

To the extent the SEC determines to move forward with rulemaking under Section 165(i) of the Dodd-Frank Act, which requires the SEC to issue rules requiring certain financial companies to perform an annual stress test, the SEC should provide that a private investment fund and/or its adviser will be deemed to have met any stress test requirement by submitting Form PF.[30] Such an approach would make regulation more efficient, effective, and appropriately tailored.

Section 165(i) of the Dodd-Frank Act requires the SEC, as a primary financial regulatory agency, to issue rules requiring financial companies that are regulated by a primary federal financial regulatory agency and that have more than $10 billion in assets to perform an annual stress test. Neither the statute nor the legislative history provides any clear indication of the purpose of the stress test language in the statute.

We note that private investment funds already perform and report stress tests on Form PF, for example, the scenarios in Question 42 of the Form. In addition, we note that other Form PF Questions, including Questions 32, 46, 49 and 50 provide stress test information relating to liquidity of investments and withdrawals. As such, we believe the stress tests performed and reported on Form PF sufficiently address the requirement in Section 165(i), at least with respect to private investment funds required to complete Form PF.

J. Incentive Compensation Rule

We encourage the Commission to make further amendments to its re-proposed rule implementing Section 956 of the Dodd-Frank Act so that it does not impose restraints on incentive-based compensation arrangements that exceed the intent of Section 956. Section 956 of the Dodd-Frank Act requires the SEC and several banking regulators to jointly issue rules or guidelines that prohibit incentive-based compensation arrangements that encourage inappropriate risk taking by covered financial institutions by providing excessive compensation or that could lead to material financial loss at the covered financial institution. Covered financial institutions include investment advisers with at least $1 billion in assets.[31]

Investment advisers engage in a fundamentally different business than banks, as they invest client money rather than investing proprietary capital and compensation rules designed for banks are not suitable for investment advisers. Further, private fund advisers structure their compensation arrangements and invest in their funds alongside outside investors, which helps align the interests of the adviser and its investors. For many private fund advisers, the owners of the adviser business are

[29] *See* Presidential Executive Order on Enforcing the Regulatory Reform Agenda.

[30] We note that the Financial Choice Act of 2017, H.R. 10, introduced in the House of Representatives in 2017, would remove the statutory requirement for non-bank financial companies to perform stress tests.

[31] We note that the Financial Choice Act would repeal Section 956 of the Dodd-Frank Act.

also principals responsible for many of the day-to-day decisions, unlike banks where the managers of the business and the owners of the business are typically different. Finally, investment advisers do not have a government backstop, unlike banks, meaning the owners of the investment adviser bear the risks if their business fails.

In re-proposing rules in May of 2016 to implement Section 956, we appreciate that the Commission made improvements as compared with the original proposed rule released in 2011. Nonetheless, we believe that the 2016 re-proposal continue to impose restraints on incentive-based compensation arrangements that exceed the intent of Section 956. Accordingly, we encourage the Commission to make further amendments to the re-proposed rule to address the concerns discussed in our comment letter on the re-proposed rule.[32]

K. Maintain SEC Examinations of SEC-Registered Investment Advisers to Private Funds

The SEC has previously indicated that it may consider a program of third-party compliance reviews for investment advisers to supplement, but not replace, examinations conducted by OCIE.[33] We believe a system of third-party compliance reviews for private fund managers would be exceedingly difficult to implement in a workable, cost-effective manner that improves upon the existing system of SEC oversight and examination. Accordingly, we recommend that the SEC maintain examinations of SEC-registered private fund managers.[34]

Private fund managers are diverse businesses, and a manager or its legal counsel may engage a third-party firm to provide a customized compliance service or legal review on a confidential basis according to its specific business or legal needs. These types of reviews may differ substantially across managers, such as in terms of the areas of a manager's business that are assessed, the scope of the review, the methodology used, the frequency of such reviews, and how observations or findings are reported. We believe these differences would present challenges to implementing an efficient, cost-effective system of third-party compliance reviews for private fund managers.

In order to create a system of third-party exams, the SEC would need to establish a set of rules or guidance to ensure that managers are provided with clear information as to the types of reviews that would qualify. Questions to be addressed would include, at a minimum, the types of third-party firms that would be eligible to perform the reviews, the manner in which firms would be chosen, the scope and assessment methodologies of the compliance areas that would be covered, the format for the evaluation or recommendations, potential concerns of liability and conflicts of interest

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[32] *See* Letter from Stuart J. Kaswell, Executive Vice President and Managing Director, General Counsel, MFA and Jiri Krol, Deputy CEO, AIMA, to Brent J. Fields, Secretary, SEC (July 22, 2016), available at: https://www.managedfunds.org/wp-content/uploads/2016/07/MFA-AIMA-Comment-Letter-on-Incentive-Based-Compensation-Rules.pdf.

[33] *See e.g.*, Testimony on "Examining the SEC's Agenda, Operations and FY 2016 Budget Request" by the Hon. Mary Jo White, Chair, SEC, before the United States House of Representatives Committee on Financial Services (Mar. 24, 2015), available at: http://www.sec.gov/news/testimony/2015-ts032415mjw.html.

[34] *See* Letter from Stuart J. Kaswell, Executive Vice President and Managing Director, General Counsel, MFA, to Brent J. Fields, Secretary, SEC (Aug. 11, 2015), available at: https://www.managedfunds.org/wp-content/uploads/2015/08/MFA-Comments-on-SEC-Form-ADV-Proposals1.pdf.

for third-party firms, and issues related to reporting, disclosure and confidentiality, in particular for the treatment of sensitive intellectual property. These types of threshold issues would be difficult to address in a uniform manner, and could create confusion among private fund managers and investors.

Depending on the scope of reviews and other factors, there is a potential for costs of third-party compliance reviews to be substantial. There are a limited number of third-party firms that may possess relevant expertise to review private fund managers, and there are thousands of SEC-registered private fund managers and other advisers that presumably would need to engage these providers. We expect that costs of these services would reflect this imbalance.

We note that the SEC already has adopted a rule requiring an annual compliance review, which incorporates a principles-based approach.[35] This approach could serve as a flexible model for addressing some of the definitional challenges set out above. However, many firms have internal audit functions that already conduct such reviews and requiring a third-party to overlap such functions would add a significant and duplicative cost. Indeed, it may have the unintended effect of encouraging managers to allocate fewer internal resources to compliance to cover the cost of third-party reviews.

We would also encourage the Commission to consider that SEC-registered private fund managers are subject to an additional level of independent oversight through their provision of annual audited financial statements to fund investors in accordance with the custody rule, Rule 206(4)-2 under the Advisers Act. As you know, under the custody rule, private fund managers must maintain client assets with a qualified custodian, and the assets must either be independently verified by examination on an annual basis, or the fund must annually distribute audited financial statements, prepared by a PCAOB-registered independent public accountant and in accordance with generally accepted accounting principles, to investors within 120 days of the end of its fiscal year. These independent audits of private funds further enhance investor protection by providing an external verification of fund assets and financial reporting, which is an important supplement to SEC inspections.

We understand that a reason the SEC may consider such a program is the frequently mentioned statistic that it examines approximately 10% of registered investment advisers each year. Based on our members' experiences and SEC initiatives like presence examinations for newly registered managers, we believe the percentage of private fund managers examined each year may be higher than this amount. Moreover, as a result of OCIE's risk-based approach for selecting which firms to examine, it is likely that the SEC examines more than 10% of private fund managers based on their total RAUM. Even if this were not presently the case, under its risk-based approach, OCIE has the ability to ensure that well over 10% of private fund managers in absolute numbers or RAUM are examined each year without increasing the total number of exams.

In addition, a number of registered investment advisers to private funds are also subject to review by SROs.[36] We would encourage the SEC to consider these factors as well as the different

[35] Rule 206(4)-7 under the Advisers Act.

[36] Registered commodity pool operators are also subject to review by the National Futures Association, and registered broker-dealers are also subject to review by FINRA.

business models and related risks between private fund managers and advisers to retail clients in its consideration of third-party compliance reviews.

L. Withdraw the Proposal for Notional-Based Leverage Limits to Regulate the Use of Derivatives by Registered Funds

MFA and AIMA filed a joint comment letter with the SEC on March 28, 2016 to express their strong disagreement with the proposed rule's alternative notional-based leverage limits, among other concerns. We believe such an overall leverage limit is both unnecessary and inappropriate because it lacks sufficient justification, given the practical effect of the SEC's proposed asset segregation requirements and the potential reinforcing effect of the Commission's other related regulations after their adoption. We note additionally that the notional-based limits are too insensitive to risk to be effective tools for gauging a permissible level of risk and leverage. Basing portfolio exposure limits on the aggregate notional amounts of derivatives transactions is too blunt a measure, and will force many mutual funds and other registered investment companies that do not, in fact, have a material amount of risk due to leverage to substantially alter their strategies or de-register without good reason. This outcome will have the potential unintended effects of limiting investor choice and undermining investor protection by depriving investors of opportunities to invest in alternative mutual fund strategies and their potential benefits.

M. Withdraw the Proposed Rule on Business Continuity and Transition Plans for Investment Advisers

While we appreciate the goals underlying the SEC's proposed rule on business continuity and transition plans,[37] we recommend that the SEC withdraw the proposal because a new rule is not necessary since existing SEC guidance has already caused most investment advisers to implement business continuity plans ("BCPs") pursuant to Rule 206(4)-7 under the Advisers Act.[38] The SEC should instead continue its practice of issuing timely, useful guidance to investment advisers as needed in response to changing market conditions and events, rather than adopt a rule that we believe could be overly prescriptive. Guidance should not mandate specific components of the plans, and should instead require that policies and procedures for the plans be reasonably designed to address operational risks related to a significant disruption in the adviser's operations.

Alternatively, if the SEC adopts the proposed rule, it should be modified to provide investment advisers with greater flexibility to tailor BCPs to their unique businesses by tailoring those components that are applicable to their businesses (such components would better serve the industry and its clients in the form of guidance). In addition, the proposed rule should be modified to include a safe harbor provision limiting a firm's liability where a BCP is reasonable and developed in good faith (including in situations where such a BCP does not prevent harm from a continuity event).

Firms Already Have Business Continuity Plans in Place Making a New Rule Unnecessary

[37] SEC Release No. IA-4439 (June 28, 2016).

[38] Letter from Stuart J. Kaswell, Executive Vice President and Managing Director, General Counsel, MFA and Jiri Krol, Deputy CEO, Global Head of Government Affairs, AIMA to Brent J. Fields, Secretary, SEC (Sept. 6, 2016), available at: https://www.managedfunds.org/wp-content/uploads/2016/09/MFA-AIMA-Comments-on-SEC-Business-Continuity-and-Transition-Plan-Proposed-Rule.pdf.

The SEC has appropriately addressed the importance of establishing BCPs in connection with the adoption of Rule 206(4)-7 and through subsequent guidance. In the adopting release of Rule 206(4)-7, the SEC discussed the need for advisers to establish a reasonable process for responding to emergencies, contingencies, and disasters, and that an adviser's contingency planning process should be appropriately scaled, and reasonable in light of the facts and circumstances surrounding the adviser's business operations and the commitments it has made to its clients.[39]

It is instructive that in adopting Rule 206(4)-7, the SEC wisely made a determination that "funds and advisers are too varied in their operations for the rule to impose a single set of universally applicable required elements." The proposed rule's focus on mandatory requirements breaks with this understanding. As a result, the proposed rule is both too generic to provide direction to investment advisers in implementing an effective plan from both practical and anti-fraud perspectives, and too specific as to certain elements that would not apply to a broad range of investment advisers.

Moreover, the proposed rule's mandatory requirements would reverse not only the SEC's prior position on BCPs, but also its long-standing approach of permitting investment advisers to tailor policies that are unique to their businesses. The industry has become even more diverse since Rule 206(4)-7 was adopted, and we believe that the Commission's current approach to BCPs has worked well.

The proposed rule also may not be consistent with the intent of Congress when it provided authority to the SEC to adopt rules under Section 206(4). The SEC typically exercises its authority under Section 206(4) in the promulgation of rules that prohibit intentional misconduct. We do not believe the authority given in Section 206(4) to allow the SEC to restrict fraudulent, deceptive, and manipulative practices should be used to convert every operational or business practice of a registered investment adviser into a potential fraud if the SEC subsequently deems those practices insufficient. Even applying a more permissive "negligence" standard under Section 206(4), the proposed rule as drafted would expand the commonly understood definition of "negligence-based fraud." In effect, we are concerned that the prescriptive nature of the proposed rule could lead to instances where an adviser's failure to anticipate or fully prevent unpredictable events could be viewed according to a standard that approaches strict liability.

A Transition Plan Rule for Hedge Funds is Unnecessary for Investor Protection

Similar to BCPs, investment advisers have implemented transition plans that have effectively met the needs of clients. As a result of SEC rules and contractual arrangements with investors, advisers structure funds in a manner that strikes the proper balance between giving investors the flexibility to move assets to another manager and protecting remaining investor assets in a fund. The SEC acknowledges that "advisers routinely transition client accounts without a significant impact to themselves, their clients, or the financial markets," due to the agency relationship of advisers managing client assets, and the Advisers Act requirement that client assets must be held at a qualified custodian, such as a bank or broker-dealer. Each year, many hedge funds close for any number of reasons such as extended poor performance, the retirement or departure of senior personnel, or a changed market environment. The fund's portfolio is wound down by the manager, sometimes

[39] SEC Release No. IA-2204 (Dec. 17, 2003).

gradually over many months and, less frequently, in a "liquidation" by the prime brokers or other market participants that hold the fund's collateral.

Existing Regulations Already Address Systemic Risk, Making a Transition Plan Unnecessary and Unsuitable for Hedge Funds

We also do not believe that the winding down of a hedge fund raises systemic risk concerns. Previously, in response to a notice by the FSOC seeking comment on asset management products and activities, MFA has set out in detail the characteristics of the hedge fund industry and its regulatory regime that make the industry and its individual members improbable sources of systemic instability in the U.S. financial system.[40] As a result of these characteristics, hedge funds regularly wind down their operations, and these hedge fund closures have not historically had systemic impact. Hedge funds close and liquidate quite frequently with no impact on the stability of the U.S. financial system.[41] During the financial crisis, many hedge funds liquidated, but neither created nor amplified systemic risk and did not require government intervention.

N. Amend Proposed Rule 18-4(d)(2) to Clarify the Application of Required Subordination of Segregated Customer Margin for Uncleared Security-Based Swaps

MFA requests an amendment to proposed segregation Rule 18a-4(d)(2) to make clear that in the event a counterparty elects to segregate IM with an independent third-party custodian, required subordination applies only to segregated IM that is kept out of the SBSD's bankruptcy estate.

Proposed segregation Rule 18a-4(d)(2) provides that an SBSD counterparty that has elected to segregate SBS IM with a third-party custodian must agree to subordinate its claims to those of SBSD customers, but only to the extent that IM provided to the custodian is not treated as customer property in a liquidation of the SBSD.

The intention is presumably to prevent a double count: if margin held by third party is excluded from the SBSD's bankruptcy estate, the counterparty should not share in the fund of customer property within the estate. Nevertheless, the SEC appears to disregard variation margin ("VM"): "If the arrangement is effective, the counterparties should not have any customer claims to cash, securities, or money market instruments used to margin their non-cleared security-based swap

[40] *See* Letter from Stuart J. Kaswell, Executive Vice President and Managing Director, General Counsel, MFA, to Patrick Pinschmidt, Deputy Assistant Secretary for FSOC (Mar. 25, 2015), available at: https://www.managedfunds.org/wp-content/uploads/2015/03/MFA_Response_to_Dec_2014_FSOC_Notice1.pdf.

[41] One study sought to distinguish hedge fund "failures" from normal attrition and discovered that the number of "failures" is quite low. *See* Ging Lian & Hyuna Park, Predicting Hedge Fund Failure: A Comparison of Risk Measures, 45 J. FIN. & QUANTITATIVE ANALYSIS 199 (2010) (finding a 3.1% closure rate versus an 8.7% attrition rate for hedge funds on an annual basis from 1995 to 2004, differentiating the conventional measure of hedge fund closures used in prior academic studies – or "attrition" – from "real failure", defined as a fund (i) with a negative average rate of return for 6 months, (ii) with decreased AUM for 12 months and (iii) that was listed in a database (such as Lipper TASS or HFR) but is no longer reporting). In 2014, 764 hedge funds launched and 260 hedge funds liquidated. *See* 2015 Preqin Global Hedge Fund Report.

transactions in a liquidation of the SBSD, as their property will be held by the independent third party custodian."[42]

The proposed rule would likely apply under the Bankruptcy Code; however, it is unclear how it would apply in a SIPA proceeding for an SBSD that is also a SIPC member broker-dealer, as it is not clear that any SBSD counterparties would be treated as customers.

One possible (and problematic) reading of proposed rule 18a-4(d)(2) is that it provides for the subordination of all of an SBSD counterparty's claims if any collateral is held by an independent third-party custodian, with no exclusion for VM held at the SBSD.[43] If this interpretation were followed it would have a punitive effect on counterparties that elect to segregate SBS IM with an independent third-party custodian, specifically both IM and VM would be subordinated if IM is segregated with a third-party independent custodian.

Assume a counterparty posts $20 of SBS IM held at a third party and $100 of SBS VM held by the SBSD. If proposed rule 18a-4(d)(2) is interpreted to provide for the subordination of all claims (*i.e.*, for the full $120), then:

- Assuming the IM is kept outside of the SBSD's bankruptcy estate, the counterparty's $100 of VM would go to other SBSD customers and the counterparty would be subordinated.
- If the IM is included in the SBSD's bankruptcy estate, the counterparty would have a $120 claim and would share that $120 *pro rata* as part of the fund of customer property.[44]

To avoid this problematic interpretation, MFA members and staff held a call with SEC Staff on December 3, 2015 to discuss the scope of the subordination agreement in proposed segregation rule 18a-4(d)(2)(i) for customers who elect tri-party segregation of their IM at an independent third-party custodian. SEC Staff clarified that VM is not intended to be subordinated; only IM held at the third-party custodian is intended to be subordinated. SEC Staff seemed receptive to reviewing our proposed language changes below to clarify the intended scope, which we sent by e-mail to SEC Staff on December 15, 2015:

> "A security-based swap dealer must obtain an agreement from a counterparty that chooses to require segregation of funds or other property pursuant to Section 3E(f) of the Act (15 U.S.C. 78c-5(f)) in which the counterparty agrees to subordinate ~~all of~~ its claims against the security-based swap dealer to the claims of security-based swap customers of the security-based swap dealer, with such subordination to be limited to the amount of the ~~but only to the extent that~~ funds or other property provided by the counterparty to the independent third-party custodian that are not treated as *customer property* as that term is defined in 11 U.S.C. 741 in a liquidation of the security-based swap dealer."

[42] SEC Release No. 34-68071 (Oct. 18, 2012).

[43] Another potential problematic reading of the proposed rule is if a counterparty's segregated IM is treated as customer property, VM would continue to be subordinated, as the subordination agreement is lifted *only to the extent of the segregated IM* brought in as customer property.

[44] Another potential outcome could be that the counterparty's $20 is included in the estate and that the counterparty's $100 is subordinated.

MFA reiterates its request to include such clarifying language in the final rulemaking.

O. Equity Market Structure Reforms

MFA and its members have a strong interest in SEC and SRO changes to equity market structure, and have been active over the years in providing an investor perspective to the discussion.[45] The U.S. market regulations have supported the evolution of equity markets by reducing anticompetitive barriers and promoting fair access to markets and market information. The regulatory framework has fostered innovations in technology that have revolutionized investing in our equity markets and promoted greater competition among marketplaces, all to the benefit of retail and institutional investors. Nevertheless, as markets and investment firms that serve investors have evolved, we believe the Commission should review certain market regulations. Regulators should take additional measures towards: (1) enhancing the resilience of critical infrastructure and the robustness of the market framework; (2) ensuring that any changes to market structure will ultimately benefit investors; and (3) increasing transparency to investors through greater order handling disclosures.

With respect to the resilience of critical infrastructure and the robustness of the market framework, we have recommended that regulators:

- Improve the reliability and oversight of consolidated market data and ensure that robust policies and controls are in place to protect the data collected through the consolidated audit trail from cyber terrorism and other risks;
- Develop contingency plans and interim processes to address unexpected trading halts and other events; and
- Reexamine at least every two years the parameters used to set circuit breakers and price collars for addressing market volatility, and amending such parameters as appropriate.[46]

In response to calls for market structure reform, the SEC has considered and worked with SROs to implement pilot programs.[47] There has been a lot of industry discussion with respect to possible changes to the Order Protection Rule, access fees, and/or a trade-at rule. The views of market participants range across the spectrum on these important issues. We share Commissioner Piwowar's sentiment that "the SEC rulemaking process would be more appropriate for . . . an

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[45] *See, e.g.*, Letter from Stuart J. Kaswell, Executive Vice President and Managing Director, General Counsel, MFA, to the Hon. Mary Jo White, Chair, SEC, on Equity Market Structure Policy Recommendations (Sept. 28, 2015), available at: https://www.managedfunds.org/wp-content/uploads/2015/09/Equity-Market-Structure-Recommendations-with-Cover-Letter.pdf. MFA was pleased to see that regulators had addressed many of its 2014 recommendations on equity market structure and continued to urge for further reforms.

[46] *See id.* (providing more details on MFA's policy recommendations).

[47] The most recent pilot program has been the Tick Size Pilot Program, to which MFA unsuccessfully urged regulators to also incorporate smaller tick sizes for highly liquid securities. We were concerned that large tick sizes could be harmful to investors. *See* Letter from Stuart J. Kaswell, Executive Vice President and Managing Director, General Counsel, MFA, to Brent J. Fields, Secretary, SEC (Dec. 22, 2014), available at: https://www.managedfunds.org/wp-content/uploads/2014/12/MFA-SEC-Tick-Pilot.final_.12.22.14.pdf. *See also*, SEC Release No. 34-74892 (May 6, 2015), available at: https://www.sec.gov/rules/sro/nms/2015/34-74892.pdf.

important undertaking as the access fee pilot" versus an NMS plan, and respectfully urge the Commission to provide public notice and comment on significant market structure proposals.[48] We look forward to providing the Commission with detailed comments on these important issues. As the SEC considers NMS Plan proposals, pilot programs and other market structure reforms, we urge the SEC to ensure that such reforms serve the needs of investors.

With respect to increasing disclosure and transparency to investors, we strongly supported the SEC's 2016 proposal to enhance order handling disclosure to investors as it would help their ability to evaluate execution quality.[49] We also supported the SEC's proposal on the "Regulation of NMS Stock Alternative Trading Systems" as it would assist investors in their understanding of how alternative trading systems ("ATSs") operate and address potential conflicts of interest.[50] In this respect, we continue to urge the SEC to extend the proposed Regulation ATS framework to include ATSs that trade fixed income securities, including government securities.[51] We believe the Commission's Regulation ATS Proposal is the most suitable vehicle for regulators to make progress on enhancing public reporting on U.S. Treasury market venue policies and services.

P. Update Rule 105 of Regulation M under the Exchange Act

We believe the Commission should consider further amendments to Rule 105 that would better accomplish the policy goals underlying the Rule, in light of changes in the market for secondary and follow-on offering that have occurred since 2007, in particular, the prevalence of overnight shelf offerings. We believe the Commission should amend the Rule to provide investors a meaningful opportunity to use the bona fide purchaser exemption and to minimize unintended violations of the Rule for investors making a good faith effort to comply with the Rule.

Rule 105 of Regulation M under the Exchange Act prohibits short selling in connection with an issuer's follow-on or secondary offering. MFA and its members strongly support the underlying policy goal of Rule 105, preventing manipulative short selling that artificially depresses the market price of an issuer's securities in connection with an issuer's follow-on or secondary offering. Yet, while we understand the SEC's reasons for its 2007 amendments to Rule 105, the amendments have had unintended consequences for issuers and investors as a result of various market changes, including: (1) in how issuers conduct secondary and follow-on offerings; (2) a more complex trading environment; (3) complex multi-fund structures; and (4) the inability of prime brokers to aggregate equity positions across multi-fund complexes on a real-time basis.

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[48] New Special Study of the Securities Markets: Keynote Address, Acting Chairman Michael S. Piwowar, March 23, 2017, available at: https://www.sec.gov/news/speech/piwowar-keynote-columbia-university-032317.

[49] *See* Letter from Stuart J. Kaswell, Executive Vice President and Managing Director, General Counsel, MFA, to Brent J. Fields, Secretary, SEC (Sept. 23, 2016), available at: https://www.managedfunds.org/wp-content/uploads/2016/09/MFA-Letter-re-SEC-Order-Handling.pdf.

[50] Proposed Rule on Regulation of NMS Stock Alternative Trading Systems, 80 Fed. Reg. 80,998 (Dec. 28, 2015), (hereinafter "Regulation ATS Proposal") available at: https://www.gpo.gov/fdsys/pkg/FR-2015-12-28/pdf/2015-29890.pdf.

[51] *See* Letter from Stuart J. Kaswell, Executive Vice President and Managing Director, General Counsel, MFA, to Brent J. Fields, Secretary, SEC (Feb. 26, 2016), available at: https://www.managedfunds.org/wp-content/uploads/2016/02/MFA-AIMA-SEC-Reg-ATS-ltr.2.26.16.final_.pdf.

Overnight Offerings

In an overnight shelf offering without prior public notice, the abuse to which the Rule is directed is not possible. If investors do not know about the offering during market hours, they cannot artificially depress the market price of the issuer's securities through short sales. However, in such an overnight offering, investors also have no opportunity to rely on the bona fide purchaser exception by covering any short position entered into within the restricted period covered by the Rule. Accordingly, the bona fide purchase exception in the Rule often is not practically available for investors who would otherwise purchase an issuer's securities in a secondary or follow-on offering, but who have previously entered into a short position with respect to the securities to be issued in the secondary or follow-on offering. As a result, in overnight offerings, the Rule does not affect pre-offering short sales at all but simply reduces the number of investors who are able to buy securities in the offering, to the detriment of issuers trying to raise capital. In its 2007 release adopting amendments to Rule 105, the SEC stated, "The bona fide purchase provision will likely contribute to capital formation by helping to ensure that the universe of potential offering investors is not unduly limited." Because the increase in issuers' use of overnight shelf offerings significantly reduces the ability of investors to use the bona fide purchase exception, the Rule no longer effectively accomplishes its policy objective.

Institutional investors are key participants in secondary and follow-on offerings. These investors often manage large portfolios and use multiple trading strategies and therefore are at greater risk to be limited in their ability to participate in those offerings because of unrelated short positions in their portfolio.

A prime example of an institutional investor being effectively precluded from participating in secondary and follow-on offerings would be an institutional investor employing convertible-arbitrage strategies. Investors using convertible-bond arbitrage strategies employ short sales to achieve a market-neutral position in order to capture what the manager believes is a mispricing in the price of the equity relative to the convertible bond. Such strategies are not only potentially valuable to investors, but advance the price discovery function of the markets.

The Rule, particularly in the context of overnight shelf offerings, effectively forecloses such an investor from also acting as a provider of liquidity to companies seeking financing through secondary and follow-on offerings. An investor employing a convertible-bond arbitrage strategy may be largely unable to provide financing for such offerings as part of a separate investment strategy, even if it wanted to cover an existing short position in order to participate in a secondary or follow-on offering. We believe investors engaged in other types of investment strategies that require short sales, particularly investors with strategies that require dynamic and regular short sales, would face similar limitations, thereby reducing the number of institutional investors who can participate in a secondary or follow-on offering.

Reducing Unintentional Violations of the Rule

Another consequence of the increased use of overnight shelf offerings is that investors who regularly engage in short sales as part of an arbitrage or other investment strategy have little notice of the secondary or follow-on offering to ensure that they do not inadvertently violate Rule 105 by participating in such an offering. In the context of monitoring compliance with Rule 105, the lack of advance notice of a secondary or follow-on offering and the short period of time from when offerings are announced to when they are completed (often in 24 hours or less) creates a significant compliance challenge for investors, particularly institutional investors that have to monitor large, complex portfolios that include multiple trading strategies. This problem is compounded by the fact that participation in a secondary or follow-on offering almost always occurs over the phone, rather than through automated trading systems, so it is not possible to introduce an automated compliance check at the time the trade is executed.

We believe it is not in the interests of the SEC, investors, or issuers to have a Rule that results in a significant number of unintentional violations by market participants who are using best efforts to try to comply with the Rule. This is particularly true given that an unintentional violation of the Rule cannot, by definition, involve the abusive conduct that the Rule was designed to prevent – short sales in anticipation of the offering.

We encourage the Commission to consider ways it could amend the Rule to ensure that investors have the practical ability to participate in overnight offerings and sufficient access to information about pending secondary offerings to develop compliance programs that are better able to prevent unintentional violations of the Rule. Potential amendments could include: (1) requiring knowledge of the offering by the investor at the time of the short sale in order for the investor to violate Rule 105; (2) changing the beginning of the restricted period to when the issuer provides public notice of the secondary or follow-on offering; or (3) creating a rebuttable presumption that an investor following reasonably designed procedures to prevent violations of Rule 105 has complied with the Rule and will not face enforcement actions, absent further facts and circumstances.

Q. Modernize the Advisers Act Advertising Rules

The SEC should rethink the restrictions on adviser advertisements and consider providing private fund advisers with greater flexibility in the type of information that they can provide to existing or potential investors in advertising materials.

In light of the JOBS Act and the related new Rule 506(c) of Regulation D, which permit general advertising and general solicitation in connection with a private offering, MFA believes that it is also important for the SEC to reconsider the advertising limitations created by the Advisers Act, and rules promulgated thereunder.[52] Although the SEC and its Staff have provided guidance on various advertising limitations in Section 206 and Rule 206(4)-1 of the Advisers Act,[53] uncertainty remains as to the scope and application of these limitations to private fund advisers. MFA's understanding is that the original intent of these restrictions was to address investor protection

[52] Section 206(4) of the Advisers Act generally prohibits any registered or exempt investment adviser from engaging in any act, practice or course of business, which is fraudulent, deceptive or manipulative. Rule 206(4)-1 of the Advisers Act further defines and limits such activities including, among other things, the publication, circulation or distribution of advertising materials that refer to any testimonial or past specific recommendations of such adviser and placing restrictions on the presentation of performance data in such advertising materials.

[53] *See e.g.*, Munder Capital Mgmt., SEC No-Action Letter (Aug. 28, 1997), which clarifies that investment adviser communications are advertisements if they are designed to maintain existing clients or solicit new clients; Franklin Mgmt., Inc., SEC No-Action Letter (Dec. 10, 1998), which provides guidance related to the use of past specific recommendations in advertisements; Clover Capital Mgmt., Inc., SEC No-Action Letter (Oct. 28, 1986), which provides specific guidance for advisers to follow related to advertisements that contain performance information.

concerns related to adviser advertisements provided to *retail* investors. In contrast, these investor protections concerns are reduced in the context of private fund advisers as these advisers provide their advertisements solely to *sophisticated* investors.[54]

By permitting general advertising and general solicitation in the JOBS Act, Congress expressed an intention to permit greater visibility of and transparency into entities, including private funds, which offer securities pursuant to Rule 506. It seems inconsistent to allow private funds to advertise broadly to the public, while continuing to limit the information that private fund advisers can provide to their sophisticated investors.

Moreover, MFA notes that prospective investors desire to have, and frequently request, the types of information limited by these advertising restrictions and discussed in the SEC Staff's guidance, even though, consistent with Staff guidance, private fund advisers provide such information only upon an unsolicited request from a potential investor.[55] Investors find such information important to ensure that they have a complete and robust view of any private fund adviser with which they have or expect to invest. Therefore, MFA believes it is consistent with Congressional intent and the protection of private fund investors to have greater disclosure of testimonials, past recommendations and performance data of registered or exempt private fund advisers; provided that, such information remains subject to the antifraud provisions otherwise applicable under the federal laws. As a result, MFA requests that the SEC rethink these restrictions on adviser advertisements and consider providing private fund advisers with greater flexibility in the type of information that they can provide to existing or potential investors in advertising materials.

R. Update Rule 102 of Regulation M under the Exchange Act for Consistency With Rule 506(c) of Regulation D

In addition to the SEC's proposed amendments on Regulation D described above, managers have also been reluctant to raise capital under Rule 506(c) due to concerns regarding the SEC Staff's potential interpretation of Rule 102 of Regulation M under the Exchange Act. We believe that it would be consistent with the policy basis underlying Rule 102 for the Staff to provide relief to private fund managers that seek to conduct private offerings pursuant to Rule 506(c).

Rule 102 of Regulation M governs the activities of an issuer or selling security holder during a public or private "distribution" of securities effected on its behalf, as well as the activities of certain parties deemed to be "affiliated purchasers" of the issuer or selling security holder. In general, Rule 102 prohibits persons subject to the rule from bidding for, purchasing, or attempting to induce any other person to bid for or purchase, the security that is the subject of the distribution, or any reference security, during a specified "restricted period."

Rule 506(c) provides a means for an issuer to conduct a private placement without the prohibition of the use of general solicitation or general advertising. However, there is a concern that

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[54] Reducing the restrictions on private fund advisers' advertisements to sophisticated investors would mirror the scope of Section 201(a)(1) of the JOBS Act, which instructed the SEC to eliminate the prohibition against general solicitation or general advertising for offers and sales made pursuant to new Rule 506(c) under Regulation D, provided that all purchasers are accredited investors.

[55] *See* Investment Counsel Association of America, Inc., SEC No-Action Letter (Mar. 1, 2004).

the SEC Staff could view such permitted "general solicitation" efforts as an indication that, in certain circumstances, a private fund could be engaged in a Regulation M "distribution,"[56] which would effectively negate the opportunity for private funds to conduct offerings under Rule 506(c).

If the offering of shares in a fund (which is generally ongoing and continuous in nature) constitutes a Regulation M "distribution," the fund would be subject to Rule 102. In such a case, neither the fund nor any of its affiliated purchasers could bid for or purchase the fund shares (including engaging in redemptions of fund shares), unless an exception was available.[57] Such a result is unworkable for private funds because funds regularly provide liquidity to their investors by offering them periodic redemption of shares, and the SEC views such redemptions as a "purchase" of the security by the issuer.

Because the SEC construes an issuer's redemption of its securities as a purchase (or repurchase) of the issuer's securities, Rule 102 contains exceptions that allow certain types of funds to effect redemptions during a continuing distribution of the fund's shares. In particular, exceptions to the general restriction apply to open-end registered investment companies (Rule 102(d)(4)), and to commodity pools and limited partnerships (Rule 102(b)(3)).[58] Under the latter exception, a hedge fund deemed to be engaged in a Regulation M distribution of fund shares that is a commodity pool or a limited partnership, together with compliance with the other conditions, would be able to rely on Rule 102(b)(3) and conduct periodic redemptions of fund shares.

Hedge funds that are not commodity pools or limited partnerships, however, do not appear to explicitly fall within the exception in Rule 102(b)(3). The policy basis underlying Rule 102(b)(3) is as applicable to commodity pools and limited partnerships as to funds organized through other corporate forms. Indeed, the rationale behind the exception in Rule 102(b)(3) that the SEC expressed in the adopting release for Regulation M was that "this exception is being adopted in response to commenter concerns, and permits commodity pools and limited partnerships to effect redemptions of their securities without seeking exemptive relief under Regulation M. Redemptions of such securities pursuant to their governing instruments at a price based on net asset value are unlikely to raise manipulative concerns."[59]

We recommend that the SEC provide relief from Rule 102 to hedge funds so that they may conduct offerings under Rule 506(c). For example, the SEC could ensure that the exception in Rule 102(b)(3) applies to other types of funds that engage in periodic investor redemptions. Alternatively, the SEC could grant relief that would ensure that funds engaged in an offering under Rule 506(c)

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[56] Rule 100 defines a distribution as an offering of securities, whether or not subject to registration under the Securities Act, "that is distinguished from ordinary trading transactions by the magnitude of the offering and the presence of special selling efforts and selling methods".

[57] Similarly, in light of its affiliation and role as investment adviser to the fund, it appears that the fund's adviser would also be subject to Rule 102 of Regulation M – *i.e.*, as an "affiliated purchaser" of the fund.

[58] Rule 102(b)(3) permits "[r]edemptions by commodity pools or limited partnerships, at a price based on net asset value, which are effected in accordance with the terms and conditions of the instruments governing the securities", provided that "such securities are not traded on a securities exchange, or through an inter-dealer quotation system or electronic communications network."

[59] SEC Release No. 34-38067 (Dec. 20, 1996).

could offer a redemption right provided it redeems any shares at net asset value and that no secondary market for the shares exists or is expected to develop.

S. Adopt an Amendment to the SEC Rules of Practice Requiring the Automatic Withdrawal of Long-Delayed Rule Proposals

We recommend that the SEC adopt an amendment to its Rules of Practice that would provide by operation of law that any proposed rule that the SEC has not adopted within a certain time period, such as three years, after publication in the Federal Register is automatically withdrawn. We believe such a Rule of Practice would enhance the effectiveness of the SEC's rulemaking process, ensure that final rules respond to current market conditions and are based on timely information, and avoid unintended impacts on market participants.

As you know, the SEC's rulemaking process can involve different lengths of time between the publication of a proposed rule and the final adoption of the rule. Reasons for a delay in the adoption of a final rule can include, for example, intervening market events, extensive comments from market participants regarding the potential impact of the rule, differing views among Commissioners, and shifts in the SEC's priorities. On occasion, a pending proposed rule may not be finalized or withdrawn for many years, if at all.[60]

We submit that long-delayed proposed rules are inconsistent with an effective and efficient rulemaking process. In order to achieve their intended objective, regulations must be adopted in response to current market conditions and practices, and based on accurate, timely information. As markets change and develop over time, the cost and benefit of a rule will similarly change. A rule proposal that has become outdated, therefore, suffers from a stale assessment of the market and its potential impact on firms and investors. In these circumstances, the SEC often would need to withdraw a long-delayed proposed rule or re-open it for additional comment.

A long-delayed rule proposal can be harmful not just to the integrity of the rulemaking process, but also can be harmful to market participants in the manner it affects their behavior. For example, often a proposed rule will provide insight into the SEC's stance on a particular issue, including how the Staff may approach the issue during an examination. As a result, firms often adjust their activities based on a rule proposal even though they are not required to do so, which may include refraining from engaging in a particular activity subject to a rule proposal.

For example, as noted above, in 2013 the SEC adopted amendments to Regulation D to repeal the ban on general solicitation in certain private placements. At the same time, however, the SEC proposed additional amendments to Regulation D, Form D and Rule 156, which have not been adopted. Since the amendments were proposed, very few private fund managers have conducted a private offering under new Rule 506(c) of Regulation D. In declining to utilize new Rule 506(c), private fund managers have strongly considered that the proposed amendments would impose significant burdens on a manager that uses Rule 506(c), and the SEC is likely to take an unfavorable view toward these types of offerings. In effect, the pending amendments have served to nullify a new method for managers to raise capital, as mandated by Congress.

[60] Between 2008 to 2014, it appears that the SEC has proposed and not yet adopted over 20 rules, based on a review of the information available at: https://www.sec.gov/rules/rulemaking-index.shtml.

As a second example, in 2010, the SEC proposed Rule 9j-1, an antifraud rule with respect to security-based swaps, which has not been adopted.[61] We submitted several letters[62] and engaged the SEC Staff, raising strong concerns that as drafted proposed Rule 9j-1 would interfere with legitimate market activity, diminish the economic benefits of the swaps markets, and harm these markets. We also raised concerns that the Commission exceeded its authority under Section 763(g) of the Dodd-Frank Act, as well as its delegated authority under the Exchange Act and the Securities Act. Proposed Rule 9j-1 continues to raise consternation for market participants as it would harm their ability to take legitimate steps to fulfill their contractual obligations or protect themselves, such as with respect to credit events, corporate actions, disruption events, and counterparty defaults or termination events.

We believe an effective, practical solution to these long-delayed rule proposals is for the SEC to amend its Rules of Practice so that by operation of law, it automatically withdraws any proposed rule that it has not adopted within a certain time period, such as three years, after publication in the Federal Register. Under such a rule, the SEC could later determine to proceed with the rule proposal after it has been withdrawn through a formal re-proposal of the rule.

T. Adopt Proposed Rule Permitting Additional Investments by Investment Companies and Private Funds in ETFs

In March 2008, the SEC proposed a rule under the Investment Company Act, Rule 12d1-4, that would permit investment companies to invest in exchange-traded funds ("ETFs") in excess of the limits of Section 12(d)(1) of the Investment Company Act, subject to certain conditions.[63] We believe extending the exemption afforded by the proposed rule to private funds is consistent with the public interest and the protection of investors, and encourage the SEC to re-propose the rule and proceed with such rulemaking.[64]

The proposed rule would provide funds with an exemption from the prohibition in Section 12(d)(1) on investment companies acquiring more than 3% of the shares of an ETF, subject to certain conditions that are designed to prevent the types of abuses that were in the past associated with fund of funds arrangements.

As proposed, Rule 12d1-4 would apply to registered investment companies but not private funds. In the proposing release, however, the SEC did not provide a policy basis for excluding

[61] *See* SEC Release No. 34-63236 (Nov. 3, 2010), available at: https://www.gpo.gov/fdsys/pkg/FR-2010-11-08/pdf/2010-28136.pdf.

[62] *See* Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, to Elizabeth M. Murphy, Secretary, SEC (Dec. 23, 2010), available at: https://www.managedfunds.org/downloads/MFA%20Final%20Comment%20Letter%20on%20SEC%20Proposed%20Rule%209j-1.pdf; *and* Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, to Elizabeth M. Murphy, Secretary, SEC (Mar. 29, 2011), available at: http://www.managedfunds.org/wp-content/uploads/2011/06/3.29.11-MFA-SEC-Antifraud-Ltr.final_.3.29.2011.pdf.

[63] SEC Release No. IC-28193 (Mar. 11, 2008).

[64] *See* Letter from Richard H. Baker, President and CEO, MFA, to Nancy M. Morris, Secretary, SEC (May 20, 2008), available at: http://www.managedfunds.org/downloads/MFA%20ETF%20comments%205%2020%2008.pdf.

private funds from the rule. We believe that private funds should be treated like other investment companies under the proposed rule and permitted to invest in ETFs without regard to the 3% limit, subject to the conditions of the proposed rule.[65]

Like other institutional investors, including other types of investment companies, private funds may use ETFs as part of their overall investment strategy, as well as to "equitize" cash balances to earn returns in excess of money market rates. In addition, private funds use ETFs for hedging and risk management purposes. For example, investment advisers with short positions in a specific industry or sector may seek to hedge their exposure through the acquisition of a long position in an industry or sector-specific ETF (and vice versa for advisers with significant long positions in individual names). We believe that removing obstacles to the use of ETFs by private funds would facilitate these types of activities and benefit fund investors.

Furthermore, the conditions of the proposed rule adequately address the abuses and concerns that led Congress to enact Section 12(d)(1), and the conditions will be equally effective when applied to private funds as to other investment companies. These abuses included undue influence and control by an acquiring fund, excessive fees when one fund invested in another, and the formation of overly complex structures that could be confusing to investors.[66]

First, the conditions of the proposed rule are adequate to prevent a private fund from unduly influencing or controlling an ETF in which it invests in reliance on the proposed rule. The proposed rule exempts an investment company from the investment limits of Section 12(d)(1) only if it does not "control" the ETF. The proposing release states that even if an acquiring fund has beneficial ownership of less than 25% of the ETF's outstanding voting securities, if it exercises a controlling influence over the ETF, it would not be able to rely on the exemption. The proposed rule also would preclude an acquiring fund from redeeming from the ETF shares it acquired above the 3% limit. This condition, when applied to a private fund (like any other investment company), would prevent it from being able to threaten large-scale redemptions as a means of coercing an ETF or exercising undue influence.[67]

Second, in the proposed rule, the Commission has determined that the concern of layering of fees should not prevent other investment companies from investing in ETFs in excess of the limitations set out in Section 12(d)(1), subject to the conditions. The layering of fees should not be viewed as a greater concern for investors in private funds than for the shareholders of the other types of investment companies covered by the proposed rule.

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[65] For example, private funds, for purposes of Rule 12d1-1, are treated identically to other investment companies and have been able to invest in shares of registered money market funds in excess of the limits of Section 12(d)(1).

[66] *See Hearings Before House Subcomm. of the Comm. on Interstate and Foreign Commerce on H.R. 10065*, 76th Cong., 3d Sess. at 112 (1940).

[67] We note, however, the proposed rule presents administrative challenges with respect to the tracking of ETF shares. We are concerned that the difficulty of implementing a tracking method to abide by the proposed rule may negate any practical benefits of the proposed rule. We suggest that the Commission consider volume and time limitations on redemption (for example, no more than 1% per month during any month in which the fund is over the 3% limit), rather than rendering particular shares ineligible for redemption.

Third, we do not believe that the risk of an overly complex structure is any greater for a private fund investing in an ETF than for any other type of investment company that may rely on the proposed rule. Indeed, we believe that the risk of an investor in a private fund, which are sophisticated individuals and institutions, being confused by an investment in ETFs is likely to be less than for a shareholder of other types of investment companies.

U. Maintain Objective Standards in the Definition of Accredited Investor

The definition of accredited investor is an important standard for investors in private funds, and we commend the SEC for its recent review of potential methods to update and enhance the standard in the SEC Staff Report on the Review of the Definition of Accredited Investor. We encourage the SEC to maintain in the definition of accredited investor clear, objective standards based on the income and net worth of an investor.[68]

These objective standards are necessary to provide certainty to an issuer that an individual is an accredited investor, and consequently that a private offering will be conducted in compliance with Regulation D. In adopting Regulation D, the SEC carefully reviewed the existing regulatory framework and appropriately determined that issuers need to be able to rely on objective standards in conducting private offerings. As a result of these bright-line standards, Regulation D has been successful in promoting capital formation and protecting investors, and private issuers, including hedge funds, continue to depend on the legal certainty of quantitative, objective standards based on financial thresholds.

We also strongly support the existing aspects of the definition that an accredited investor includes a person who meets one of the listed qualification methods, or who an issuer reasonably believes meets one of the qualification methods, at the time of the sale of the securities to the person.[69] Under these standards, issuers are able to determine that a person is an accredited investor at the time of investment in a private offering, and are provided with additional legal certainty in their reasonable belief that a person is an accredited investor.

With respect to the recommended increases to the income and net worth thresholds for individuals, MFA continues to support efforts to increase investor qualification standards for private fund investors over time, which ensure that only sophisticated investors with the financial wherewithal to understand and evaluate the investments are able to purchase interests in private funds.[70] Hedge funds that rely on Section 3(c)(7) of the Investment Company Act may only sell interests to "qualified purchasers," which include individuals with at least $5 million in investments,

[68] Letter from Stuart J. Kaswell, Executive Vice President and Managing Director, General Counsel, MFA, to Brent J. Fields, Secretary, SEC (June 16, 2016), available at: https://www.managedfunds.org/wp-content/uploads/2016/06/MFA-Comments-on-SEC-Accredited-Investor-Study.pdf.

[69] Rule 501(a) of Regulation D.

[70] MFA supported the Commission's proposal to amend the definition of accredited investor, pursuant to Section 413 of the Dodd-Frank Act, to exclude the value of a natural person's primary residence for purposes of determining the net worth of a natural person. MFA also supported the Commission's proposal in July 2011 to implement Section 418 of the Dodd-Frank Act by raising the qualification thresholds for an individual in the definition of "qualified client," increasing the required assets under management from $750,000 to $1 million and the required net worth from $1.5 million to $2 million.

and institutions with at least $25 million in investments. Hedge funds that rely on Section 3(c)(1) generally only sell interests to accredited investors, and funds of this type managed by SEC-registered investment advisers generally only sell interests to "qualified clients," as defined in Rule 205-3 under the Advisers Act.

Accordingly, we support the recommendations in the Report to amend the income and net worth thresholds to account for the effect of inflation, which would help to ensure that the thresholds have not been diluted over time.[71] Similarly, we support indexing the thresholds for inflation. These thresholds should remain independent qualification methods under the definition of accredited investor, and should not include investment limitations or other qualitative conditions that would introduce uncertainty for an issuer confirming the status of an investor.

We strongly support the Staff recommendation to permit "knowledgeable employees" of private fund managers, as defined in Rule 3c-5 under the Investment Company Act, to qualify as accredited investors for investments in private funds of their employers.[72] We agree with the conclusions in the Report that such knowledgeable employees have meaningful investing experience and sufficient access to information necessary to make informed investment decisions about the private fund's offerings. In addition, investments by knowledgeable employees are beneficial for private fund investors in that they further align investor interests of adviser employees and fund investors.

Similarly, we recommend that the SEC further harmonize the existing sophisticated investor tests under the federal securities laws by including "qualified purchasers," as defined in Section 2(a)(51) of the Investment Company Act, as accredited investors, and by amending the definition of "qualified client" under the Advisers Act to include accredited investors. These changes would simplify the existing mismatch in standards for private fund investors without raising investor protection concerns. In particular, these changes would maintain existing financial thresholds and continue to ensure that only sophisticated investors are able to invest in private funds.[73]

Regarding other types of qualification methods, we agree that the SEC should consider whether individuals with certain professional credentials should also qualify as accredited investors. For example, we recommend that the SEC consider including in the definition of accredited investor individuals who are certified public accountants or chartered financial analysts, and individuals who have received an MBA from an accredited educational institution. As noted in the report, the CPA Exam includes a section that tests for knowledge of corporate governance, economics and finance, and a CFA must complete three CFA Institute administered examinations and have four years of relevant professional work experience. In addition, individuals who have received an MBA from an accredited institution have completed programs that provide them with a level of financial and

[71] The report describes two potential indices for calculating inflation adjustments, the Consumer Price Index ("CPI") and the Personal Consumption Expenditures Chain-Type Price Index ("PCE"). We would recommend the method based on the PCE because it would provide consistency with the PCE method of inflation adjustment used in the definition of qualified client in Rule 205-3 under the Advisers Act.

[72] We also note that a trust should qualify as an accredited investor if the grantor and trustee or person responsible for making the investment decision are knowledgeable employees.

[73] The increased thresholds for the definition of accredited investor would be comparable to the existing thresholds for the definition of qualified client.

business sophistication that should qualify them as accredited investors. Importantly, these types of professional credentials should remain independent qualification methods from the financial thresholds.

V. Amend Rule 206(4)-5 under the Advisers Act (the Pay-to-Play Rule) to Minimize Intrusion into the Personal Political Activities of an Adviser's Employees

We believe that the rule should be narrowed to more effectively target the potential conduct that the rule was designed to prohibit. Accordingly, we recommend that the SEC review the impact of the rule on political contributions in the industry, and consider modifying the rule.

We support efforts by both the SEC and state enforcement authorities to punish individuals and entities that engage in improper activities in connection with the selection of firms to manage government assets. Rule 206(4)-5 under the Advisers Act, however, has required investment advisers to adopt expansive compliance measures that impose significant restrictions on the political contributions of large numbers of employees across the industry. In our view, the pay-to-play rule should be amended to more narrowly tailor its application to prevent those activities that are more likely to involve pay-to-play practices. We are concerned that the rule currently imposes a disproportionately severe punishment on investment advisers for political contributions by their employees that do not involve pay-to-play arrangements.

Since its adoption, the rule has had a significant effect on investment advisers and their employees. In order to ensure compliance with the rule and avoid the substantial penalty for an inadvertent violation, managers have adopted policies to require their employees to disclose and obtain approval for all intended political contributions and, in many cases, prohibit those contributions or limit them to much lower amounts than otherwise permitted. As a result, in our experience, most large managers have now adopted policies and procedures that effectively prohibit contributions to state and local candidates exceeding $150 or $350. We do not believe this result was intended by the SEC when it adopted the rule, nor do we believe that these widespread restrictions are consistent with the policy rationale of the body of law governing political contributions, which permits individuals to make contributions in much larger amounts.

In our previous comments to the rule, we noted that advisers would likely need to adopt expansive compliance measures, and we recommended that the Commission more narrowly tailor the rule to prevent activities more likely to involve pay to play practices.[74] We continue to believe that the rule should be narrowed to more effectively target the potential conduct that the rule was designed to prohibit. Accordingly, we recommend that the SEC review the impact of the rule on political contributions in the industry, and consider modifying the rule in the following ways:

- Eliminate application of the rule to any candidate for federal office, regardless of whether the candidate is currently a state or local office holder. The existing rule

[74] Letter from Stuart J. Kaswell, Executive Vice President and Managing Director, General Counsel, MFA, to Elizabeth Murphy, Secretary, SEC (Oct. 6, 2009), available at: https://www.managedfunds.org/downloads/MFA%20Comments%20to%20Pay%20to%20Play%20Proposal%2010.06.09.pdf.

often creates an unfair situation that an adviser's employees may contribute to one candidate in a federal race but not the other.[75]

- Provide a clear exemption from the two-year time-out if the adviser causes the employee to obtain a full refund of the contribution promptly after the adviser becomes aware of the contribution. Such inadvertent contributions should not disqualify an adviser when they are refunded in a timely manner.

- Increase the *de minimis* threshold to a reasonable level, such as $2,500. The current contribution levels are too low to allow a covered associate meaningful political participation, and a contribution of $2,500 would not affect an elected official's decision about which manager or fund to select.

- Limit application of the rule to contributions to elected officials who are directly responsible for selecting investment advisers or funds. The current definition is overly broad in applying to officials who are not directly involved in these selections.

- Limit application of the rule to an adviser's most senior personnel, with a definition sufficiently precise as to allow an adviser to identify such senior personnel with legal certainty.

- Eliminate application of the rule to contributions by an employee before he or she joins the adviser. The existing rule requires investment advisers to identify and evaluate potential employees' political contributions during the two years preceding employment, which presents challenges to an adviser and does not significantly further the underlying objective of the rule.

W. Expand the Definition of "Knowledgeable Employee"

Permitting "knowledgeable employees" of an investment adviser, as defined in Rule 3c-5 under the Investment Company Act, to invest in that adviser's private investment funds helps promote alignment of interest between the adviser's employees and the fund's investors. While SEC Staff has provided useful guidance to the industry through no-action letters regarding the scope of the knowledgeable employee definition, we believe Rule 3c-5 unnecessarily limits the scope of adviser employees who may qualify as knowledgeable employees, as there are senior adviser employees who may not be covered under the SEC staff guidance. Allowing senior adviser employees to invest in an adviser's funds would align the interests of those employees with investors. We believe that permitting these employees to invest in the funds managed by the adviser also would reduce the desire for those employees to engage in personal trading, which would reduce an area of potential conflicts of interest.

Accordingly, we encourage the Commission to revise the definition of knowledgeable employee in Rule 3c-5 to better align the interests of senior adviser employees and investors in private investment funds. One approach we encourage the Commission to consider is to expand the definition knowledgeable employee to include any employee of the adviser who is an "accredited investor," as defined in Rule 501 of Regulation D. We would welcome the opportunity to discuss

[75] For example, this was the case in certain federal elections in 2016.

with the Commission this approach or other approaches to expand the knowledgeable employee definition to include a broader range of senior adviser employees.

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MFA appreciates the opportunity to provide these comments, and we look forward to continuing to provide what we hope will be useful and constructive comments on future Commission rulemakings. If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact Matthew Newell, Associate General Counsel, or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

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