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August 11, 2015

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File No. S7-08-15
Investment Company Reporting Modernization
Release Nos. 33-9776; 34-75002; IC-31610 (the "Release")

Dear Secretary Fields:

Simpson Thacher & Bartlett LLP is pleased to submit these comments developed in consultation with certain clients that sponsor or advise registered investment companies that focus on alternative investment strategies.[1] We welcome the opportunity to comment on the amendments proposed by the U.S. Securities and Exchange Commission (the "Commission") with respect to the modernization of investment company reporting requirements.

Overview

We and our clients generally support the Commission's efforts to modernize the reporting regime for investment companies. Enhancements in this area have the potential to benefit investment companies and the investing public and to facilitate regulation by the Commission. We acknowledge that access to the type of information requested will strengthen the Commission's ability to remain the primary regulator of the asset management industry.

It is inevitable that increased reporting as a result of any meaningful modernization of the reporting regime, such as the proposed monthly reports sought by the Commission in the Release, will lead to an increased burden on investment companies and their service providers. As discussed below, we believe that *administrative* and *compliance* burdens on registrants that

[1] Specifically, our clients advise and/or sub-advise open- and closed-end investment companies, business development companies and exchange-traded funds. While our clients collectively manage a range of funds that employ traditional investment strategies (i.e., investing in long-only equities, corporate and government fixed income securities and money market instruments), this letter focuses specifically on their alternative investment strategies, which we define as any strategy other than the traditional investment strategies referred to above. We have received input on this letter from approximately a dozen asset management firms. The views contained herein do not necessarily reflect the views of each of those firms.

are commensurate to the benefits sought by the Commission would be appropriate.[2] Our main concern, however, is that the disclosure of certain information proposed in the Release would impose material *competitive* burdens on investment companies and asset managers, particularly those focusing on alternative investment strategies. As the Release notes, alternative investment strategies have become increasingly popular among investors,[3] and we urge the Commission not to impose competitive burdens on such popular products through unduly burdensome reporting requirements.

Our comments below are based on the assumption that the Commission does not intend for the proposed reporting requirements to disturb the competitive equilibrium among investment companies, asset managers, service providers or unrelated third parties. Accordingly, we urge the Commission to eliminate from any new disclosure requirements provisions that would compel disclosure of certain types of sensitive information. In this regard, we first note that disclosure of whether a debt security is in default, or otherwise distressed, would impose a competitive burden on funds that hold private loans. Such disclosure could disrupt fund management and the private loan market, as discussed below. Second, reporting of position-level information regarding derivatives would place an unintended competitive burden on investment companies and asset managers that employ alternative investment strategies, as such detailed information is more likely to cause investor confusion than improve investor understanding. Third, disclosure of portfolio-level interest rate risk, credit spread risk and duration would pose a competitive risk that an investment strategy could be reverse-engineered, especially for fixed-income funds that hold a relatively low number of positions. Lastly, disclosure of securities lending "splits" in financial statements could disrupt the securities lending market, thereby imposing a competitive burden on investment companies and securities lending agents alike.

In addition, we address four other issues in the comments below:

1) We note that some of the new information that would be required to be reported regarding derivatives and convertible securities may not be readily available or easily obtainable.

2) We urge the Commission to provide additional details regarding the safekeeping of confidential reported information prior to finalizing the new reporting requirements.

3) We discuss our belief that the Commission's burden estimates are not realistic given the frequency and volume of new reports.

4) We suggest an improvement to proposed Rule 30e-3 that would allow investors to opt for electronic notification of the availability of shareholder reports in addition to receiving reports electronically.

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[2] Below, we address separately whether the administrative and compliance burdens on registrants are in fact commensurate to the benefits sought by the Commission.

[3] *See* Release, at n.30.

Public disclosure of certain information would raise competitive issues for investment companies and asset managers.

Proposed Form N-PORT would require detailed monthly reporting, including disclosure of a significant amount of information that currently is not required to be reported. The Release outlines the Commission's rationale for requesting such detailed information, noting that much of it should be readily available and that the proposed disclosures will directly benefit the Commission and indirectly benefit individual investors. We appreciate the Commission's considered approach in this regard and agree that much of the requested information may reasonably be viewed as useful to the Commission and investors. However, we would like to draw the Commission's attention to certain items among the information proposed to be disclosed that raise competitive concerns, especially for investment companies and asset managers that employ alternative investment strategies. We urge the Commission to reconsider whether the information discussed below should be required to be reported. If the Commission, after consideration of our comments, intends to require that this information be reported nonetheless, we request that such information be reported to the Commission on a confidential basis only,[4] and not released to the public, even on a delayed basis.

A. Disclosure of certain information regarding private borrowers could disrupt fund management and the private loan market.

With respect to debt securities, Form N-PORT would require disclosure of, among other details, (i) whether a security is in default, (ii) if any interest payments are in arrears or (iii) if any coupon payments have been legally deferred by the issuer.[5] We believe that this information raises significant competitive concerns when a debt security relates to a borrower that is a private company. Absent the disclosure requested by the Commission, this information would not normally be made public. Our concerns are three-fold:

1) For investment companies that own (through origination, purchase, participation, assignment or otherwise) the loans of a private company, public disclosure indicating that a borrower is or may be distressed could dramatically increase prepayment risk and be very disruptive to an investment company and its adviser's ability to manage its relationship with the borrower and more generally implement its strategy. This increased prepayment risk would be a result of the practical effect of the disclosure notifying a broad range of potential lenders that a refinancing opportunity may be palatable to the borrower. Whether or not that would be a good thing for the borrower, we assume that the Commission's proposal was not intended to affect in any way the operation of the private loan market.

2) Borrowers that are private companies could be harmed by disclosure of this information. This is particularly relevant to their relationships with vendors, and potentially could impact relationships with key employees and customers. Upon discovering that a

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[4] We assume that any information filed on a confidential basis will not be made publicly available pursuant to any Freedom of Information Act requests.

[5] *See* Items C.9.c and C.9.d of proposed Form N-PORT.

borrower is or may be distressed, vendors and other counterparties to the borrower could seek to renegotiate contracts, accelerate receivable schedules, and/or decline to renew contracts, and a borrower's competitors could attempt to lure key personnel away from the borrower. Some private companies, in our experience, utilize private loans as opposed to bonds because reporting to vendors that they are having financial difficulties can dramatically heighten default risk, as vendors could demand cash-only payments. Similarly, customers may be less willing to contract with a private company that is distressed, notwithstanding the likelihood that the day-to-day business of the company may be unimpaired.

3) Because of the previous two points, private borrowers in need of financing may avoid registered investment company lenders, or non-investment company lenders may avoid investment company assignees. Indeed, even if such data were to be reported by investment companies on a confidential basis, a possible alternative that we propose below, the simple risk of inadvertent disclosure may be enough to have a chilling effect on the ability of investment companies to participate in the private loan market.

Accordingly, we request that the Commission either eliminate any requirement for reporting when private borrowers are in distress, or make such reporting confidential in all cases. If it follows the latter approach, we urge the Commission to issue an interim release describing its planned cybersecurity protocols, as discussed further below.

B. <u>Disclosure of position-level reporting of derivatives does not enhance investor understanding, can provide a misleading sense of portfolio-level exposure and exacerbates informational asymmetries between institutional and retail investors.</u>

With respect to derivatives, we recommend that the Commission dispense with any requirement for position-level reporting of information regarding derivatives. In virtually all cases, but particularly with respect to alternative asset managers, an investment in derivatives is part of an overall investment strategy. A fund may, for example, invest in a swap that provides returns on a basket of securities negotiated between an adviser and a counterparty. The fund may simultaneously write an option that locks in downside risk on some or all of those securities. When reported on an individual basis, it may appear that the fund has significant exposure to two different derivatives positions, resulting in an aggregate exposure that appears high. If the positions are effectively offsetting, however, the value at risk for the fund is not as high as the disaggregation of those positions would suggest.[6]

Accordingly, we believe that any derivatives reporting should focus on metrics based on a portfolio-level analysis, as reporting on such a basis would more accurately reflect an investment company's overall use of, and, more meaningfully, its net exposure to, derivatives. This is particularly true for multi-manager funds where different sub-advisers employ different strategies within a single fund. We believe that portfolio-level reporting not only would be more useful for investors, but would also be more useful for the Commission in assessing the risk profile of individual funds. Even with the development of tools to aggregate individual positions

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[6] Conversely, a derivatives instrument may be used for hedging purposes. Thus, the derivatives exposure would not represent risk to the portfolio but actually would reflect a reduction in risk of the portfolio.

that might begin to facilitate an understanding of overall portfolio metrics, the existence of bespoke terms in derivatives contracts will limit the ability of the Commission to make use of position-level disclosures to understand with accuracy the exposures of fund portfolios.

For example, the Commission and investors might benefit more from reporting of portfolio-level information based on a "value at risk" model. Value at risk is a risk management tool that measures portfolio-level risk based on the past performance of each security and type of derivative held in a portfolio. This approach would give the Commission and investors an understanding of an investment company's exposure to derivatives, and allow for better comparison between investment companies.[7] Because the Commission has not sought comment on the appropriate risk-level metrics for derivatives position, we urge the Commission to defer reporting on individual derivatives positions and seek public comment on appropriate position-level reporting (including on the question of whether position-level reporting is more appropriate than portfolio-level reporting).

In the event that the Commission adopts requirements for position-level reporting for derivatives, we urge the Commission to allow for such reporting to be made on a confidential basis. We believe that public reporting of individual derivatives positions, without the necessary context of how such positions interact with one another and the rest of the investment portfolio, could be misleading to investors and cause confusion, as discussed above. Any such confusion could have an outsized impact on investment companies that employ alternative investment strategies, as they often hold more derivatives positions than other types of investment companies. The risk of confusion is magnified for multi-manager funds, as each sub-adviser independently manages a piece, or "sleeve," of a fund's portfolio. Thus, position-level reports are likely to create the appearance that a multi-manager fund has inflated derivatives exposure relative to actual risk, as duplicate or off-setting derivatives positions would appear without showing how each position relates to a sub-adviser's individual sleeve of the fund's portfolio.

We further note that public disclosure of detailed information about each derivatives position will provide competitors of funds significantly enhanced ability to reverse-engineer strategies. This ability is exacerbated by the requirement that each derivative instrument be assigned a unique identifier, which makes tracking (including through third-party systems) easier. Because of this reverse-engineering concern, we urge the Commission to at least make such unique identifiers confidential. More broadly in this regard, we believe that the reverse engineering possibility highlights that position-by-position reporting will exacerbate informational asymmetries between institutional and retail investors. In sum, position-level reporting would give institutional investors the tools to reverse-engineer investment strategies, while providing misleading information devoid of context to retail investors and we urge the Commission to seek comment on whether portfolio-level reporting would better serve the Commission's ultimate goals than position-level reporting.

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[7] For a more detailed discussion of value at risk, we refer the Commission to the comments of OppenheimerFunds, Inc. on the Commission's 2011 derivatives concept release (*available at* https://www.sec.gov/comments/s7-33-11/s73311-44.pdf).

C. Disclosure of certain information regarding debt securities raises similar concerns.

With respect to investment companies that invest more than 20% of their assets in debt securities, Form N-PORT would require calculation and reporting of interest rate risk, credit spread risk and portfolio-level duration.[8] We believe that public disclosure of this combination of information, which for a fixed-income fund manager indicates particular views with respect to macro-economic conditions, will allow reverse engineering an investment company's strategy, especially if an investment portfolio is made up of a limited number of positions. We recommend that the Commission provide that such information be reported on a confidential basis. Alternatively, if the Commission determines to require public reporting of this information, we request that the Commission address this potential competitive burden by requiring disclosure only if an investment company invests more than 20% of its assets in debt securities (the current threshold) and holds more than 100 debt securities (since more diverse portfolios are harder to reverse engineer).

Additionally, the Release proposes that these metrics be calculated for 11 different maturity points. Several of our clients have expressed that they do not currently maintain calculations for all of these maturity points. Additional calculations will be very burdensome and time consuming, and we question whether there is a need to provide so many data points for investors. We ask that the Commission consider eliminating the less common maturity points, including the one-, three- and six-month and seven-year maturity points, as they do not appear to provide commensurate benefits to investors relative to the burden they would create.

D. The market for securities lending agents would be disrupted by certain disclosure requirements.

Amendments to Rule 6-03 of Regulation S-X would require reporting of securities lending "splits" in financial statements (i.e., the amount of the profits from securities lending activities retained by the fund versus the lending agent).[9] Such information is competitively sensitive, not only for the securities lending agents that enter into such arrangements, but for the investment companies as well. Splits are generally negotiated in light of a variety of factors, including the anticipated level of securities lending activity and the expected difficulty of lending the securities in the portfolio. We question whether this information regarding the securities lending market will have a value commensurate with the possible disruption in the securities lending market that may be engendered by such reporting. In this regard, we assume that the Commission's goal is not to disrupt the functioning of markets as a result of reporting requirements.

We note that Forms N-CEN and N-PORT, as proposed, contemplate the reporting of a substantial amount of securities lending information that would offer investors insight into an investment company's securities lending activities. To address the competitive concerns associated with disclosure of securities lending splits, we recommend that the Commission

[8] *See* Item B.3 of proposed Form N-PORT.

[9] *See* proposed Rule 6-03(m)(4) of Regulation S-X.

remove these disclosure requirements or allow for confidential reporting of securities lending splits.

Certain information that would be reported on Form N-PORT is not readily available or easily obtainable.

In the Release it is asserted that investment companies and their advisers already collect, or have access to, the new types of information that would be required to be reported on Form N-PORT. We believe that this is indeed the case for certain large asset management organizations. However, in consultation with our clients, we have reviewed the new requirements and would like to note for the Commission that certain information is not currently tracked and may not be easily obtainable, particularly for funds with multiple sub-advisers. Specifically, we believe that registrants will have particular difficulty reporting the following:

1) For derivatives, information regarding individual non-public components of reference instruments (i.e., custom baskets, some of which may consist of dozens or more securities or be proprietary to the counterparty);[10]

2) For derivatives, delta (i.e., the ratio of the change in the value of the derivative to the change in value of the reference instrument) may only be readily available for derivatives covered by services such as Bloomberg;[11]

3) For swaps, upfront payments and/or receipts (i.e., whether cash was paid or received when entering into a swap contract);[12] and

4) For convertible securities, information on whether conversion is mandatory or contingent, description of reference instrument and conversion ratio(s).[13]

Accordingly, we ask that the Commission consider deleting these new reporting requirements.

The Commission should publish detailed cybersecurity plans before finalizing the proposed new reporting requirements.

We are deeply concerned about the security of the data to be reported to the Commission on a confidential basis under an amended reporting regime. The amendments and new

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[10] *See* Item C.11.c.iii.2 of proposed Form N-PORT.

[11] *See* Item C.11.c.vii proposed Form N-PORT. Some of our clients have informed us that they generally would rely on a third-party vendor, such as Bloomberg, to calculate this information, as they would have difficulty generating these calculations on their own.

[12] *See* Item C.11.f.iii of proposed Form N-PORT.

[13] *See* Item C.9.f.i and ii of proposed Form N-PORT. Our clients have informed us that they are not able to obtain this information without reviewing the prospectus for each individual security, which would be very time consuming.

requirements proposed in the Release would result in the Commission becoming custodian to "vast amounts of new data," much of which will never be released to the public.[14] Unfortunately, the Release does not include any details regarding how the Commission plans to safeguard this potentially vast amount of non-public information. As noted above, we believe that some of the information requested by the Commission is competitively sensitive and, if reported, should only be reported directly to the Commission on a confidential basis. We believe the Commission should clarify its cybersecurity policies to ensure that such sensitive information is not released to the public, accidentally or otherwise, and do so in a manner that solicits public review and comment.

The Commission is asking registrants to report an immense amount of data at a time when government computer systems face unprecedented vulnerability. Recently, it has come to light that the Office of Personnel Management's systems experienced "the largest cyberattack into the systems of the United States government" in history.[15] The attack compromised the sensitive personal information of 21.5 million people, and followed a similar breach that exposed the personnel data of 4.2 million federal workers.[16] In light of these recent cybersecurity breaches, the lack of detail in the Release raises questions of whether the Commission will be able to protect sensitive confidential data. We strongly recommend that the Commission put forth an interim release addressing the industry's cybersecurity concerns, and allow for public comment on this topic, before finalizing the new reporting requirements.

The Commission's burden estimates are not realistic.

In the Release, it is estimated that Form N-PORT would impose an hour burden of 198 hours in the first year, and 168 hours per year thereafter for each investment company.[17] We believe that the Commission's estimates are unrealistic. Several of the firms that we consulted in connection with this letter have informed us that they currently devote more than 198 hours per year on existing investment company quarterly reporting, and Form N-PORT is asking for more information and eight additional reports. As much of the new information that would be required to be reported relates to alternative investment strategies, the new burden will disproportionately impact alternative investment companies and asset managers. Current computers systems will need to be reconfigured or upgraded and new personnel will likely need to be hired to comply with the new reporting requirements, by both advisers and other fund service providers. Indeed, at least one of our clients anticipates hiring one or more full-time equivalent employees to focus solely on the new reporting requirements, assuming they are adopted by the Commission. Other clients intend to rely on service providers, such as custodians and administrators, who in turn

[14] *See* Commissioner Kara M. Stein, Statement at an Open Meeting on Investment Company and Investment Adviser Reporting, May 20, 2015, *available at* http://www.sec.gov/news/statement/stein-investment-company-reporting-modernization.html

[15] *See* Julie Hirschfeld Davis, *Hacking of Government Computers Exposed 21.5 Million People*, NY Times, July 9, 2015, http://www.nytimes.com/2015/07/10/us/office-of-personnel-management-hackers-got-data-of-millions.html.

[16] *See* Information about OPM Cybersecurity Incidents, U.S. Office of Personnel Management, https://www.opm.gov/cybersecurity/ (last visited August 4, 2015)

[17] *See* Release, at nn. 739, 740.

will need to hire more individuals to meet the reporting requirements and may increase fees for their services as a result. These increased fees will be borne by registrants and thus ultimately by fund shareholders. Given that it is reasonably foreseeable that the investing public will pay higher fees as a result of the proposed reporting requirements, we urge the Commission to be particularly mindful that the increased burdens provide benefits to investors themselves. We ask that this be recognized as the Commission considers whether to remove some of the proposed reporting requirements.

With respect to the Commission's proposed compliance dates for the new reporting requirements, we are concerned that the timeline outlined in the Release is too aggressive for smaller investment company complexes. In the Release it is proposed that any complex with registered fund assets under management of $1 billion or more would be required to comply within 18 months of the effective date of the new requirements.[18] In our view, $1 billion in assets under management does not equate to a "larger" complex in the current market landscape. In the alternative, we suggest that the Commission revise this threshold so that complexes with $20 billion in registered fund assets under management would be required to comply with the earlier compliance date. We believe the revised threshold more accurately captures the Commission's intent in implementing staggered compliance dates, because entities of that size are more prepared to provide the type of reporting proposed in the Release.

Additionally, we request that the Commission clarify the standard of care and potential liability that will apply to reports on proposed Forms N-PORT and N-CEN. Given that the new reporting requirements will involve increased amounts of data and more frequent filings on new forms and in new filing formats, we ask that the Commission, regardless of the standard of care applicable, consider limiting liability for a transition period upon the effectiveness of the proposed reporting requirements. The Commission authorized a similar transition period for liability purposes in connection with earlier interactive data reporting rules.[19] In that context, the Commission provided that for a two-year transition period, interactive data filings would remain subject to standard anti-fraud provisions under federal securities laws, but would not be subject to Section 34(b) of the Investment Company Act of 1940, as amended (the "1940 Act") or Section 18 of the Securities Exchange Act of 1934, as amended. Additionally, electronic filers were allowed to benefit from the protections of Rule 103 of Regulation S-T under the Securities Act of 1933, as amended, with respect to electronic filing errors that are beyond the filer's control. We believe such a transition period would ease the burden on investment companies and asset managers as they work to implement and refine the systems and procedures necessary to comply with the new reporting requirements.

Investors who opt for electronic delivery of shareholder reports under proposed Rule 30e-3 may also want electronic notice when such reports are available.

We wish to express our support for the Commission's proposed Rule 30e-3 under the 1940 Act. As the Commission notes in the Release, many investors prefer to access information

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[18] *See* Release, at nn. 624, 625.

[19] *See* Interactive Data to Improve Financial Reporting, Securities Act Release No. 9002, Exchange Act Release No. 59,324, Investment Company Act Release No. 28,609 (Jan. 30, 2009).

about their investments through the Internet. We note that, in addition to the convenience of electronic materials, many investors have expressed a preference for environmentally friendly "green" initiatives, such as the option for electronic account statements in lieu of receiving hard copies through the mail. As proposed, Rule 30e-3 would seem to require investment companies to mail hard copy notices to investors when a shareholder report becomes available. We recommend that the Commission consider a revision to the proposed rule to clarify that investors may opt for electronic transmission of this notice via e-mail. We believe that many of the investors who would prefer electronic shareholder reports would also prefer electronic notice. Additionally, such notice would provide for a direct link to the relevant website where an investor could find the latest shareholder report. This would allow investors to access shareholder reports more easily and more quickly than if investment companies were required to mail a hard copy notice. Investors could provide their e-mail address when they consent to receive electronic shareholder reports.

As proposed, Rule 30e-3 would accommodate investor preferences, provide them with better and easier access to shareholder reports and benefit investors as investment companies would have lower printing and mailing costs related to shareholder reports. The addition of an option for electronic notice of the availability of such reports would only serve to increase these benefits.

Conclusion

The proposed new reporting requirements set forth in the Release would require alternative investment companies and asset managers to shoulder a significant burden, potentially much more so than more traditional registrants, the costs of which will ultimately be borne (at least in part) by fund shareholders. We request that the Commission consider carefully the potential competitive side effects of the new reporting obligations proposed in the Release. While we believe that some of this information does not need to be reported, if the Commission determines to require disclosure of competitively sensitive information by investment companies and asset managers, provision should be made to permit such disclosure to be made on a confidential basis.

We appreciate the opportunity to submit, and the Commission's consideration of, our comments on the proposed modernization of the reporting requirements for investment companies. Should the Commission have any questions regarding these comments, please feel free to contact Rajib Chanda at (202) 636-5543 or rajib.chanda@stblaw.com.

Sincerely,

Simpson Thacher & Bartlett LLP

Simpson Thacher & Bartlett LLP

cc: Sarah E. Cogan, Esq.; Christopher P. Healey, Esq.