Blackstone

March 28, 2016

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

Re: File No. S7-24-15
Use of Derivatives by Registered Investment Companies and Business Development Companies
Release No. IC-31933 (the "Release")

Dear Secretary Fields:

Blackstone Alternative Investment Advisors LLC ("BAIA") appreciates the opportunity to comment on the new rule and amendments proposed by the U.S. Securities and Exchange Commission (the "Commission") with respect to the use of derivatives by registered investment companies and business development companies.

We support the SEC's proposal to modernize the guidance around the use of derivatives in the U.S. mutual fund industry. Derivatives have played an increasingly important role in providing liquidity to funds, and exposure to types of investments that otherwise may not be available to fund investors. Additionally, many funds use derivatives to hedge market risks across various asset classes.

While proposed Rule 18f-4 (the "Proposed Rule") makes great strides in introducing a risk-based framework for regulating funds' derivatives use, we believe that some changes are necessary to truly align the derivatives limits with the advances in portfolio theory and risk management that have developed since the enactment of the Investment Company Act of 1940 (the "1940 Act").

BAIA wishes to echo the views which we understand will be expressed in comment letters by the Investment Company Institute (the "ICI"), Simpson Thacher & Bartlett LLP ("Simpson Thacher") and others agreeing that the Proposed Rule could be better tailored to address the Commission's concerns that funds are unduly speculative. Similarly, we share these commenters' concern that the Proposed Rule would have significant unintended consequences for the fund industry, fund investors and the broader economy. BAIA generally supports the proposals that will be put forth by these other comment letters, including the ICI's recommendation that the Commission focus on asset segregation instead of exposure limits, or, in the alternative, adopt one of the modified exposure limit frameworks proposed by the ICI or Simpson Thacher.

Blackstone Alternative Investment Advisors LLC
345 Park Avenue New York NY 10154
T 212 583 5000 F 212 583 5749
www.blackstone.com

The purpose of our comment letter is to offer some additional points for the Commission's consideration with respect to the merits of using relative "value at risk," or "VaR," as a metric for limiting derivatives exposure, as we believe it is the metric that most closely reflects the Congressional intent behind Section 18 of the 1940 Act. Additionally, we have noted an operational issue that may impact multi-manager and multi-strategy funds under the Proposed Rule, but may not have been considered by the Commission in the Release.

Background Regarding BAIA and its Funds

The Blackstone Group L.P. ("Blackstone") was founded in 1985 in New York City by Peter G. Peterson, Chairman Emeritus, and Stephen A. Schwarzman, current Chairman and Chief Executive Officer. On June 21, 2007, a portion of Blackstone's ownership interests were sold through an initial public offering on the New York Stock Exchange, and are now trading under the symbol "BX."

Blackstone is one of the world's leading investment firms. Our alternative asset management businesses includes the management of corporate private equity funds, secondary private equity funds, real estate funds, hedge funds, credit-oriented funds and collateralized loan obligation vehicles (CLOs). BAIA is part of Blackstone's hedge fund solutions group, which is known in the marketplace as Blackstone Alternative Asset Management ("BAAM)" and serves many of the world's largest and most sophisticated institutional investors. Clients include corporate, public and union pension funds, as well as sovereign wealth funds, central banks, insurance companies and other institutional investors. These investors look to BAAM to create bespoke investment solutions across multiple asset classes and strategies while seeking to protect capital through robust risk and portfolio management processes. BAAM's strategies offer a diverse array of commingled and customized investor solutions, including long-only replacement strategies, special situations investing, emerging manager platforms, permanent capital vehicles and a multi-manager platform.

BAAM has a history of creating products to meet the needs of investors and capture investment opportunities for the benefit of our clients. BAAM's first open-end fund launch was nearly three years in the making, as we evaluated the market for liquid alternatives and felt not only that we had built the necessary extensive legal and compliance framework, but also that we were best positioned to take advantage of investment opportunities in the space for the benefit of fund shareholders. BAAM currently has four funds registered under the 1940 Act: (i) Blackstone Alternative Multi-Manager Fund ("BXMMX"), an open-end fund launched on August 6, 2013; (ii) Blackstone Alternative Multi-Strategy Fund ("BXMIX"), an open-end fund launched on June 16, 2014; (iii) Blackstone Alternative Alpha Fund, a closed-end fund launched on April 1, 2012; and (iv) Blackstone Alternative Alpha Fund II, a closed-end fund launched on July 1, 2013.

BAAM's open-end funds seek attractive long-term, risk-adjusted returns by allocating assets among hedge fund sub-advisers who possess the necessary 1940 Act infrastructure and have experience managing alternative investment strategies. Investing in alternative strategies such as those employed by hedge funds may help to diversify an investor's portfolio and reduce overall risk. Because the funds are broadly diversified in terms of strategies, securities, sectors and geographies, they have historically offered low volatility and low beta compared to traditional equity and fixed income markets.

Although diversified alternative strategies generally entail a heavier usage of derivatives than traditional equity and credit funds, these strategies can deliver attractive risk-adjusted returns with a low beta compared to traditional asset classes. The Commission's Proposed Rule, as currently drafted, would require adjustments to the investment strategy of our open-end funds, which we believe could detract from performance and provide no additional benefits to our investors, given the low volatility target of the strategies employed. The chart below demonstrates the significantly lower volatility achieved by these funds since inception compared to the overall market, as well as the downside protection offered by these funds in declining markets. As part of an overall investment portfolio, these funds can play an important role in reducing investors' overall risk.

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD			
													BXMMX		SPXT Index	
BXMMX US Equity													Return	Volatility	Return	Volatility
2013								-1.20%	1.42%	2.20%	1.17%	1.19%	4.83%	3.24%	9.89%	10.10%
2014	0.67%	2.85%	-1.39%	-0.00%	1.03%	0.46%	-0.37%	0.93%	0.03%	-0.74%	0.37%	-0.33%	3.53%	4.38%	13.69%	11.34%
2015	0.70%	2.00%	1.08%	-0.29%	1.17%	-1.15%	1.84%	-1.05%	-0.48%	0.29%	0.58%	-0.74%	3.95%	4.02%	1.38%	15.43%
2016	-1.92%	-3.19%											-5.04%	4.78%	-5.09%	21.20%
ITD													**7.13%**	**4.14%**	**20.21%**	**13.64%**

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	BXMIX		SPXT Index	
BXMIX US Equity													Return	Volatility	Return	Volatility
2014						0.50%	-0.40%	0.90%	0.30%	-0.59%	0.30%	-0.19%	0.80%	4.03%	7.41%	11.64%
2015	0.70%	1.88%	0.97%	-0.39%	1.26%	-1.15%	1.93%	-1.04%	-0.67%	0.29%	0.48%	-0.71%	3.55%	3.72%	1.38%	15.43%
2016	-2.17%	-2.22%											-4.35%	4.29%	-5.09%	21.20%
ITD													**-0.16%**	**3.91%**	**3.35%**	**14.95%**

Figure 1: Historical Returns of BAIA Open-End Funds[1]

Prepared solely for inclusion in this comment letter. The Funds' prospectuses are available at www.blackstone.com/the-firm/asset-management/registered-funds. Performance data for the Funds is net of fees and expenses. Performance data quoted represents past performance and does not guarantee future results. All returns include dividend and capital gain distributions. Investors cannot invest directly in an index. Index returns do not reflect fees and expenses.

Notional Exposure is Not an Appropriate Metric for Limiting Derivatives Exposure

We agree with the Commission that leverage, if left unchecked, could in some cases result in a fund's portfolio taking on an "unduly speculative" character that exposes investors to such a high risk of substantial losses that it cannot be adequately captured by prospectus risk disclosure. Furthermore, we believe that the framework of Section 18 of the 1940 Act, which limits the potential for excessive leverage, can appropriately be used as a basis to address this issue.[2]

The Proposed Rule offers two possible limits on a fund's use of derivatives—an exposure limit and a risk-based limit. The Commission appropriately crafted alternative limits in a manner that would allow different funds to manage their portfolios to one of the two limits, depending on how a fund uses derivatives.

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[1] SPXT = S&P 500 Total Return Index, YTD = Year To Date and ITD = Inception To Date. Returns are only presented for Class I shares.

[2] *See* 15 U.S. Code § 80a–18.

The exposure limit proposes to limit a fund's aggregate exposure to derivatives transactions, "financial commitment transactions"[3] and any other senior security, to 150% of its net asset value, measured by notional exposure. The risk-based limit proposes to allow a fund to have aggregate exposure of up to 300% of its net assets, also measured by reference to notional exposure, on the condition that the fund's derivatives positions act to reduce the VaR of the fund's overall portfolio when compared to the VaR of the fund's securities positions.

We support the Commission's approach of offering funds multiple ways to comply with the Proposed Rule's limits on derivatives use. However, as pointed out by the ICI, Simpson Thacher and other commenters, notional exposure is an imperfect indicator of leverage and risk. To illustrate this problem, imagine that a fund invests $100 in corporate bonds. These bonds would be subject to interest rate risk—meaning that as interest rates increase the price of these bonds generally would decrease. In order to hedge the fund's risk of losses on the bonds, the manager may choose to enter into an interest rate hedging strategy. As an example, assuming the bonds have a duration of 8.5, the fund would require a notional amount of $136 to hedge the interest rate risk using treasury futures (assuming a duration of 6.25). A similar hedging strategy employing Eurodollar futures (with a duration of 0.25) would result in significantly higher notional exposure, while still reducing the overall risk of the fund.[4]

Accordingly, in addition to the exposure limit and risk-based limit in the Proposed Rule, we believe that the SEC should provide an alternative limit that relies on a metric that is a better indicator of leverage and risk than notional exposure. We recommend that the Commission consider using relative VaR, which is already used in the proposed risk-based limit, to provide an alternative to the proposed exposure limit. Relative VaR is superior to notional exposure because it takes into account investment instrument volatilities and correlations. In addition, and a relative VaR approach would avoid some of the drawbacks associated with using notional exposures that were acknowledged by the Commission in the Release and are being raised by commenters. Among these drawbacks, in our view, are unintended consequences of the risk-based alternative proposed, which may have the effect of pushing funds into derivatives that might otherwise not use them. For example, a fund might choose to enter into bilateral derivatives positions to achieve the risk-reducing benefit of a short position, even when achieving a short position through a prime broker may be more efficient or beneficial for the fund. A relative VaR approach would avoid a system that treats investments which expose the fund to the same level of investment risk differently purely as a result of the method of achieving such exposure.

Relative VaR Better Reflects the Leverage Limits Imposed Under Section 18 of the 1940 Act

We believe that the original intent of Section 18 of the 1940 Act was to limit the amount of risk to which individual investors in mutual funds could be exposed. As Congress did not have the benefit of

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[3] The Proposed Rule defines "financial commitment transactions" as reverse repurchase agreements, short sale borrowing, firm or standby commitment agreements (or similar agreements).

[4] Modified duration measures the price sensitivity of a fixed income security to changes in interest rates, and is defined as the percentage derivative of price with respect to yield. In order to hedge the interest rate sensitivity of a bond with a modified duration of 8.5, the investor needs to enter into a short bond (or other interest rate derivative position) with an equal duration. In the example above, assume that a short position in treasury futures has a duration of 6.25 to hedge the bonds. In order to match duration, one would need to enter into 1.36 times the notional of the bonds being hedged (1.36 x 6.25 = 8.5). This strategy would hedge a parallel shift in the yield curve, but may not provide an effective hedge for different changes in the yield curve. For example, short term interest rates may increase, while long term interest rates may decrease (known as curve flattening), which may affect the value of the hedge differently from the bond investment.

considering principles of modern portfolio theory, such as portfolio diversification and correlation, in enacting the 1940 Act, we believe that Congress focused on the best known risk at the time—leverage.[5] The most significant concern associated with leverage is that it magnifies changes in a fund's investment portfolio. In other words, leverage increases the volatility of fund performance.[6] Accordingly, we propose that the Commission, in proposing a modern approach to meet the statutory aims of the 1940 Act, use volatility as the metric for a limit on derivatives use.

We believe that the best proxy for volatility is relative VaR. VaR is a measure of potential portfolio loss based on expected portfolio volatility, which is derived from the historical returns and correlations of a fund's investments. We agree with the Commission that absolute VaR has its limits, and that using relative VaR can provide a better tool for assessing whether a fund is unduly speculative, particularly if a fund's portfolio VaR is compared to the VaR of the broader market.

We propose that the Commission adopt a limit that would require a fund using derivatives to limit its overall portfolio VaR to no more than 1½ times[7] the VaR of a basket of medium- to large-cap U.S. listed equity securities designated by the Commission, such as the S&P 500 Index.[8] Based on our reading of Section 18, we believe that the correct comparison for the relative VaR calculation should be overall portfolio VaR (inclusive of derivatives) versus the VaR of the general market, because the goal of Section 18 is to prohibit undue speculation through leverage. It is highly unlikely that Congress considered the concept of undue speculation to be based on any absolute scale—rather, undue speculation must be evaluated relative to the degree of speculation involved in investing generally. This concept of relative speculation reflects reality. For instance, most investors would agree that a fund that invests in a basket of securities replicating the S&P 500 Index would generally be less speculative than a fund that invests all of its assets in a concentrated basket of emerging market equity issuers in the energy sector. While the current exposure limit and risk-based limit in the Proposed Rule would view the two funds similarly as long as both utilize the same degree of leverage, this proposal addresses the inherent speculative difference between the divergent investment strategies.

We believe this proposal provides a strong and direct link to an acceptable risk level as established by Congress in Section 18's leverage limit. This proposal also addresses some of the shortcomings of absolute VaR, which may not accurately reflect downside risk during benign market periods. By using relative VaR, the maximum risk that funds can obtain through derivatives would automatically be

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[5] *See, e.g.,* A Bill to Provide For The Registration and Regulation of Investment Companies and Investment Advisers, and For Other Purposes: Hearings Before the U.S. House Senate, Subcommittee of the Committee on Banking and Currency, 76th Cong., 3 (April 26, 1940) (statement of Mr. L.M.C. Smith) ("The volatility of the common stock of leverage investment companies accounts for a considerable part of the losses sustained by investors. . . The common stock of a leverage investment company is a very volatile and hazardous security. . . . The Conclusion to be drawn from the operation of the principle of leverage and from these statistics is that the common stock of leverage investment companies is so fraught with danger to the investor and so hazardous a commodity that it is definitely inappropriate as an offering of a public investment institutions, especially upon consideration of the sales emphasis of investment companies upon the savings and investment character of the securities of such companies.").

[6] *See SEC, Report on the Study of Investment Trusts and Investment Companies, Part Two, p. 310* ("[F]rom the point of view of the common stockholder, it is necessary to examine the influence of these leverage capital structures in accentuating changes in the asset value and fluctuations in the market price of their shares.")

[7] This multiple is derived from the fact that Section 18 allows an open-end fund to obtain leverage in an amount of up to 150% of its net assets through borrowing from a bank.

[8] The VaR calculations for the portfolio and the basket would be calculated using the same calculation methodology and settings.

reduced in benign market conditions, and extended during periods of heightened volatility in line with broader market sentiment.

Our proposed relative VaR limit is not intended to be a target for all mutual funds, but instead an upper limit set by the Commission to avoid excessive speculation in the mutual fund industry. We believe that a fund's board, working closely with the investment adviser and the designated risk manager, should be required to set prudent fund risk limits that lie within this outer bound and reflect the fund's stated investment objective. For example, Blackstone's multi-strategy diversified alternative funds have historically had around a third of the volatility of the S&P 500 Index, and a board of a fund that runs a similar strategy may opt for a lower maximum relative VaR of 66% of the VaR of the S&P 500 Index.

As mentioned above, VaR models estimate expected portfolio risk based on the historical returns and correlations of fund investments. During periods of stress (e.g., 2008), returns, correlations and volatilities tend to change dramatically, over a very short period of time, which will not likely be captured in the standard relative VaR model results. We therefore recommend that the SEC require designated risk managers to run additional stress testing and back testing of the VaR models at least monthly, and include the results of these tests in the proposed reporting to a fund's board.

In the event that a fund breaches its designated relative VaR limit, we recommend that the fund be prohibited from entering into any further derivatives transactions, other than those that would act to reduce its relative VaR in order to reestablish compliance with the fund's limit. We propose that, in any event, a fund should be allowed a cure period of 30 days in the event of a breach, and should be required to notify the fund's board of the circumstances surrounding the breach, and any remedial actions taken, at the next regularly scheduled board meeting.

Any Notional Exposure Limit Should Incorporate Risk-Weighting

Although we do not see a direct link between limits on notional exposures and risk, or a direct mandate from Section 18 to limit notional exposure for derivatives, we recognize the possibility that the Commission may determine to impose additional limits based on notional exposure as another layer of protection on top of a relative VaR limit. Given the limits of notional exposure as an indicator of risk and leverage, we believe that any notional limit would be reasonable only if it takes into consideration the risks of the underlying reference assets for these derivatives.[9] In this regard, we support the recommendation of the ICI and Simpson Thacher, among others, that any limit based on notional amount use risk-weighting, or "haircutting," to account for the fact that the risk of a derivatives transaction will depend on the risk associated with its reference asset.

Operational Issue for Multi-Manager and Multi-Strategy Funds

Finally, we would like to highlight a potential operational issue that could arise under the Proposed Rule, so that the Commission can consider ways to ameliorate these issues in any final rule. This operational issue is particularly relevant for multi-manager and multi-strategy funds, which often rely on

[9] We understand that the Commission may adopt a relative VaR approach, such as the one outlined above, or a risk-weighting approach, but not both. We believe either approach would be preferable to the current formulation. If the Commission is hesitant to adopt a relative VaR approach because it is concerned that there would not be a practical limit on leverage, we urge the Commission also to consider using a relative VaR approach coupled with a notional exposure limitation of 300% or greater.

sub-advisers for the day-to-day management of their respective allocated sleeves of a fund's portfolio or utilize multiple portfolio management teams. The issue relates to the timing of a fund's calculation of compliance with the proposed derivatives limits. The Proposed Rule requires that a fund calculate compliance with the derivatives limits "immediately after entering into" a derivatives transaction. It would be very difficult for a multi-manager fund to make such calculations in real time, as the fund's adviser usually delegates trading authority to the fund's sub-advisers. A multi-strategy fund could run into this issue as well, as multiple portfolio management teams with trading authority may present similar difficulties. To improve the administrability of the Proposed Rule, we recommend the Commission permit that, at a fund's option, compliance with the derivatives limits could also be calculated daily after market close. This would achieve the same result as a "time of purchase" test, but would be more administrable for multi-manager and multi-strategy funds.

Conclusion

The Proposed Rule represents a thoughtful approach by the Commission to a difficult and complex topic. Our recommendations are intended not to discard the Commission's proposals, but to improve the likelihood that the rule will accomplish its goal of limiting leverage and risk while hewing more closely to the Congressional intent behind Section 18 of the 1940 Act. We also believe that the proposals discussed in this letter would make the Proposed Rule more easily administrable and mitigate some of the more serious issues acknowledged by the Commission in the Release and raised by commenters.

We appreciate the opportunity to submit these comments for the Commission's consideration. If you have any questions or would like any additional information regarding these comments, please feel free to contact Peter Koffler, Esq. at [redacted] or [redacted].

Sincerely,

/s/ Blackstone Alternative Investment Advisors LLC

Blackstone Alternative Investment Advisors LLC

cc: David Mehenny
James Hannigan, Esq.
Kevin Michel, Esq.