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

August 11, 2015

VIA EMAIL

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Proposed Amendments to Form ADV and Investment Advisers Act Rules; File Number S7-09-15

Dear Mr. Fields:

Managed Funds Association ("MFA")[1] appreciates the opportunity to provide comments to the Securities and Exchange Commission (the "SEC" or "Commission") in response to its proposals to expand reporting on Form ADV and amend certain rules under the Investment Advisers Act of 1940 ("Advisers Act").[2] Among other things, the proposals would require advisers to provide additional information about their businesses and clients on Form ADV, in particular with respect to separately managed account ("SMA") clients, and amend Form ADV to provide for private fund manager "umbrella registration." We fully support the SEC's efforts to obtain information that furthers its mission to oversee investment advisers, and we generally support the proposed amendments to Form ADV. We believe, however, that certain sensitive business information about client accounts would not be appropriate for reporting and public disclosure in Form ADV.

Information about Separately Managed Accounts ("SMAs")

While we appreciate that the SEC is seeking additional information about advisers for its oversight purposes, we are concerned that the proposal would require advisers to publicly disclose detailed, confidential business information about their separately managed account ("SMA")

[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] 80 F.R. 33718 (June 12, 2015).

clients on Form ADV.[3] In particular, advisers would be required to report: (i) the approximate percentage of regulatory assets under management ("RAUM") in SMAs that is invested in each of ten asset categories, (ii) the number of accounts they advise that correspond to certain categories of gross notional exposure and the weighted average amount of borrowings (as a percentage of net asset value) in the accounts, (iii) the weighted average gross notional value of derivatives of the accounts with respect to each of six different categories of derivatives,[4] and (iv) information about each custodian that holds 10% or more of SMA client RAUM.

MFA supports the reporting of information to the Commission, however, we believe that the proposed information relating to gross notional amounts of derivatives in client accounts would, for the reasons below, provide an inaccurate representation of market exposures and would not provide information that is meaningful to the Commission for that purpose. Accordingly, we do not believe that the Commission should collect this information. In addition, public disclosure of SMA account information would reveal proprietary data that could be used by competitors in a manner that could harm SMA clients.

Gross Notional Amounts of Derivatives Should Not be Reported on Form ADV

We are most concerned with the proposed requirements for advisers with RAUM attributable to SMA clients of at least $10 billion to report information about the gross notional values[5] of SMAs with respect to different categories of derivatives.[6] We believe that measures of gross notional exposure[7] ("GNE") and gross notional value do not represent a fair approximation of economic or market exposure and would not be useful to regulators seeking to better understand SMAs. Such information would also raise considerable competitive concerns if publicly disclosed.

Gross Notional Amounts of Derivatives Do Not Represent Market Exposure

As we have recently explained to other regulators,[8] it is improper to look at gross notional amounts alone without adjusting for significant variations in actual risk and exposure. Among other limitations, gross notional amounts fail to account for material variations in the risk posed

[3] Proposed Section 5.K. of Schedule D.

[4] Advisers with RAUM attributable to SMAs of at least $10 billion would report this information.

[5] Gross notional value would be defined as the gross nominal or notional value of all transactions that have been entered into but not yet settled as of the reporting date. For contracts with variable nominal or notional principal amounts, the basis for reporting is the nominal or notional principal amounts as of the reporting date. For options, the delta adjusted notional value would be used.

[6] Column 3 of Proposed Section 5.K(2)(a).

[7] Gross notional exposure would be the percentage obtained by dividing: (i) the sum of (a) the dollar amount of any borrowings and (b) the gross notional value of all derivatives, by (ii) the net asset value of the account.

[8] Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, to Secretariat of the Financial Stability Board (May 29, 2015), available at: https://www.managedfunds.org/wp-content/uploads/2015/05/MFA-comment-letter-on-GSIFI-Assessment-Methodologies1.pdf.

by a given position or portfolio based on: (i) asset class, (ii) tenor, (iii) netting terms, (iv) margining and collateral arrangements, and (v) clearing status. As proposed, GNE and gross notional amounts are thus flawed metrics that overstate a true market or counterparty exposure.

At the most basic level, the notional value of a derivative is purely a nominal number. For example, Contract A could have a notional value of $1 billion and a fixed rate of 1 bps while Contract B could have a notional value of $100 million and a fixed rate of 10 bps. The economics of the two are identical, but the notional value differs by a factor of 10x. With respect to asset class, GNE overstates interest rate derivatives, which for similar amount of risk have much higher notional amounts than other derivatives. For example, the risk of a $100 million notional USD 5 year interest rate swap and the risk of a $100 million notional 5 year single-name CDS are significantly different and bear no relation to each other.

With respect to tenor, notional exposures of derivatives (listed and OTC) without modification to account for differences in duration do not provide a particularly useful measure. The risk of a $100 million notional 1 year interest rate swap is significantly different than the risk of a $100 million notional 30 year interest rate swap. In addition, the delta adjustment for options fails to differentiate not only among options of different terms, but also between long and short options – the maximum loss on a long option is generally much less than its delta equivalent, while the maximum loss on a short option can be considerably higher.

In this respect, we note that the proposed approach to determining the value of interest rate derivatives is inconsistent with the approach taken in Form PF, which accounts for differences in duration by providing for the calculation of interest rate derivatives in terms of the 10-year equivalent duration-adjusted value for such positions.[9] At a minimum, the definition of interest rate derivative in Form ADV should be consistent with Form PF and include this duration adjustment.

With respect to netting and hedging, gross notional amounts overstate the risk in portfolios that have demonstrable and widely accepted offsetting exposures. In particular, options that are hedged with the reference asset or other offsetting options, futures hedged with the deliverable reference asset, interest rate swaps hedged with corresponding government bonds, and interest rate derivatives held under the same master agreement or at the same clearinghouse should, to the extent there are offsetting cash flows, be recognized in any effort to measure a total exposure.

With respect to margin and collateral, it is important that any exposure threshold account for the fact that derivatives positions for which initial and daily variation margin are posted pose significantly less risk than derivatives positions for which margin or collateral is not posted. We note in this regard that many hedge funds and SMAs have zero net uncollateralized exposure.

With respect to clearing, positions cleared through a central counterparty (a "CCP") create less risk than uncleared transactions. In broad terms, a CCP reduces systemic risk by interposing itself as a counterparty to every trade, performing multilateral netting, and providing various safeguards and risk management practices to ensure that the failure of a clearing member to the

[9] Form PF Glossary. *See also* Form PF Frequently Asked Questions, Question 26.4.

CCP does not affect other members. Given the different risk profiles of cleared positions compared to uncleared positions, we believe that any exposure calculation needs to provide for adjustments to account for cleared versus uncleared positions.

For these reasons, we believe that the proposed gross notional value is not a fair approximation of economic or market exposure, and we strongly recommend that advisers should not be required to report on Form ADV the proposed information about the average gross notional value of derivatives by category.

Gross Notional Amounts of Derivatives Would Be Misleading and Raise Competitive Concerns if Publicly Disclosed

For the reasons described above, the proposed disclosure of the average gross notional value of derivatives would be misleading to investors if publicly disclosed. Because this measurement does not represent true market exposure, an investor that obtains the information through a manager's Form ADV would have a flawed figure on which it could make inaccurate assumptions about the risk of the portfolio. We believe such a result would be harmful to both investors who view Form ADV data, and the manager who is obligated to report the misleading information.

Although not helpful for understanding market exposure, public disclosure of this information would reveal highly proprietary data to sophisticated competitors and counterparties and offer valuable insight into a manager's use of derivatives that could harm SMA clients. Moreover, since many SMAs are managed with the same or a similar investment strategy as pooled vehicles operated by the same manager, disclosure of proprietary information about SMA clients would often reveal information about the strategies of related pooled vehicles. Sophisticated market participants and counterparties could use the data to better understand the manager's strategy and use of derivatives within its strategy, which they could use to invest in a manner that impairs the performance of SMA and pooled vehicle clients. These concerns would be exacerbated if, as proposed, a manager needed to report both mid-year and end-year data, as a competitor or counterparty could more easily identify changes in a portfolio with additional data points.

These competitive issues would be more acute for private fund managers, which typically have fewer SMA accounts than other types of investment advisers and therefore would be unable to aggregate much, if any, SMA information. In fact, a fund manager may need to disclose non-aggregated data of a single SMA client under the proposed disclosure format, which would present serious concerns to the manager and the SMA client whose proprietary investment data would be revealed to the public.

For the above reasons, we recommend that the SEC not collect and publicly disclose on Form ADV the weighted average gross notional value of derivatives.[10]

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[10] *See* Advisers Act Section 202(c).

Other SMA Information Should Only be Reported on a Non-Public Basis

The proposed information would also require managers to report the number of accounts that fall within particular ranges of GNE amounts,[11] the average borrowings of such accounts,[12] and separately, the percentage of RAUM in SMA invested in each of ten asset categories.[13]

This proposed information is substantially more detailed than information currently collected on Form ADV, and is similar to information that private fund managers report on a confidential, non-public basis on Form PF for purposes of systemic risk assessment. In the release, the SEC confirms that it is collecting certain of the information because it is comparable to information it collects on Form PF, which was created to obtain information for the assessment of systemic risk.[14] We believe the proposed information about SMAs should be afforded the same level of confidentiality protection as information submitted on Form PF.

The proposed disclosure of the GNE or average borrowings of SMAs would reveal sensitive information about an account's investment strategy. For similar reasons as described above, disclosing the GNE of accounts as well as their average borrowings could harm both SMA clients and pooled vehicle investors. While we do not believe these values are appropriate measurements of account exposures, they nevertheless would provide insight into an investment strategy. As noted, a fund manager may need to report data of a single SMA client, which is not suitable for public disclosure.

We are also concerned with public disclosure of the percentage of RAUM in SMAs that is invested in certain asset categories. While we recognize that these data would likely be more aggregated than other SMA information, they nevertheless could reveal important information to market participants and counterparties. For example, if a manager that pursues a global macro strategy indicates that a significant percentage of SMA assets is invested in equities, competitors and counterparties could gain some understanding of the manager's strategy. If a subsequent update to the Form ADV indicates that assets have shifted from equities to fixed income, market participants will have additional insight that the manager has modified its investment strategy.

In the release, the SEC seeks feedback on whether disclosure of the proposed information could raise concerns under Section 210(c) of the Advisers Act, which prohibits the SEC from requiring any investment adviser to disclose the identity, investments, or affairs of any client, except insofar as the disclosure may be necessary or appropriate in an enforcement proceeding or investigation, or for the assessment of systemic risk. In our view, the information to be reported about SMAs potentially could be viewed as the disclosure of the identity, investments or affairs of an adviser's client if there were little or no aggregation of information.

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[11] Column 1 of Proposed Section 5.K(2)(a).

[12] Column 2 of Proposed Section 5.K(2)(a).

[13] Proposed Section 5.K(1)(a).

[14] Release at 33720.

For these reasons, we encourage the SEC to carefully consider whether the additional step of publicly disclosing this information would enhance its oversight, and whether any benefits would outweigh the costs to managers and clients in making the information public. The SEC should collect this SMA information on Form ADV in a non-public format, or use another collection method that is non-public and subject to enhanced confidentiality protections, such as those applicable to information submitted on Form PF.[15]

Additional Comments on Reporting SMA Information

We believe it would be appropriate for the SEC to provide an exclusion from reporting SMA information when a manager is acting as a sub-adviser to a registered investment company or other pooled vehicle pursuant to an arrangement with the adviser of such registered investment company or pooled vehicle. Such a manager may need to consider the entity an SMA client for purposes of the proposed amendments to Form ADV.

We recommend that the investment adviser to the pooled vehicle, rather than the sub-adviser, report any required information about the registered investment company or pooled vehicle. Such a requirement would properly allocate reporting obligations to the investment adviser, which would be responsible for, and have authority over, the operation of the registered investment company or pooled vehicle. The investment adviser would have full access to portfolio information, whereas a sub-adviser may not have complete access to such information. It would also avoid potential duplication of data reported to the SEC if both the investment adviser and sub-adviser were required to submit information about the same client, such as information required to be submitted about registered investment companies or private funds.

The SEC also requests feedback on whether Form ADV should require advisers to report information about the use of securities lending and repurchase agreements in SMAs. We do not believe this information would be appropriate for public disclosure. For reasons similar to those described above, such information could harm the competitive position of SMA clients or investors in pooled vehicles. Public disclosure of information about securities lending, for example, could have an adverse impact on the investment position of the account by providing competitors with insight into the manager's investment strategy.

Form ADV Amendments – Identifying Information

The SEC asks if it should seek information about whether advisers permit employees to have social media accounts associated with the advisers' business. We would not support including such a question in the Form. Private fund managers generally are aware of their obligations with respect to social media use by their employees, and the SEC staff has provided guidance for managers to ensure they are in compliance with applicable regulations.[16] To the extent a social media account associated with a firm is publicly available, it is easily discovered.

[15] *See* Advisers Act Section 202(c).

[16] Investment Adviser Use of Social Media, National Examination Risk Alert, SEC Office of Compliance Inspections and Examinations (Jan. 4, 2012).

And, to the extent that it is not publicly available, it should not be singled out any more than email or other forms of electronic communication.

Use of Third-Party Compliance Auditors

In the release, the SEC asks whether it should request information about advisers' use of third-party compliance auditors. We are also aware of recent comments by the SEC indicating that it may consider a program of third-party compliance reviews for investment advisers to supplement, but not replace, examinations conducted by OCIE.[17] In this light, we thought it would be helpful to provide our views on potential third-party compliance reviews for private fund managers.

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 difficult challenges to implementing an efficient, cost-effective system of third-party compliance reviews for private fund managers.

In order to create such a system, 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 and the manner in which firms would be chosen, the scope and applicable 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 for third-party firms, and issues related to reporting, disclosure and confidentiality, in particular for the treatment of sensitive intellectual property. We believe these types of threshold issues would be difficult to address in a uniform manner, and could create confusion among private fund managers and investors.

We also believe that, depending on the scope of reviews and other factors, there is a significant potential for costs of third-party compliance reviews to be substantial. We note, for example, that 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 to private fund managers would reflect this imbalance.

We would note that the SEC already has adopted a rule requiring an annual compliance review, which incorporates a principles-based approach.[18] This approach could serve as a flexible model for addressing some of the definitional challenges set forth above. However, many firms

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

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

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 is considering 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, it is worth noting that a number of registered investment advisers are dually-registered and therefore subject to review by SROs.[19] We would encourage the SEC to consider these factors as well as the different business models and related risks between private fund managers and advisers to retail clients in its consideration of third-party compliance reviews, and tailor any system to reflect the additional controls, such as external audits, that private fund managers already are required to have.

With respect to the SEC's question as to whether it should request information about advisers' use of third-party compliance auditors, we would not support collecting this information through a simple question on Form ADV. For the reasons described above, it would be hard for the SEC to obtain meaningful information about diverse compliance services through a simple question on the Form. Managers would face interpretive difficulties in answering the question, which would limit the usefulness of the information to regulators. A manager may also consider modifying a review in order to conform to the question, which would detract from a manager focusing on the needs of its clients.

[19] 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.

For these reasons, we believe 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.

Umbrella Registration

The proposal would amend Form ADV's instructions to establish conditions for an adviser to assess whether umbrella registration is available, and add a new schedule to Part 1A – Schedule R – that would have to be filed for each relying adviser. We support codifying the existing umbrella registration guidance, which we believe has been helpful to both private fund managers and regulators. We recommend, however, that the SEC permit certain exempt reporting advisers to be included as relying advisers in an umbrella registration.

In the release, the SEC explains that the filing of a single Form ADV for exempt reporting advisers in a manner similar to the filing of an umbrella registration for registered advisers would not be available.[20] We believe there are instances where umbrella registration of exempt reporting advisers would be consistent with the SEC's policy objectives and reduce burdens for both the SEC staff and private fund managers. For example, for a variety of reasons, an SEC-registered private fund manager may establish an affiliated entity to separately manage a private fund. Such an affiliated entity could fall within the definition of an exempt reporting adviser, depending on its level of assets under management.[21]

We believe it would be consistent with the goals of umbrella registration to permit a private fund manager to include such an affiliated entity in its umbrella registration as a relying adviser, if it is operated as part of a single advisory business and meets the listed conditions of umbrella registration set out in the release. Including this type of exempt reporting adviser in the umbrella registration would avoid the anomalous result of requiring an SEC-registered private fund manager to separately register certain of its affiliated entities with a state regulator, which would lead to unnecessary administrative complexity and costs for the manager and its clients.

It would also provide the SEC and investors with a single filing for the private fund manager's advisory affiliates, which would enhance and simplify the SEC's oversight of the manager. This increased filing efficiency is entirely consistent with the goals of umbrella registration, and we strongly recommend that the SEC permit managers to include these exempt reporting advisers in their umbrella registration.

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[20] Footnote 56 at 33725 ("[T]he conditions of a single advisory business are designed, in part, to reflect requirements that only apply to registered advisers, including the requirement for compliance policies and procedures pursuant to rule 206(4)–7 under the Advisers Act and for a code of ethics pursuant to rule 204A–1 under the Advisers Act.").

[21] An exempt reporting adviser includes an investment adviser that qualifies for the exemption from registration under Rule 203(m)–1 under the Advisers Act because it is an adviser solely to private funds and has assets under management in the U.S. of less than $150 million.

MFA appreciates the opportunity to provide comments to the Commission regarding the proposals. 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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