September 11, 2020

Via Electronic Submission: rule-comments@sec.gov

Ms. Vanessa Countryman, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Proposed Rule on Investment Adviser Advertisements; Compensation for Solicitations (RIN: 3235-AM08; Release No. IA-5407; File No. S7-21-19)

Dear Ms. Countryman:

The Managed Funds Association ("MFA") and the Alternative Investment Management Association ("AIMA") (the "Associations") appreciate the opportunity to provide additional comments on the Proposed Rule on Investment Adviser Advertisements; Compensation for Solicitations (the "Proposals"). The Associations recognize that the use of hypothetical performance in advertising materials presents a challenging issue and share the Commission's concern that such use has the potential to mislead investors if done improperly or without appropriate disclosure. We believe it is also important to recognize, however, that hypothetical performance is a key component of the process by which sophisticated investors evaluate private fund investments and alternative investment strategies. As such, it is critical that the Commission adopts a balanced approach that ensures non-retail investors can receive the type of information on which they have come to rely, while requiring appropriate disclosure that allows those investors to use such information in an informed manner.

As noted in our prior letters,[1] the Associations strongly believe that the Proposals do not strike this balance. As a result, we believe the Proposals inadvertently would harm current and prospective clients and investors (together, "Allocators") by effectively preventing managers from providing those Allocators with hypothetical performance information that they consider crucial in evaluating advisers and investments. Of primary concern is language requiring an adviser to disclose information that would "enable the recipient to attempt to replicate the hypothetical performance."

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[1] *See* MFA-AIMA February 10, 2020 comment letter on the Proposed Rule on Investment Adviser Advertisements; Compensation for Solicitations, available at: https://www.managedfunds.org/wp-content/uploads/2020/04/SEC-Proposed-Advertising-and-Solicitation-Rules-Final-MFA-and-AIMA-Letter.pdf. *See also*, MFA-AIMA May 8, 2020 letter summarizing the Associations' recommendations on the SEC's advertising rule, available at: https://www.managedfunds.org/wp-content/uploads/2020/05/MFA-AIMA-Summary-of-Advertising-Rule-Recommendations-Final-5-8-20.pdf.

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We do not believe that the Commission intended this language to be interpreted to require an adviser to disclose its proprietary information and we encourage the Commission to modify the Proposals to avoid creating such an interpretation.

We believe these issues are generally applicable to all adviser-Allocator relationships; however, we recognize that there may be additional considerations that are relevant in the context of retail investors. The discussion and recommendations below are framed in the context of the relationships and interactions that our members maintain with sophisticated Allocators, consistent with the restrictions in the securities laws regarding the offer and sale of private funds.

To better tailor the requirements of the final rule, we encourage the Commission to make the following modifications:

(1) delete the language about information that would enable a recipient to replicate the hypothetical performance and confirm that the Proposals are not intended to require an adviser to disclose its proprietary information;
(2) amend the Proposals to adopt a more principles-based and tailored framework for disclosures to be provided, or offered to be provided, in advertisements with hypothetical performance provided to non-retail Allocators, consistent with the discussion below; and
(3) modify the definitions of retail and non-retail investors, as discussed in more detail in the Associations' prior comment letters.

Set out below is a brief summary of the principles we believe are key to a well-tailored disclosure regime, as well as a discussion of the value that clients and investors place on the different types of hypothetical performance that are used in the industry today and their associated risk profiles. We also provide a detailed discussion of sample disclosure language to demonstrate how an appropriately tailored disclosure regime would facilitate useful, explanatory disclosure that does not threaten an adviser's valuable intellectual property and that provides Allocators with the information they need to make informed decisions.

I. A Principles-Based Disclosure Regime with Practical Guidelines

Because the goal of disclosure is to be explanatory, any disclosure regime for hypothetical performance should provide advisers with appropriate flexibility to tailor that disclosure to the applicable content. As such, an adviser should be required to explain the core characteristics of a given return stream shown in its advertisements and should tailor its disclosure based on the risk profile of the performance being shown. It is critical, however, that the framework not require an adviser to disclose its proprietary information.

Accordingly, we encourage the Commission to adopt a non-prescriptive disclosure regime, together with Commission guidance on key disclosure elements that advisers would be expected to provide or offer to provide, as relevant, in advertisements with hypothetical performance. In the appendix, we include a discussion of disclosure elements in existing staff guidance on advertisements and how the Commission could consider updating that guidance. We believe the development of generally applicable, practical guidelines is a better solution for a diverse community of advisers that use hypothetical performance in connection with a wide range of investment strategies and products. Most importantly, such an approach allows advisers to tailor disclosure based on the risk profile of the performance information being presented and the sophistication of its recipients. We believe that prescriptive rules, on the other hand, are not well suited to adapt to evolving market dynamics and the expectations of sophisticated investors.

II. Allocator Use of Hypothetical Performance

As noted in our prior comment letters, hypothetical performance is a critical component of the ongoing dialogue between advisers and Allocators. For many advisers, particularly those that employ systematic, rules-based approaches to investing, creating and testing models are core to their research and investment processes. Advisers regularly test a potential investment approach by creating a model and then applying historical market data to that model, which generates hypothetical performance. This process helps the adviser understand how the model would likely have performed through different market conditions and timeframes and is critical to how advisers explain their investment processes and strategies to Allocators.

Similarly, Allocators use hypothetical performance as a central part of their analysis of the research and investment processes of many advisers. Hypothetical performance aids Allocators in assessing an investment strategy and provides valuable data to analyze, including performance of a strategy during a variety of market conditions, across different time horizons, or with different parameters applied (*e.g.*, use of leverage or a different base currency). This information can help Allocators assess the overall quality of a given strategy, inform an Allocator's expectations for how a strategy might perform through time, and provide insight into the ways in which the adviser accounts for different types of economic environments. Without hypothetical performance information, Allocators may find it difficult or impossible to assess adequately the potential risks and returns of certain strategies in which they are seeking to invest.

This type of analysis is helpful both in assessing new investment strategies that do not have a track record and in assessing strategies with a track record that has not endured certain economic environments. For example, if earlier this year an Allocator conducted diligence on an equity long/short strategy that began trading in 2010, the Allocator would not have been able to assess how the strategy would have performed in an environment similar to 2008. With access to hypothetical performance that applies historical market data to the strategy's model, the Allocator could better understand the potential weaknesses of the strategy in a way the actual trading results alone might not reveal.

Of course, Allocators do not rely on hypothetical performance alone when assessing an adviser or an investment strategy. Allocators understand the limitations of hypothetical performance as well as its utility and, accordingly, consider hypothetical performance in conjunction with an adviser's actual track record(s) and a host of other materials and analytical perspectives.

III. Different Types of Hypothetical Performance and Risk Profiles

In the Proposals, the Commission noted that hypothetical performance can be broadly defined as performance results that were "not actually achieved" and goes on to provide three non-exhaustive examples of hypothetical performance: (1) back-tested performance; (2) representative performance; and (3) targets and projections. Even though the Commission recognized in its commentary that these examples carry differing risk profiles, the Proposals apply the same disclosure obligations to each category, which we believe is contrary to the Commission's stated goal of a principles-based regulatory scheme.

Forward-Looking Statements

The Proposals include as "hypothetical performance" forward-looking statements such as targets and projections. In our view, such statements should not be considered hypothetical performance, as these are statements of an adviser's own expectations or goals for the future returns of a given portfolio, a fact that is well understood by Allocators. We believe that forward-looking statements are most appropriately regulated by the anti-fraud provision of the advertising rule.

Performance Not Based on Actual Trading

This type of hypothetical performance typically includes the application of a model to market data over a certain time frame and is often referred to as back-tested or simulated performance. There are certain risks inherent in the generation of such track records, including the possibility that an adviser's model benefits from hindsight and/or the fact that the adviser need not take on financial risk when generating the returns from the model.

Another variation of hypothetical performance not based on actual trading is representative performance, which shows the returns of a portfolio an adviser has been "managing" and documenting in real time through use of a model. Representative performance has a lower level of risk of hindsight benefit than back-tested performance, because the portfolio was "managed" in real time, but the lack of actual financial risk taken by the adviser in the representative portfolio remains. With respect to back-tested and representative performance, we believe the rule should provide more flexibility so that advisers can appropriately tailor their disclosure in a manner consistent with the associated risk.

Performance Based on Actual Trading

This type of hypothetical performance typically results from taking an actual return stream and adjusting it based on currency, volatility, the removal of certain asset classes, or a combination of the foregoing. Most frequently, this is referred to as related fund performance or related portfolio performance. In these cases, despite the fact that such performance was "not actually achieved," we believe the risks are lower than for back-tested or representative performance. Because the basis for the return stream is something the adviser actually achieved in live trading, there is significantly lower hindsight bias, and the performance reflects real financial risk taken by the adviser. With respect to related fund or related portfolio performance, we believe a simple description of the manner by which the return stream has been adjusted should generally constitute sufficient explanatory disclosure.

IV. Conclusion

MFA[2] and AIMA[3] appreciate the opportunity to continue discussing the Proposals with the Commission. We believe that it is critical for the final rules to adopt a balanced approach that ensures Allocators receive the type of information they expect with appropriate disclosure that allows those Allocators to make informed judgments about the information. We would welcome the opportunity to discuss our comments with the Commission in a telephonic meeting. If you have any questions about these comments, please do not hesitate to contact Benjamin Allensworth [redacted] at MFA or Suzan Rose [redacted] at AIMA.

Respectfully submitted,

/s/ Mark D. Epley
Mark D. Epley

Chief Legal Officer
Managed Funds Association

/s/ Jiří Król
Jiří Król

Deputy CEO
Global Head of Government Affairs
Alternative Investment Management Association

cc:
The Hon. Jay Clayton, Chairman
The Hon. Hester M. Peirce, Commissioner
The Hon. Elad L. Roisman, Commissioner
The Hon. Allison Herren Lee, Commissioner
The Hon. Caroline A. Crenshaw, Commissioner

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[2] 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 over time. 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.

[3] The Alternative Investment Management Association is the global representative of the alternative investment industry, with around 2,000 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2 trillion in hedge fund and private credit assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programs and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council ("ACC") to help firms focused in the private credit and direct lending space. The ACC currently represents over 170 members that manage $400 billion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation ("CAIA"), the first and only specialized educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors).

APPENDIX

We discuss below disclosure elements drawn from existing SEC staff guidance, identifying those that we believe generally are appropriate in advertisements with hypothetical performance.[4] We also discuss those elements that we believe require some level of flexibility for advisers to determine if they are material to the hypothetical performance information being presented and, if material, how the element should be disclosed. We also discuss how advisers think about certain of the elements specifically in the context of back-tested hypothetical performance as well as in the context of related fund or related portfolio performance. We encourage the Commission to consider the discussion below as it contemplates how to finalize the Proposals in a manner that provides guidance to advisers on how to comply with a principles-based approach without creating overly prescriptive requirements that can be difficult to apply in practice.

<u>General Disclosure Elements</u>

We would expect advertisements that present hypothetical performance information to contain the following explanations and disclosures:

(1) the "as of" date of the performance, as well as the start date and frequency (*e.g.*, if the performance is annualized) of data presented;

(2) whether the returns are presented net or gross of fees. As discussed in our February comment letter to the Commission, we are concerned that the proposed requirement to include a specific schedule of fees and expenses will create unnecessary complexity and we encourage the Commission to delete that language from the Proposals;

(3) as discussed in more detail in the "Disclosure Elements for Performance Not Based on Actual Trading" section below, whether the returns presented reflect actual or hypothetical performance (and if hypothetical, which form);

(4) whether the performance reflects the reinvestment of dividends or other earnings, where appropriate;

(5) a statement that performance is not guaranteed and any actual investment may not achieve the depicted performance and may experience losses; and

(6) discussion of any material differences relevant to a comparison to a market benchmark, if applicable. We note that many private fund strategies do not utilize a relevant benchmark for comparison purposes. As such, we believe the "if applicable" language needs to be included if this element were to be required.

We believe that requiring an adviser to disclose market or economic conditions that materially impacted the hypothetical performance portrayed would create significant complexity for advisers to determine how to determine which conditions should be included. Given the subjectivity required to determine which conditions should be disclosed and which conditions would not have

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[4] We would expect these general disclosure elements to apply to advertisements that contain actual performance disclosures as well, though the focus of our discussion in this letter is on advertisements with hypothetical performance information.

been material, we believe such disclosure could be confusing to Allocators in understanding the characteristics and limitations of the hypothetical returns shown. Accordingly, we encourage the Commission not to require advisers to include this as a required disclosure element. Alternatively, we would expect advisers to include a more general disclosure that market or economic conditions are relevant to the performance of any portfolio.

We believe that requiring an adviser to disclose if conditions, objectives, or investment strategies changed materially during the time period portrayed, and what any such change had on the results portrayed would be challenging to implement in practice, particularly with respect to changes in conditions (which may be more relevant in the context of actual performance), and not useful for Allocators in understanding the characteristics and limitations of the hypothetical returns shown. We believe it would be reasonable for advisers to disclose whether investment strategies or objectives have changed and what any such change had on the results portrayed, if applicable.

Disclosure Elements for Performance Not Based on Actual Trading

In the case of back-tested performance, the Associations believe an adviser also should clearly disclose that: (1) the returns shown are not based on actual trading and are based on assumptions made by the adviser; and (2) the adviser made such assumptions and otherwise developed the track record with the benefit of hindsight and without undertaking actual financial risk. In the case of representative performance, the Associations believe that the same considerations generally apply, except that disclosure of the benefits of hindsight would be less relevant because the performance was experienced and documented in real time.

The adviser should provide a description of the hypothetical portfolio's strategy and the types of asset classes comprising the portfolio (*e.g.*, any limitations on the investment universe). The adviser should also disclose if the portfolio's investment strategy or objective changed materially during the time period presented, and how such change affected the results portrayed. We do not believe that an adviser should be required to disclose the criteria it used to select securities, as this would create a significant risk that an adviser would be required to disclose its intellectual property or other proprietary information. In explaining the scope of an adviser's disclosure obligations, we believe it is important for the SEC to make clear that an adviser is not required to disclose its intellectual property or other proprietary information.

Disclosure Elements for Performance Based on Actual Trading

In the case of related fund or related portfolio performance, disclosure should include an explanation of the adjustments the adviser made. For example, assume that an adviser manages a fund that employs a global macro strategy and that runs at 10% target volatility. Certain prospects of the adviser are interested in the strategy but would like to invest at a higher volatility. In such situations, an adviser takes the actual returns of the global macro strategy and adjusts such returns to account for the desired, higher volatility. In this case, the Associations believe that indicating that the returns shown are based on the actual returns of a related portfolio that have been adjusted to a higher target volatility would be sufficient to help an Allocator understand the performance shown.

Forward-Looking Statements

As noted above and in our prior comment letters, the Associations do not believe that targets and projections should be included in the definition of hypothetical performance. Nevertheless, should the Commission take the view that targets and projections are hypothetical performance, the Associations believe that such statements should not be subject to onerous disclosure obligations; these statements should be permitted so long as the adviser makes clear that the target or projection is not a guarantee of a particular result in the future.

Ancillary Disclosure Considerations

The Associations do not believe that the Commission should mandate a specific template for disclosure; however, we believe that it may be informative for the Commission to see an example of what disclosure that incorporates the above elements might look like. We have included such sample language in this Appendix for informational purposes. We note that the sample disclosure language below would not be appropriate for all advisers or all investment strategies; however, we believe that the sample language helps to demonstrate how incorporating the elements discussed above can provide meaningful disclosure to investors. In addition, we agree with the SEC's suggested means of providing such disclosure to investors, which would require an adviser either to provide or, in the case of materials provided to non-retail persons, offer to provide promptly relevant disclosure information.

It also is important to bear in mind that many of the Associations' members are registrants with multiple regulators and self-regulatory organizations, such the National Futures Association ("NFA"). In the case of NFA members, any promotional material that contains hypothetical performance must include a prominent legend in proximity to any hypothetical performance that explains the limitations of such performance.

While investor protection is the paramount consideration, we urge the Commission to avoid a scenario in which disclosure overtakes content, as investors are less likely to read and carefully consider lengthy disclosure that appears multiple times throughout a presentation. In this regard, it is important to note that FINRA recently expressed a similar concern in Notice 19-31, in which it advocated in favor of simpler, concise disclosure to ensure that disclosure "does not inhibit an investor's understanding of the required information." We encourage the Commission to work with the NFA to develop a harmonized approach to disclosure so that dual registrants can provide meaningful disclosure to Allocators under both regulatory frameworks.

Sample Disclosure Language

Back-Tested Performance

Chart/Table bearing period of performance and "as of" date. Sample disclosure language to be provided, or offered to be provided:

The performance is hypothetical, is presented for illustrative purposes only and does not represent the results of actual trading in any portfolio managed by ABC Fund Management during the period shown. It was developed with the benefit of hindsight and may not reflect the impact that material economic and market factors might have had on ABC Fund Management's decision-making were it managing capital deploying the relevant strategy during such period.

No representation or warranty is made as to the reasonableness of the assumptions made or that all assumptions used in achieving the returns have been stated or fully considered. Changes in the assumptions may have a material impact on the hypothetical returns presented.

The hypothetical portfolio used to generate the returns above reflects application of an equity arbitrage strategy that seeks to take advantage of temporary mispricings in listed and non-listed securities. The portfolio is predominantly focused on U.S. securities in the Healthcare and Biotechnology sectors.

For the purposes of this presentation, performance is presented net of all management and performance fees, as well as other typical fees and expenses incurred by investors, as described in ABC Fund Management's Form ADV Part 2A and relevant offering documents. Actual fees may vary, and investors should refer to a fund's respective offering documents for specific details on applicable fees.

ABC Fund Management did not manage any portfolio in a manner similar to this during the period depicted, and no representation is being made that any account will or is likely to achieve profits or losses similar to those shown. Actual performance is not guaranteed, and any actual investment may result in losses.

Related Portfolio Performance

Chart/Table bearing period of performance and "as of" date. Sample disclosure language to be provided, or offered to be provided:

The above performance is hypothetical, is presented for illustrative purposes only. The hypothetical portfolio comprises the actual historical positions of Fund A during the same time period, adjusted to apply a 15% volatility target and 2.0x leverage. The performance of Fund A was materially different from the hypothetical performance shown during the period depicted.

The hypothetical portfolio used to generate the returns above employs a long-short total return strategy, using the MSCI XXXX Total Return Index as a benchmark. No representation or warranty is made as to the reasonableness of the assumptions made in developing this hypothetical performance or that all assumptions used in achieving the returns shown have been stated or fully considered. Changes in the assumptions may have a material impact on the hypothetical returns presented.

The hypothetical performance is presented gross of fees. It includes the reinvestment of dividends and capital gains but does not include the deduction of advisory and performance fees or transaction costs and taxes, which if included would lower performance. Actual fees may vary, and investors should refer to a fund's respective offering documents for specific details on applicable fees.

No representation is being made that any account will or is likely to achieve profits or losses similar to those shown. Actual performance is not guaranteed, and any actual investment may result in losses.