

February 14, 2017

Bruce H. Newman

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Ms. Josephine J. Tao  
 Assistant Director  
 Division of Trading and Markets  
 U.S. Securities and Exchange Commission  
 100 F Street, NE  
 Washington, DC 20549

Dear Ms. Tao:

I write on behalf of Magnitude Capital, LLC (“**Magnitude**”), which respectfully requests that the staff of the Division of Trading and Markets (the “**Division**”) of the U.S. Securities and Exchange Commission (the “**Commission**” or “**SEC**”) consider Magnitude’s request for exemptive relief for Magnitude Special Investments Portfolio Fund, Ltd. (“**MSIPF**”) from the requirement under Rule 200(c) of Regulation SHO<sup>1</sup> under the Securities Exchange Act of 1934, as amended (the “**Exchange Act**”), to have a net long position in a security in order to be deemed to own such security for purposes of Rule 200(g)(1) of Regulation SHO<sup>2</sup>, thereby permitting executing brokers to mark sell orders for sub-accounts of MSIPF in the manner set forth below.

I. Facts and BackgroundA. **Key Facts Regarding Magnitude**

Magnitude was formed in 2003. Since 2006, it has been registered with the SEC as an investment adviser pursuant to the Investment Advisers Act of 1940, as amended (the “**Advisers Act**”). Magnitude also is registered with the Commodity Futures Trading Commission as a “commodity pool operator” and is a member of the National Futures Association. As a registered investment adviser, pursuant to Advisers Act Rule 204-2 Magnitude is required to maintain accurate books and records in connection with its advisory business, including among other things a record as to whether each sell order was entered as long, short, or short exempt. Pursuant to Section 204 of the Advisers Act Magnitude and its books and records are subject to examination by the SEC or its representatives at any time. Magnitude was examined by the staff of the SEC’s Office of Compliance Inspections and Examinations in 2011.

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<sup>1</sup> 17 C.F.R. § 242.200(c).

<sup>2</sup> 17 C.F.R. § 242.200(g)(1).

Substantially all of Magnitude's assets under management are attributable to private funds of hedge funds sponsored and managed by Magnitude (the "**Funds**").<sup>3</sup> As of December 31, 2016, Magnitude had net assets under management of approximately \$3,986,717,106. Magnitude is neither a broker-dealer nor affiliated with any broker-dealer.

## **B. Background on Fund Structures Generally**

Many hedge funds and funds of hedge funds utilize "master-feeder" structures. These are generally two-tiered structures consisting of one or more "feeder" funds and a single "master" fund. End investors purchase interests in a feeder fund. In turn, the feeder funds invest all or a substantial portion of their capital in the master fund, which makes the underlying investments in which end investors indirectly participate. For tax reasons, funds of hedge funds are typically established as parallel onshore and offshore master-feeder structures in which an onshore master fund invests in underlying hedge funds that are characterized as partnerships for U.S. federal income tax purposes, and an offshore master fund invests in underlying funds that are characterized as foreign corporations for U.S. federal income tax purposes.

While a master-feeder structure in its simplest form is generally two-tiered, additional legal entities may be included for tax, regulatory or other purposes; for example, between a feeder fund and a master fund, or as direct or indirect subsidiaries of a master fund. Such entities may be used as trading vehicles, as "special purpose investment vehicles" used to hold one or more particular investments, or for other reasons.

While funds of hedge funds often invest in private investment funds managed by third-party asset managers ("**Third-Party Funds**"), they also frequently invest with such third-party managers through "managed accounts." Such managed accounts may be owned by separate legal entities that are subsidiaries of a master fund, rather than by the master fund itself.

## **C. Magnitude's Fund Structure**

The Funds consist of, among other things: (1) "feeder" funds in which end investors purchase interests (the "**Feeder Funds**"); (2) "master" funds in which the Feeder Funds (and in some cases other master funds) pool their capital (the "**Master Funds**"); and (3) one or more intermediate entities owned by a Feeder Fund and investing in a Master Fund.

Feeder Funds. Interests in the Feeder Funds are offered and sold to U.S. investors that are "accredited investors" under Regulation D of the Securities Act of 1933 (the "**Securities Act**") and either "qualified purchasers" or "knowledgeable employees" under the Investment Company Act of 1940 ("**40 Act**").<sup>4</sup> Interests in the Feeder Funds are offered and sold to non-

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<sup>3</sup> Funds of hedge funds generally invest all or substantially all of their assets in other hedge funds or similar private investment vehicles.

<sup>4</sup> The Feeder Funds offered and sold solely to U.S. taxable investors are not required to be registered under the '40 Act in reliance on the exclusion from the definition of "investment company" in Section 3(c)(7) of that Act. The interests in those Feeder Funds are exempt from registration under the Securities Act pursuant to Rule 506(b) of Regulation D thereunder.

U.S. investors that are not “U.S. persons” within the meaning of such term in Regulation S under the Securities Act.<sup>5</sup>

**Master Funds.** Each Feeder Fund invests all or a portion of its assets in one of the Master Funds. In addition, one of the Master Funds invests in an intermediate Master Fund (the “**Intermediate Master Fund**”) that invests as described below. The Master Funds invest their capital directly or indirectly with third-party asset managers (“**Third-Party Manager(s)**”), generally by investing in Third-Party Funds sponsored and/or managed by such managers, or by investing with Third-Party Managers through separately managed accounts.

**MSIPF.** MSIPF, a Cayman Islands exempted company, is jointly owned by (i) the Intermediate Master Fund, and (ii) indirectly (through another entity) by one Master Fund. Magnitude invests a portion of the Master Funds’ assets with Third-Party Managers via separately managed accounts held through MSIPF. MSIPF currently has two prime brokerage accounts, each of which has multiple sub-accounts. Magnitude and MSIPF have entered into sub-advisory agreements with Third-Party Managers pursuant to which Magnitude, on behalf of MSIPF, has delegated full investment discretion to each such Third-Party Manager with respect to assets of a given sub-account or sub-accounts of MSIPF (“**Managed Sub-Account(s)**”). Among other things, each Third-Party Manager has the authority to select executing brokers and to place orders for securities transactions with those brokers with respect to its Managed Sub-Account(s). Pursuant to Advisers Act Rule 204-2, Magnitude maintains records showing all purchases, sales, receipts, and deliveries of securities for Managed Sub-Accounts of MSIPF, including records as to whether each sell order was entered as long, short, or short exempt.

The Third-Party Managers for MSIPF are currently either SEC-registered investment advisers, or “exempt reporting advisers” under the Advisers Act,<sup>6</sup> and thus subject to the SEC’s examination authority and recordkeeping requirements under that Act, among other things.

#### **D. Independence of Third-Party Managers**

Magnitude represents that the Third-Party Managers for MSIPF are independent of Magnitude and each other, including in the following respects:

1. No Third-Party Manager is affiliated with Magnitude or with any other Third-Party Manager.
2. Each Third-Party Manager is physically separate from the other Third-Party

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<sup>5</sup> The Feeder Funds offered and sold to U.S. tax-exempt investors and non-U.S. investors are not required to be registered under the ‘40 Act pursuant to Section 7(d) of that Act and the principles of Section 3(c)(7) thereof. Interests in those Feeder Funds are exempt from registration under the Securities Act pursuant to (a) Rule 506(b) of Regulation D with respect to offers and sales of interests to U.S. tax-exempt investors, and (b) Regulation S under the Securities Act with respect to offers and sales of interests to non-U.S. investors.

<sup>6</sup> Of the four exempt reporting advisers, three are registered with foreign securities regulators; one is registered with the FCA in the United Kingdom, one is licensed by the Financial Services Board of South Africa, and one is registered with the Korean Financial Services Commission/Financial Supervisory Service.

Managers and has its own office space, facilities and personnel.

3. Each Third-Party Manager's investment strategies and objectives are developed independently.
4. No Third-Party Manager<sup>7</sup> has access to information regarding holdings or transactions in any sub-account managed by any other Third-Party Manager.
5. Each Third-Party Manager uses its own separate trading systems and infrastructure.<sup>8</sup>
6. Except as described in Section IE.4 below, Third-Party Managers do not coordinate their trading or investment activities with Magnitude<sup>9</sup> or with any other Third-Party Manager.
7. Magnitude has established policies and procedures limiting persons directly supervised by Magnitude from sharing information regarding any Third-Party Manager's holdings, transactions, or investment strategy with respect to an account or subaccount of MSIPF with any other Third-Party Manager.

#### E. Magnitude's Risk Management, Hedging, and Oversight Activities

Magnitude may establish and from time to time modify risk management goals and investment guidelines and otherwise monitor positions and performance across MSIPF's sub-accounts, and may perform hedging activities in connection with such risk management analysis. Specifically, Magnitude represents that:

1. Magnitude has access to and reviews reports containing information on the holdings of Managed Sub-Accounts on a T+1 basis.
2. Magnitude may direct or effect hedging activities in one or more separate sub-accounts owned by MSIPF that are managed directly and solely by Magnitude (and not by any Third-Party Manager) to reduce MSIPF's and/or the Master Funds' overall exposure to broad market risks (such sub-accounts, "**Sub-Hedging Accounts**"). Magnitude has access to current information on the holdings of Hedging Sub-Accounts. When evaluating hedging activities, Magnitude may analyze market exposures of an individual Managed Sub-Account, of multiple Managed Sub-Accounts, of MSIPF in the aggregate, or of the Master Funds. To

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<sup>7</sup> The reference to Third-Party Manager here and elsewhere in this letter, as appropriate, includes any natural person associated with the Third-Party Manager.

<sup>8</sup> Third-Party Managers may use systems and infrastructure provided by the same service providers; however, those systems and infrastructure operate independently of each other and do not provide Third-Party Managers with information regarding account holdings or transactions of other Third-Party Managers.

<sup>9</sup> The reference to Magnitude here and elsewhere in this letter, as appropriate, includes any natural person associated with Magnitude,

date, all hedges: (i) have been designed to reduce long market exposure of a Managed Sub-Accounts or MSIPF; (ii) have been implemented through short sales of index-tracking ETFs within Sub-Hedging Accounts or through index swaps; (iii) have been rebalanced on a periodic basis (typically no more frequently than monthly) based on MSIPF's or the relevant Managed Sub-Accounts' long market exposure.

3. Magnitude investment personnel who participate in these activities are not involved in directing or effecting individual trades for any Managed Sub-Account.
4. Magnitude may have approval rights over certain individual transactions for MSIPF where a Third-Party Manager proposes a principal transaction<sup>10</sup> or cross trade<sup>11</sup> between MSIPF and another client account unaffiliated with Magnitude and MSIPF for which the Third-Party Manager has investment discretion. Such approval rights are designed to require Magnitude's consent to transactions that are subject to conflicts of interest between the Third-Party Manager and MSIPF, and thus are for the protection of MSIPF and its indirect investors. Magnitude also may have approval rights over certain transactions proposed by a Third-Party Manager that deviate from agreed-upon investment guidelines, such as investments in privately-issued securities or non-ordinary course transactions in municipal bonds.

## II. Analysis

Rule 200(g) of Regulation SHO requires broker-dealers to mark sell orders long or short based on, among other things, whether "the seller is deemed to own the security being sold." Circumstances under which a person will be "deemed to own" securities are defined in Rule 200(b) through (e); in particular, Rule 200(c) provides that a "person shall be deemed to own securities only to the extent that he has a net long position."

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<sup>10</sup> Section 206(3) of the Advisers Act generally makes it unlawful for an investment adviser acting as principal for its own account to buy or sell securities from or to a client without providing disclosure to, and obtaining the consent of, that client. Accordingly, any Third-Party Manager entering into such a "principal transaction" with MSIPF is required by law to disclose the transaction and obtain MSIPF's consent thereto. In such instances, Magnitude, acting as investment manager to MSIPF, would have authority to consent or withhold consent.

<sup>11</sup> Cross trades are pre-arranged transactions effected by an investment adviser between two client accounts managed by that adviser. If the investment manager is not also a broker-dealer and receives no special compensation besides its advisory fee, cross trades require general disclosure but do not require client consent under the Advisers Act. Nonetheless, they are inherently prone to potential conflicts of interest and specifically implicate the investment adviser's fiduciary duties in determining whether such transactions are appropriate — in particular, the duty to seek best execution and the duty to act in the best interests of each client. Accordingly, Magnitude has negotiated consent rights with respect to cross trades between MSIPF and other accounts managed by Third-Party Managers, in an effort to ensure that MSIPF is not disadvantaged by the potential conflicts of interest associated with any cross trade.

On its face, Rule 200 would require executing broker-dealers to mark sell orders for MSIPF long or short based on, among other things, whether “the seller” — *i.e.*, MSIPF — is deemed to own the security being sold. The determination of whether the seller has a net long position thus would be required to be made by netting the positions of all accounts and sub-accounts of MSIPF.

Since Third-Party Managers may trade in the same or similar asset classes, industries and sectors, they may have overlapping positions in the same security, which would require netting positions across Managed Sub-Accounts managed by different Third-Party Managers. Netting the positions of all accounts and sub-accounts of MSIPF for order marking purposes is impractical because Magnitude and Third-Party Managers use separate trading systems and infrastructure and creating a system that nets for positions across Magnitude and Third-Party Managers would be cost prohibitive.<sup>12</sup> In addition, for Third-Party Managers, doing so would require pre-trade sharing of sensitive confidential and proprietary information regarding Third-Party Managers’ portfolios. This would make it possible for Third-Party Managers to trade, for their other customers’ or their own accounts, on information about other Third-Party Managers’ pending transactions and/or established positions for MSIPF’s account. Each Third-Party Manager’s position and order information is central to its competitive advantage, and failing to protect that information thus poses potential harm to the Third-Party Manager’s other advisory clients (for example, other managers “crowding in” on pending trades may impact execution prices). In addition, requiring MSIPF’s Third-Party Managers to share that information with other managers would likely make those Third-Party Managers unwilling to do business with MSIPF, thus disadvantaging MSIPF’s ultimate investors (*i.e.*, investors in the Feeder Funds) by making Third-Party Manager expertise unavailable to them. Pending order information also may itself be market-moving, material nonpublic information, the sharing of which could raise concerns under Exchange Act Section 10(b) and Rule 10b-5 thereunder.

Requiring netting of all MSIPF positions would thus interfere with trading of Third-Party Managers to the detriment of MSIPF’s underlying investors.

### III. Request for Relief

Magnitude respectfully requests exemptive relief for MSIPF from the requirement in Rule 200(c) for MSIPF to have a net long position in a security in order to be deemed to own such security for purposes of Rule 200(g)(1) of Regulation SHO, subject to certain conditions described below. The requested exemption would permit MSIPF’s executing brokers to mark sell orders placed:

- by a Third-Party Manager on behalf of MSIPF, as “long” or “short” (or “short exempt”) based on the net position of the Managed Sub-Account(s) managed by that Third-Party Manager on behalf of MSIPF, and not based on the net position of all accounts and sub-accounts owned by MSIPF; or

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<sup>12</sup> As discussed above, Magnitude has access to and reviews reports containing information on the holdings of Managed Sub-Accounts on a T+1 basis.

- by Magnitude on behalf of a Sub-Hedging Account, as “long” or “short” (or “short exempt”) based on the net position of the Sub-Hedging Account(s) managed by Magnitude on behalf of MSIPF, and not based on the net position of all accounts and sub-accounts owned by MSIPF.<sup>13</sup>

The requested relief would be subject to the following conditions:

1. MSIPF shall be deemed to own such security for purposes of Rules 200(g)(1), 201(d)(1), 203(b)(2)(ii), and 204(a)(2) of Regulation SHO only if either:

(a) all Managed Sub-Accounts managed by such Third-Party Manager have, in the aggregate, a net long position in such security at the time such order to sell is submitted by such Third-Party Manager (as determined in accordance with paragraph III(2)(a)) equal to or in excess of the total number of shares to be sold in such order; or

(b) all Sub-Hedging Accounts have, in the aggregate, a net long position in such security at the time such order to sell is submitted by Magnitude (as determined in accordance with paragraph III(3)(a)) equal to or in excess of the total number of shares to be sold in such order; and

2. At the time any Third-Party Manager submits any order to sell a security to a broker-dealer for execution for a Managed Sub-Account managed by such Third-Party Manager, such Third-Party Manager shall:

(a) determine the net position of all Managed Sub-Accounts managed by such Third-Party Manager (“**Third-Party Manager’s Sub-Accounts**”) in such security on a real-time basis by aggregating the long positions in such security that MSIPF is deemed to own pursuant to Rule 200(b) of Regulation SHO and the short positions in such security, each such position in the Third-Party Manager’s Sub-Accounts at the time such order is submitted;<sup>14</sup> and

(b) solely for purposes of whether the seller is deemed to own the security being sold, inform such broker-dealer whether or not such order should be marked “long” or “short,” provided that such Third-Party Manager shall inform such broker-dealer that such order should be marked “long” only if the Third-Party Manager’s Sub-Accounts have a net long position in such security, as determined under subparagraph (a), that is equal to or in excess of the total number of shares to be sold in such order; and

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<sup>13</sup> In the event that Magnitude or a Third-Party Manager wishes to purchase shares in an offering subject to Rule 105 of Regulation M under the Exchange Act, Magnitude or the relevant Third-Party Manager will comply with Rule 105.

<sup>14</sup> In determining the net position in such security, the Third-Party Manager shall also follow the guidance on pending unexecuted sell orders contained in Questions 2.5, 2.5(A), 2.5(B), 2.5(C) and 2.6 of Responses to Frequently Asked Questions Concerning Regulation SHO, available at: <http://www.sec.gov/divisions/marketreg/mrfaqregsho1204.htm>.

3. At the time Magnitude submits any order to sell a security to a broker-dealer for execution for a Sub-Hedging Account, Magnitude shall:

(a) determine the net position of all Sub-Hedging Accounts in such security on a real-time basis by aggregating the long positions in such security in all Sub-Hedging Accounts that MSIPF is deemed to own pursuant to Rule 200(b) of Regulation SHO and the short positions in such security in all Sub-Hedging Accounts at the time such order is submitted;<sup>15</sup> and

(b) solely for purposes of whether the seller is deemed to own the security being sold, inform such broker-dealer whether or not such order should be marked “long” or “short,” provided that Magnitude shall inform such broker-dealer that such order should be marked “long” only if MSIPF has a net long position in such security, as determined under subparagraph (a), that is equal to or in excess of the total number of shares to be sold in such order; and

4. Any transactions involving equity securities in Sub-Hedging Accounts shall be conducted by Magnitude without transparency into the holdings of any Managed Sub-Account during the trading day, consistent with Magnitude’s access to holdings and transaction information of Managed Sub-Accounts on a T+1 basis; and

5. Magnitude shall establish, maintain, and enforce written policies and procedures reasonably designed to comply with the conditions under paragraphs (3) and (4) above, as well as establish, maintain, and enforce written policies and procedures reasonably designed to ensure compliance by Third-Party Managers with the conditions under paragraph (2) above, including, but not limited to, written policies and procedures requiring each Third-Party Manager to implement policies and procedures reasonably designed to comply with the conditions under paragraph (2) above and requiring Magnitude to surveil, at least weekly, for compliance by Third-Party Managers, to promptly address any issues identified by such surveillance,<sup>16</sup> and to document in its books and records the results of such surveillance, any efforts to address identified issues, and the results of any such efforts; and

6. Magnitude is registered with the Commission as an investment adviser pursuant to the

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<sup>15</sup> In determining the net position in such security, Magnitude shall also follow the guidance on pending unexecuted sell orders contained in Questions 2.5, 2.5(A), 2.5(B), 2.5(C) and 2.6 of Responses to Frequently Asked Questions Concerning Regulation SHO, available at: <http://www.sec.gov/divisions/marketreg/mrfaqregsho1204.htm>.

<sup>16</sup> At a minimum, Magnitude’s written policies and procedures to promptly address any issues identified by such surveillance shall require that: (1) if Magnitude determines that an order was not correctly marked in accordance with Regulation SHO and the conditions of this request, Magnitude shall promptly provide, or cause the relevant Third-Party Manager to provide, corrected data to the relevant broker-dealers; and (2) if Magnitude determines that any short sale order was improperly marked long, Magnitude shall promptly purchase, or cause the relevant Third-Party Manager or prime broker to purchase, sufficient shares to settle the transaction.



Advisers Act, and as a registered investment adviser, pursuant to Advisers Act Rule 204-2, Magnitude maintains accurate books and records in connection with its advisory business, including, but not limited to, records showing all purchases, sales, receipts, and deliveries of securities for all Managed Sub-Accounts and all Sub-Hedging Accounts and all other debits and credits to such sub-accounts, including records as to whether each sell order for such sub-accounts was entered as long, short, or short exempt, the sub-account for which each transaction was placed, and the name of the executing and clearing brokers for each transaction, and records of each security in which each such sub-account has a position, which shall show the amount and interests of such position and the location of each security; and

7. Magnitude shall establish, maintain, and enforce written policies and procedures reasonably designed to ensure that each Third-Party Manager is separate and independent from Magnitude and from each other Third-Party Manager, including, but not limited to, written policies and procedures requiring: (i) that Magnitude does not direct trading of, or coordinate trading with, a Third-Party Manager on a real-time basis and that Third-Party Managers do not direct trading of, or coordinate trading with, any other Third-Party Manager or Magnitude;<sup>17</sup> (ii) that each Third-Party Manager's trading strategy and trading activities are separate from, and independent of, Magnitude<sup>18</sup> and each other Third-Party Manager; (iii) that no Third-Party Manager is affiliated with Magnitude or with any other Third-Party Manager; (iv) that each Third-Party Manager is physically separate from the other Third-Party Managers and Magnitude and does not share office space, facilities, management, or personnel with any other Third-Party Manager or Magnitude; (v) that each Third-Party Manager pursues only its own separate and independently developed investment objective(s) and strategy(ies) as documented in an individually tailored sub-advisory agreement; (vi) that each Third-Party Manager uses its own separate trading systems and infrastructure that do not share trading or position information with other Third-Party Managers; (vii) that each Third-Party Manager is subject to confidentiality and non-disclosure agreements with Magnitude and/or MSIPF with respect to strategy, trading, and position information for MSIPF and does not share such information with any other Third-Party Manager; (viii) that Magnitude does not share information regarding any Third-Party Manager's positions, transactions, or investment or trading strategy for MSIPF with any other Third-Party Manager; and (ix) that there are no allocations or transfers of securities between or among MSIPF sub-accounts managed by different Third-Party Managers or Magnitude; and

8. Magnitude is required annually to document in its books and records, based on an annual

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<sup>17</sup> Except to the extent that Magnitude may have approval rights over certain individual transactions that are subject to conflicts of interest (as necessary to comply with Section 206(3) of the Advisers Act or as necessary for Magnitude to carry out its fiduciary duty to MSIPF with respect to any cross trade between a Managed Sub-Account and another client of a Third-Party Manager) or that deviate from agreed-upon investment guidelines. Further, except to the extent that Magnitude may establish and from time to time modify the risk management goals and investment guidelines and otherwise monitor positions and performance across MSIPF's sub-accounts, and may perform hedging activities in connection with such risk management analysis.

<sup>18</sup> *Id.*

review by Magnitude, any deficiencies in compliance with the conditions listed in Section III herein by Magnitude or by any Third-Party Manager discovered during the annual review as well as specific efforts to address identified issues, and the results of any such efforts and the time period in which remediation is expected to occur; and

9. All books and records required pursuant to these conditions shall be maintained by Magnitude consistent with its recordkeeping obligations under Advisers Act Rule 204-2.

Thank you for your consideration of this request. Should you have any questions or require additional information, please don't hesitate to call me at 212.230.8835.

Respectfully submitted,



Bruce H. Newman

cc: Valerie Dahiya  
Thankam Varghese  
Andrew Messinger  
Matt Caverly  
Leigh Rovzar  
Nicholas D'Ambrosio