

COMMENT LETTER

April 12, 2011

ICI Comment Letter on Proposed Private Fund Systemic Risk Reporting (Form PF) (pdf)

April 12, 2011 Ms. Elizabeth M. Murphy Secretary Securities and Exchange Commission 100 F Street, NE Washington, DC 20549-1090 Mr. David A. Stawick Secretary Commodity Futures Trading Commission Three Lafayette Centre 1155 21st Street, NW Washington, DC 20581 Re: Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF (File No. S7-05-11 and RIN 3235-AK92) Dear Ms. Murphy and Mr. Stawick: The Investment Company Institute¹ is pleased to provide its views to the Securities and Exchange Commission and the Commodity Futures Trading Commission on proposed new rules to implement provisions of Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) that require advisers to private funds to report information on a new form (Form PF).² The information to be collected on Form PF is intended to assist the Financial Stability Oversight Council in monitoring the potential systemic risks posed by private funds. ICI and its ¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$13.0 trillion and serve over 90 million shareholders. ² See SEC Release No. IA-3145 (January 26, 2011) (“Release”), available on the SEC’s website at <http://www.sec.gov/rules/proposed/2011/ia-3145.pdf>. Ms. Elizabeth M. Murphy Mr. David A. Stawick April 12, 2011 Page 2 members are committed to working with policymakers to bolster policies that promote a well- functioning financial system. As discussed below, however, we are concerned that the broad reach of Form PF’s proposed aggregation rules would unnecessarily capture registered investment companies (RICs) and be misleading to regulators who desire an accurate picture of potential systemic risk across the private fund industry. Background Proposed Rule 204(b)-1 under the Advisers Act of 1940 requires that SEC-registered investment advisers report non-public systemic risk information to the SEC on Form PF if they advise one or more private funds.³ The proposal would require advisers to private funds, including hedge funds, “liquidity funds” (i.e., unregistered money market funds), and private equity funds, to report basic information about the operations of their private funds on Form PF once a year and “large private fund advisers,” as defined in the Release, to submit this basic information each quarter along with additional systemic risk related information concerning certain of their private funds. The amount of information a private fund adviser would be required to report on Form PF would vary based on both the size of the adviser and the type of funds it advises. With

respect to hedge funds, for example, proposed Form PF would include questions about large hedge funds' investments, use of leverage and collateral practices, counterparty exposures, and market positions that are designed to assist FSOC in monitoring and assessing the extent to which stress at those hedge funds could have systemic implications by spreading to prime brokers, credit or trading counterparties, or financial markets. The portfolio-level information that the SEC is proposing to require advisers to liquidity funds to report is designed to allow FSOC to assess liquidity funds' susceptibility to runs and ability to otherwise pose systemic risk. When providing responses in Form PF with respect to a private fund, the adviser also must include the assets of any "parallel managed account" related to the private fund. This would include any of the adviser's managed accounts or "other pools of assets" that pursue substantially the same investment objective and strategy and invest side by side in substantially the same positions as the private fund. Form PF's general instructions explain that for purposes of reporting information about individual private funds, any parallel managed account must be aggregated with the largest private fund to which that parallel managed account relates. The Release explains that the proposed aggregation requirement prevents an adviser from structuring its activities to avoid the reporting requirements.

3 The proposed CFTC rule would require commodity pool operators and commodity trading advisors registered with the CFTC to satisfy certain proposed CFTC filing requirements by filing Form PF with the SEC if they also are registered with the SEC as investment advisers and advise one or more private funds. Ms. Elizabeth M. Murphy Mr. David A. Stawick April 12, 2011 Page 3 Effect of Form PF on Registered Investment Companies

As noted above, proposed Form PF would require private fund advisers to aggregate assets of parallel managed accounts with related private funds. The proposed definition of "parallel managed account" is drafted broadly and would seem to include not only separately managed accounts and unregistered pools of assets, but also RICs that invest side by side with private funds. Capturing RIC assets in a form designed to assess the systemic risk of private funds, however, is unnecessary to achieve the stated goals of the Dodd-Frank Act, and may skew the reporting in a way that lessens the effectiveness of the data available to regulators. RICs are subject to a comprehensive regulatory framework under the Investment Company Act of 1940 and other federal securities laws that sets them apart from other types of financial entities and ensures that their activities do not threaten the U.S. financial system. These laws encompass not only disclosure and anti-fraud requirements but also substantive requirements and prohibitions on funds' structures and day-to-day operations. Indeed, the Investment Company Act contains multiple provisions designed to address funds' stability with respect to investment activities.

- Limitations on leverage. RICs are subject to significant limitations on their ability to use leverage, limiting their ability to cause or contribute to systemic risk. Under Section 18 of the Investment Company Act, the maximum ratio of debt-to-assets allowed by law is 1- to-3, which translates into a maximum allowable leverage ratio of total assets-to-equity of 1.5-to-1. As a result, most RICs operate with little if any leverage.
- Requirements for custody of investment securities. Under Section 17(f) of the Investment Company Act, RICs must "place and maintain" their assets in the custody of a bank or, subject to certain SEC rules, a member of a national securities exchange or the RIC itself.
- 4 • Limitations on exposure to certain counterparties; Diversification. Under Section 12(d)(3) of the Investment Company Act, RICs' exposure to securities of securities-related businesses are subject to certain percentage limitations. RICs electing to be "diversified companies" under the Investment Company Act also must invest at least 75 percent of their total assets in cash and securities and, within this 75 percent of assets, may not invest more than 5 percent of total capital in any single issuer.
- 5 • Disclosure requirements. RICs are subject to extensive disclosure requirements that describe: 1) the types of securities in which they may invest and the related risks

4 As a practical matter, most RICs' assets are maintained

with a bank custodian. 5 See Section 5 of the Investment Company Act. Ms. Elizabeth M. Murphy Mr. David A. Stawick April 12, 2011 Page 4 (prospectus and statement of additional information); 2) the results of operations and financial position, including a comprehensive listing of all securities held (Form N-CSR); 3) portfolio holdings disclosure (Form N-Q); 4) more detailed financial and operating disclosures (Form N-SAR); and 5) annual proxy vote disclosure (Form N-PX). The purpose of the prospectus is to provide essential information about the RIC in a way that will help investors to make an informed decision about whether to purchase fund shares. The prospectus must describe, among other things, the RIC's investment objectives and policies, its principal investment strategies, any policy to concentrate in a particular industry or group of industries (i.e., more than 25 percent of net assets) and the principal risks of investing in the RIC. The statement of additional information must describe the RIC's policies with respect to: issuing senior securities; borrowing money, including the purpose for which proceeds will be used; underwriting securities of other issuers; purchasing or selling real estate or commodities; making loans; and any other policy the RIC deems fundamental or that may not be changed without shareholder approval. Form N-CSR must be filed with the SEC on a semi-annual basis. The form includes, among other things, the RIC's audited financial statements prepared in conformity with generally accepted accounting principles (statement of operations, statement of changes in net assets, schedule of investments, financial highlights and notes to financial statements). The schedule of investments must identify each security held at the report date, and provide the number of shares or principal amount and the current fair value. Form N-CSR must be certified by the RIC's principal executive officer and principal financial officer as required by Investment Company Act Rule 30a-2(a). Form N-Q must be filed with the SEC after the RIC's first and third fiscal quarters. Form N-Q must provide a schedule of investments listing each security held at the report date, and provide the number of shares or principal amount and the current fair value. Like Form N-CSR, Form N-Q must be certified. Form N-SAR must be filed with the SEC on a semi-annual basis. The form includes, among other things: broker custodial arrangements and brokerage commissions paid; monthly share issuance and redemption amounts; front end and deferred sales load amounts; Rule 12b-1 expenditures; calculation of investment advisory fees paid; expense limitations or reductions; and the independent accountant's report on internal controls. Form N-PX must be filed annually with the SEC. The form provides the RIC's proxy voting record for each matter relating to a portfolio security considered at any shareholder meeting held during the period covered by the report. Ms. Elizabeth M. Murphy Mr. David A. Stawick April 12, 2011 Page 5 • Other requirements. RICs also are obligated to maintain comprehensive compliance programs to ensure that all of the obligations are fully met to protect investors and the markets. Registered money market funds have all the protections of the Investment Company Act, and are subject to additional regulation pursuant to Rule 2a-7 under that Act. This rule permits money market funds to value their securities at amortized cost in order to maintain a stabilized value, typically \$1.00 per share. In addition to the important protections described above, money market funds must comply with stringent risk-limiting conditions relating to credit quality, liquidity, maturity, and diversification requirements designed to minimize the deviation between a money market fund's stabilized net asset value and its mark-to-market per-share value.⁶ Money market funds also are subject to extensive monthly disclosure obligations that go far beyond those that are being proposed for liquidity funds in Section 3 of Form PF. Specifically, money market funds must file with the SEC on Form N-MFP a detailed portfolio holdings report disclosing information about each portfolio security, as well as information about the money market fund, including the fund's weighted average maturity, weighted average life, and seven-day gross yield. Additionally, this monthly report must include market-based values for each portfolio security as well as the money market fund's market-

based (i.e., “shadow”) net asset value per share, in each case with separate entries for values that do and do not take into account any capital support agreements. Thus, to avoid unnecessary and burdensome regulatory overlap, we strongly urge the SEC and CFTC to exclude all RICs from the definition of “parallel managed account.” Aggregating the assets of private funds with RICs, which are already subject to a comprehensive regulatory and disclosure scheme, also would be potentially misleading to regulators who desire a “baseline picture of potential systemic risk across both the entire private fund industry and in particular kinds of private funds”⁷ Moreover, we believe that excluding RIC assets from Form PF would still allow the SEC and the CFTC to meet their goal of preventing improper avoidance of the reporting requirements while giving a complete picture of private fund assets managed by a particular private fund adviser group. * * * *⁶ For more information on Rule 2a-7’s risk-limiting conditions, see Letter from Paul Schott Stevens, President and CEO, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, January 10, 2011 at 19-22 (ICI’s comment letter on the President’s Working Group report on money market fund reform options). In addition, a chart comparing money market fund regulations before and after the recent amendments to Rule 2a-7 is available on ICI’s website at http://www.ici.org/policy/regulation/products/money_market/11_mmf_reg_summ.⁷ Release at 8. Ms. Elizabeth M. Murphy Mr. David A. Stawick April 12, 2011 Page 6 We appreciate the opportunity to comment on proposed Form PF. If you have any questions regarding our comments or need additional information, please feel free to contact me at (202) 326- 5815 or Jane Heinrichs, Senior Associate Counsel, at (202) 371-5410. Sincerely, /s/ Karrie McMillan Karrie McMillan General Counsel cc: The Honorable Mary L. Schapiro The Honorable Kathleen L. Casey The Honorable Elisse B. Walter The Honorable Luis A. Aguilar The Honorable Troy A. Paredes Eileen Rominger, Director Robert E. Plaze, Associate Director Division of Investment Management Securities and Exchange Commission The Honorable Gary Gensler, Chairman The Honorable Michael V. Dunn, Commissioner The Honorable Jill E. Sommers, Commissioner The Honorable Bart Chilton, Commissioner The Honorable Scott D. O’Malia, Commissioner Commodity Futures Trading Commission