MANAGED FUNDS ASSOCIATION

Alternative Investment Management Association

News Release

FOR IMMEDIATE RELEASE
MARCH 28, 2016

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MFA, AIMA File Comment Letter on SEC Derivatives Rule

As written, rule could limit investor choice, undermining investor protection

WASHINGTON – Managed Funds Association and the Alternative Investment Management Association today submitted a joint comment letter to the U.S. Securities and Exchange Commission on the Commission's proposed rule on the use of derivatives by mutual funds and other registered investment companies. While generally supporting several aspects of the SEC's proposal, including asset segregation requirements and an activities-based approach to regulation, the Associations have concerns with the adverse effects of the rule's imposition of a new notional-based leverage limit on registered funds.

The letter also questions the SEC's attempt to redefine and regulate derivatives as "senior securities" under Section 18 of the Investment Company Act of 1940.

MFA President and CEO Richard H. Baker said, "Both institutional and retail investors have shown increasing demand for registered funds that offer alternative strategies using derivatives. Many of these strategies provided substantial benefits to investors during the global financial crisis and continue to do so today. While we support many aspects of the SEC's proposal, the Commission's policy objective to protect investors would be well-served by establishing a better balance between authorizing funds to use derivatives for hedging, risk-mitigation and investment purposes, and imposing reasonable, practical restrictions that address the risks derivatives may present to funds and their investors."

AIMA CEO Jack Inglis said, "Basing funds' portfolio exposure limits on the aggregate notional amounts of derivatives transactions is too blunt a measure, and will force many funds that do not, in fact, have a material amount of risk due to leverage to substantially alter their strategies or de-register without good reason. This outcome will have the potential unintended effects of limiting investor choice and undermining investor protection by depriving investors of opportunities to invest in alternative mutual fund strategies and their potential benefits."

The letter suggests alternative options for the Commission's consideration and provides qualitative and quantitative support for the Associations' main concern – that a new notional-based limit is "unnecessary and inappropriate, because it lacks sufficient justification given the practical effect of the Commission's proposed asset segregation requirements and the potential reinforcing effect of the Commission's other related regulations after their adoption." The letter also notes that basing a fund's portfolio leverage limit on the aggregate notional amount of a fund's derivatives is too blunt of a measure because it has inherent problems as an accurate measure of risk and leverage.

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To address these and other concerns with the proposed rule, the Associations make several recommendations in their letter, including that:

- A broader scope of liquid assets with appropriate regulatory haircuts be allowed as qualifying coverage assets for asset segregation purposes – rather than restricted only to cash and cash equivalents – so the proposed rule would not strain a fund's ability to hold sufficient cash and cash equivalents in reserve to satisfy the payment obligations under its derivatives transactions;
- A fund's board should be authorized to base the proposed risk-based coverage amount on no less than the required initial margin for each of the derivatives transactions in the fund's portfolio;
- A fund should have the flexibility to determine which types of derivatives transactions may properly offset other derivatives transactions in calculating derivatives exposure. For example, a fund should be permitted to offset a futures contract against an option, if the offset reduces exposure and risk; and
- If the Commission decides to impose a notional-based limit in its final rule, the letter explains the merits of allowing funds to use risk adjustments to notional exposure based on a derivatives transaction's underlying asset class to determine more accurate measures of a fund's actual derivatives exposure.

A copy of the Associations' full letter is **available here.**

About Managed Funds Association
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, the Americas, Australia and all other regions where MFA Members are market participants. For more information, please visit: www.managedfunds.org.

About AIMA
The Alternative Investment Management Association (AIMA) has over 1,700 corporate members and over 10,000 individual contacts in over 50 countries. Members include hedge fund managers, fund of hedge funds managers, prime brokers, legal and accounting firms, investors, fund administrators and independent fund directors. AIMA's manager members collectively manage more than $1.5 trillion in assets. All AIMA members benefit from AIMA's active influence in policy development, its leadership in industry initiatives, including education and sound practice manuals, and its excellent reputation with regulators worldwide. AIMA is a dynamic organisation that reflects its members' interests and provides them with a vibrant global network. AIMA is committed to developing industry skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the industry's first and only specialised educational standard for alternative investment specialists. For further information, please visit AIMA's website, www.aima.org.

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