MANAGED FUNDS ASSOCIATION
Policy Brief

25 YEARS 1991-2016

April 2016

Newly Proposed Incentive Compensation Rule Addresses MFA Concerns

The National Credit Union Administration (NCUA) released on April 22 a re-proposed rule on Incentive Compensation Arrangements under section 956 of Dodd-Frank. The statute requires the rule to be implemented on a joint basis by banking regulators and the SEC.

While the SEC has not yet re-proposed the Incentive Compensation rule, the statutory requirement to implement a joint rule means that the SEC's re-proposal should be substantively the same as the NCUA's proposed rule. MFA expects the SEC is likely to schedule a meeting to vote on re-proposing the rule in the near future.

The re-proposed rule generally would establish principles-based rules for covered financial institutions (including investment advisers) with assets of at least $1 billion, along with more prescriptive rules for covered financial institutions with at least $50 billion or $250 billion in assets, respectively.

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

May 31, 2011

Via Electronic Mail: rule-comments@sec.gov

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Managed Funds Association Comments on Incentive-Based Compensation Arrangements; File No. S7-12-11

Dear Ms. Murphy:

Managed Funds Association ("MFA")[1] appreciates the opportunity to comment on the joint proposed rules, "Incentive-Based Compensation Arrangements" (the "Proposed Rules"), issued by the Securities Exchange Commission (the "SEC") and other federal regulatory agencies (together the "Joint Agencies").[2] We recognize that Congress in enacting Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank

Notably, the rule release contains clarifying language regarding the calculation of an adviser's assets for purposes of the thresholds, which was a key issue we raised in MFA's 2011 letter to the SEC on the original rule proposal.

In the original proposal, MFA expressed concern that the asset test for advisers could inadvertently make private fund advisers' assets under management into balance sheet assets because of accounting rules that the proposal used for purposes of determining the thresholds. In response to this concern, the re-proposal makes clear that an adviser's balance sheet assets do not include non-proprietary assets. MFA believes this more appropriately tailors the scope of the rule to the statutory language.

The Federal Deposit Insurance Corp., the Office of the Comptroller of the Currency and the Federal Housing Finance Agency approved the NCUA's proposal earlier this week, on Tuesday.

National Credit Union Administration Rule Proposal

FSOC Provides Update on Asset Management Review

The Financial Stability Oversight Council (FSOC) released a statement on April 18 providing a public update on its review of potential risks to U.S. financial stability that may arise from asset management products and activities. The statement details the Council's views regarding potential financial stability risks and next steps to respond to these potential risks.

The Council's evaluation of risks focused on the following areas: (1) liquidity and redemption; (2) leverage; (3) operational functions; (4) securities lending; and (5) resolvability and transition planning. The Council announced it is creating an interagency working group that will share and analyze relevant regulatory information in order to better understand hedge fund activities and further assess whether there are potential risks to financial stability.

The working group will: (1) use regulatory and supervisory data to evaluate the use of leverage in combination with other factors – such as counterparty exposures, margining requirements, underlying assets, and trading strategies – for purposes of assessing potential risks to financial stability; (2) assess the sufficiency and accuracy of existing data and information, including data reported on Form PF, for evaluating risks to financial stability, and consider how the existing data might be augmented to improve the ability to make such evaluation; and (3) consider potential enhancements to and the establishment of standards governing the current measurements of leverage, including risk-based measures of synthetic leverage.

As regulatory bodies continue collecting information on hedge fund activities, MFA's Government Affairs Committee decided on April 28 to undertake a comprehensive examination of issues related to leverage, reporting and systemic risk information the industry currently provides regulators. MFA's Trading and Markets Committee will lead the effort and potentially work with other committees or third parties as necessary. MFA will update members as this effort develops.

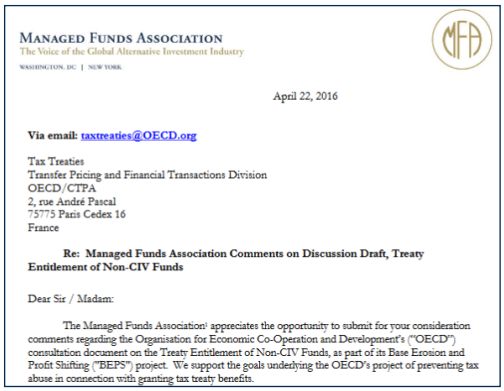
FSOC Statement on Review of Asset Management Products and Activities, Prepared Remarks by Treasury Secretary Jacob J. Lew Statement from the U.S. Treasury Department, SEC Chair Mary Jo White and CFTC Chairman Timothy Massad

MFA Submits Letter to OECD on Treaty Benefits for Investment Funds

MFA submitted on April 22, a comment letter to the Organization for Economic Co-operation and Development (OECD) in response to the OECD's consultation paper on treaty entitlements for investment funds.

In the letter, MFA encouraged the OECD to permit (1) widely-held, regulated investment funds to obtain treaty benefits; and (2) non-widely held, regulated investment funds to obtain proportional treaty benefits, to the extent that investors in such funds would be eligible to receive treaty benefits if they had invested directly instead of through an investment fund.

MFA noted that this framework would avoid imposing double taxation on investors in private investment funds, many of which are tax-exempt institutional investors, while addressing the OECD's policy concerns regarding treaty shopping.



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

April 22, 2016

Via email: taxtreaties@OECD.org

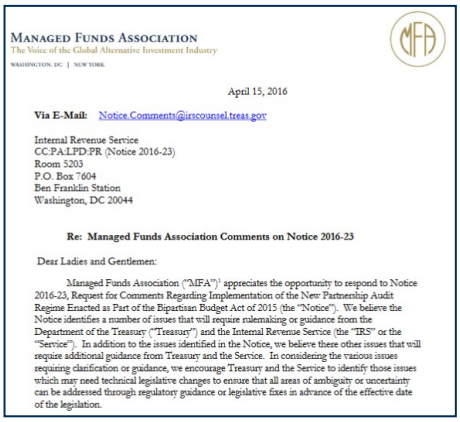
Tax Treaties
Transfer Pricing and Financial Transactions Division
OECD/CTPA
2, rue André Pascal
75775 Paris Cedex 16
France

Re: Managed Funds Association Comments on Discussion Draft, Treaty Entitlement of Non-CIV Funds

Dear Sir / Madam:

The Managed Funds Association[1] appreciates the opportunity to submit for your consideration comments regarding the Organisation for Economic Co-Operation and Development's ("OECD") consultation document on the Treaty Entitlement of Non-CIV Funds, as part of its Base Erosion and Profit Shifting ("BEPS") project. We support the goals underlying the OECD's project of preventing tax abuse in connection with granting tax treaty benefits.

MFA Provides Comments to Treasury, IRS on New Partnership Audit Rules



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

April 15, 2016

Via E-Mail: Notice.Comments@irscounsel.treas.gov

Internal Revenue Service
CC:PA:LPD:PR (Notice 2016-23)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Managed Funds Association Comments on Notice 2016-23

Dear Ladies and Gentlemen:

Managed Funds Association ("MFA")[1] appreciates the opportunity to respond to Notice 2016-23, Request for Comments Regarding Implementation of the New Partnership Audit Regime Enacted as Part of the Bipartisan Budget Act of 2015 (the "Notice"). We believe the Notice identifies a number of issues that will require rulemaking or guidance from the Department of the Treasury ("Treasury") and the Internal Revenue Service (the "IRS" or the "Service"). In addition to the issues identified in the Notice, we believe there other issues that will require additional guidance from Treasury and the Service. In considering the various issues requiring clarification or guidance, we encourage Treasury and the Service to identify those issues which may need technical legislative changes to ensure that all areas of ambiguity or uncertainty can be addressed through regulatory guidance or legislative fixes in advance of the effective date of the legislation.

MFA submitted on April 15 a comment letter to the Department of the Treasury and the Internal Revenue Service providing comments on the implementation of the new partnership audit rules, implemented as part of the Bipartisan Budget Act of 2015.

In the letter, MFA noted that, as a matter of fundamental tax policy and basic tax fairness, the new partnership audit rules should not force taxpayers to bear liability for other taxpayers' obligations, to pay taxes that they do not rightfully owe to the government, or to pay taxes twice on the same income.

MFA encouraged Treasury and IRS to focus on implementing the legislation in a manner that establishes an efficient, administrable regime that best ensures that the government collects the correct amount from the correct taxpayers. We specifically urged Treasury and IRS to: (1) ensure that partnerships and their partners receive appropriate basis adjustments, modifications for taxes already paid, modifications for the applicable tax characteristics of all partners, direct and indirect, and appropriate adjustments for overpayments as well as underpayments; and (2) develop rules or guidance permitting tiered partnerships to use the reporting option provided in section 6226 of the legislation. MFA also commented on other technical issues that require additional clarification or guidance from Treasury and IRS for the new partnership audit rules to be effective in practice.

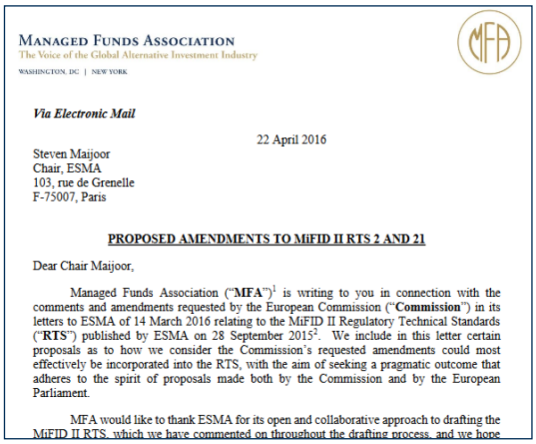
MFA Submits Letter on Increasing Access, Liquidity in Treasury Markets

MFA submitted on April 22 a comment letter to the U.S. Department of Treasury examining the evolution of Treasury markets and ways to improve liquidity and transparency. MFA's letter to the Treasury Department discusses and offers suggestions in the following areas:

- **Improving Treasury Market Liquidity**: Many markets, including the Treasury futures markets, have been trading electronically for several decades without impacting liquidity. MFA believes a combination of factors has played a role, including increased adoption of electronic trading technology, and post-crisis regulatory reforms, in spurring changes in market making and liquidity. To enhance liquidity, Treasury should encourage greater market participation from a broader swath of participants by requiring non-discriminatory access to Treasury trading venues.
- **Continued Monitoring of Trading and Risk Management Practices**: MFA's letter supports greater oversight of trading platforms through registration and public disclosures. However, since the events of October 15, 2014, do not appear to have been triggered by electronic or algorithmic trading, more information is needed before imposing halts or circuit breakers on Treasury markets.
- **Official and Public Data on Treasury Cash Markets**: The Treasury Department should coordinate with the Securities and Exchange Commission and Commodity Futures Trading Commission to collect data from Treasury cash market trading platforms and dealers. This would help decrease complexity and ensure quality data for regulators by avoiding inconsistent, redundant or duplicative reporting. As for public data, MFA supports real-time public reporting of cash Treasury transactions with a capped notional threshold for block trades and exceptions for off-the-run or less liquid securities. Greater market transparency to the public is also likely to encourage greater market participation.

MFA Comment Letter to the Department of Treasury on Increasing Access, Liquidity in Treasury Markets

MFA Submits Letter to ESMA on MiFID Position Limits and Bond Transparency



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

Via Electronic Mail

22 April 2016

Steven Maijoor
Chair, ESMA
103, rue de Grenelle
F-75007, Paris

PROPOSED AMENDMENTS TO MiFID II RTS 2 AND 21

Dear Chair Maijoor,

Managed Funds Association ("**MFA**")[1] is writing to you in connection with the comments and amendments requested by the European Commission ("**Commission**") in its letters to ESMA of 14 March 2016 relating to the MiFID II Regulatory Technical Standards ("**RTS**") published by ESMA on 28 September 2015[2]. We include in this letter certain proposals as to how we consider the Commission's requested amendments could most effectively be incorporated into the RTS, with the aim of seeking a pragmatic outcome that adheres to the spirit of proposals made both by the Commission and by the European Parliament.

MFA would like to thank ESMA for its open and collaborative approach to drafting the MiFID II RTS, which we have commented on throughout the drafting process, and we hope

MFA submitted on April 22 a comment letter to the European Securities and Markets Authority (ESMA) regarding the comments and amendments requested by the European Commission regarding the MiFID II Regulatory Technical Standards (RTS) ESMA published in September 2015. In the letter, MFA submitted recommendations on how ESMA might effectively incorporate the Commission's comments with respect to position limits and non-equities transparency.

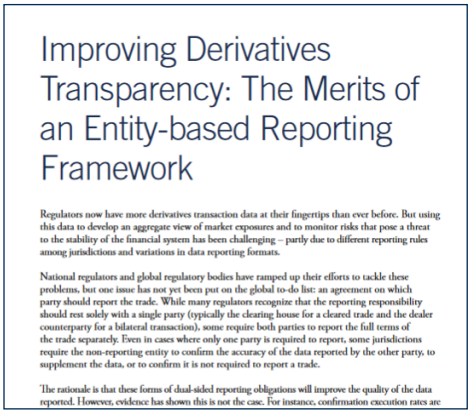
Regarding commodity derivative position limits, MFA acknowledged support and preference for ESMA's draft RTS from September 28, 2015, and then provided the following suggestions to address the European Commission's comments with respect to:

- **The baseline for non-spot month limits:** MFA suggested that to the extent ESMA incorporates the European Commission's proposal (to base limits on deliverable supply) into RTS 21, MFA would urge that the interpretation of what constitutes a "significant discrepancy" between open interest and deliverable supply is left to national competent authorities (NCAs).
- **The definition of "economically equivalent" commodity derivative contracts:** MFA urged ESMA to ensure that as much certainty as possible is provided in determining what constitutes an "economically equivalent" contract. MFA suggested that the draft RTS refer to OTC commodity derivatives resulting in the "same economic exposure" as exchange-traded contracts.
- **Volatility:** While MFA acknowledges that the Level 1 text introduces a need for NCAs to take volatility into account in setting position limits, MFA does not consider that the RTS should mandate greater volatility must necessarily result in lower position limits.

Regarding non-equities transparency, MFA, in general, strongly supported the application of proportionate and effective transparency requirements in the non-equities markets, particular in relation to derivatives. For bond transparency requirements, MFA supports the Commission's proposal to require annual assessments of liquidity levels in all classes of bonds, as it will help to ensure that transparency has been set at the correct level and is not negatively affecting liquidity.

However, in light of the more cautious approach to bond transparency suggested by the Commission, MFA cautions ESMA from applying the same standard in relation to the bond and derivatives markets. MFA believes that the maximum post-trade transparency deferral period set by RTS 2 should not be set at the same level across both types of instrument. Specifically, while a two-day deferral period applying to illiquid or large in scale bond transactions may be appropriate for bonds, MFA members do not consider that the same deferral period (which may in some cases be extended as long as four weeks) is necessary in the case of cleared derivatives. Deferring the publication of transparency data for cleared derivative transactions longer than necessary could be detrimental to CCP risk management and undermine the ability of market participants to accurately value their cleared portfolios and accurately calculate and/or validate initial and variation

MFA, Trade Associations Jointly Publish Paper on Improving Derivatives Transparency



Improving Derivatives Transparency: The Merits of an Entity-based Reporting Framework

Regulators now have more derivatives transaction data at their fingertips than ever before. But using this data to develop an aggregate view of market exposures and to monitor risks that pose a threat to the stability of the financial system has been challenging – partly due to different reporting rules among jurisdictions and variations in data reporting formats.

National regulators and global regulatory bodies have ramped up their efforts to tackle these problems, but one issue has not yet been put on the global to-do list: an agreement on which party should report the trade. While many regulators recognize that the reporting responsibility should rest solely with a single party (typically the clearing house for a cleared trade and the dealer counterparty for a bilateral transaction), some require both parties to report the full terms of the trade separately. Even in cases where only one party is required to report, some jurisdictions require the non-reporting entity to confirm the accuracy of the data reported by the other party, to supplement the data, or to confirm it is not required to report a trade.

The rationale is that these forms of dual-sided reporting obligations will improve the quality of the data reported. However, evidence has shown this is not the case. For instance, confirmation execution rates are

MFA and twelve other trade associations jointly published a paper on April 13 titled "Improving Derivatives Transparency: The Merits of an Entity-based Reporting Framework". The paper encourages regulators to adopt on a harmonized, global basis an entity-based, single-sided reporting regime for derivatives.

In particular, the trade associations explain in the paper that an entity-based reporting regime would benefit the market by: (1) reducing the cost and burden of transaction reporting currently placed on end users; (2) eliminating the duplication and replication of other regulatory requirements; (3) streamlining and clarifying reporting obligations to improve the quality and accuracy of reported transactional data; and (4) making high-level, multi-jurisdictional harmonization of reporting requirements easier and more effective.

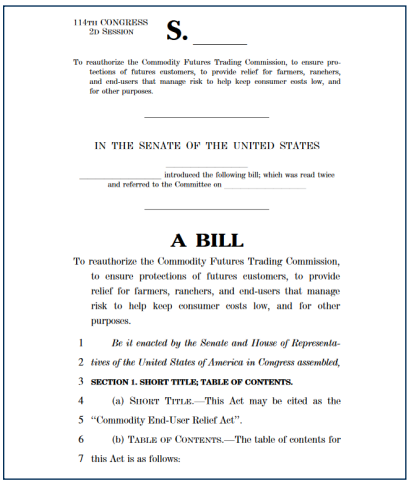
In conclusion, the paper recommends the following next steps: (1) an entity-based reporting framework should be adopted across jurisdictions; (2) existing processes, and not dual-sided reporting, should be used to identify mismatches in trade terms; (3) a tiebreaker methodology for determining the responsible reporting party should be implemented consistently; (4) legal responsibility for non-reporting counterparties to verify trade reports should be removed; and (5) greater focus should be placed on global data harmonization efforts.

Joint Trade Association Paper on Improving Derivatives Transparency

CFTC Reauthorization Approved By Senate Agriculture Committee

The Senate Agriculture Committee, chaired by Senator Pat Roberts (R-KS) approved on April 14 the "Commodity End-User Relief Act" by a vote of 11-9, along party lines, that would reauthorize the Commodity Futures Trading Commission (CFTC) through FY 2019.

Notably, at the request of two senior Committee Members, Senators Charles Grassley (R-IA) and Patrick Leahy (D-VT), who serve as Chairman and Ranking Member of the Senator Judiciary Committee, a key provision in Section 204 of the bill, of interest to MFA members, was removed as part of a Managers' Amendment approved by voice vote. The measure is now pending further negotiations prior to possible floor consideration. Section 204 would protect the confidentiality of sensitive information reported to the CFTC by CTAs and CPOs. Senator Grassley cited strong jurisdictional concerns that the provision included an exemption from the Freedom of Information Act (FOIA), a statute over which the Judiciary Committee has oversight responsibility. Chairman Roberts acknowledged the jurisdiction issue, while also affirming that the confidentiality of information submitted to the government is important. He agreed to work on these issues with Senators Grassley and Leahy as the legislation moves forward.



114TH CONGRESS
2D SESSION

S. _____

To reauthorize the Commodity Futures Trading Commission, to ensure protections of futures customers, to provide relief for farmers, ranchers, and end-users that manage risk to help keep consumer costs low, and for other purposes.

IN THE SENATE OF THE UNITED STATES

_____ introduced the following bill; which was read twice and referred to the Committee on _____

A BILL

To reauthorize the Commodity Futures Trading Commission, to ensure protections of futures customers, to provide relief for farmers, ranchers, and end-users that manage risk to help keep consumer costs low, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Commodity End-User Relief Act".

(b) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

The bill approved earlier this month by the Senate Agriculture Committee retains language of interest to MFA Members providing enhanced customer protections and the residual interest requirement in Sections 101 – 104. Separately, during Committee consideration of the bill, Ranking Member Debbie Stabenow (D-MI) offered an amendment intended to provide additional funding to the CFTC through fees for service; it was rejected along party lines. Senator Sherrod Brown (D-OH) offered and withdrew an amendment that would have removed Section 304 of the bill to study the appropriate de minimis level of swap dealing under the CEA.

The next step for the measure is possible consideration by the Senate. The party line Committee vote likely complicates any effort to bring the bill before the full Senate under regular order, although there may be separate efforts to include a version of the legislation in some other "must-pass" measure later this year. Chairman Roberts is also expected to continue to negotiate the confidentiality provisions in Section 204 that Senators Grassley and Leahy requested be struck as the Senate Agriculture Committee seeks opportunities to move the bill forward.

The House approved its version of CFTC Reauthorization legislation, the "Commodity End-User Relief Act" (H.R. 2289) on June 9, 2015, which would also reauthorize the CFTC until 2019. That measure, currently pending in the Senate, included confidentiality provisions at Section 212 similar to those struck in Senate Agriculture Committee markup. No further action on the House-passed

Department of Labor Releases Fiduciary Rule

In July, August and September of last year, MFA provided written comments to and testified in front of the Department of Labor (DoL) regarding the DoL's proposed rule on the definition of fiduciary under ERISA. MFA explained that private investment funds are sold only to sophisticated investors, as determined by thresholds under the federal securities laws, and that the marketing and sales activities and investor communication activities associated with managing private investment funds should not create fiduciary obligations under ERISA,. This is particularly true when ERISA fiduciary obligations do not apply to the investment management activities of a private fund manager. MFA noted that ERISA has clearly defined rules for when managing retirement plan assets within a private investment fund creates a fiduciary obligation for the manager and that those rules should determine ERISA fiduciary status, not the marketing and reporting activities.

MFA explained that the DoL's proposed rules seemed to inadvertently create fiduciary obligations for these marketing and reporting activities and encouraged the DoL to modify its proposed rule to address those concerns. On April 6, the DoL released its final conflict of interest rule amending the definition of fiduciary under ERISA. The DoL also released several related documents, including the final Best Interest Contract Exemption, the final Class Exemption for Principal Transactions, and other amended exemptions. While MFA and outside counsel are analyzing the extensive and complicated final rule and related documents with respect to the issues it raised in its response to the proposed rule, including the potential effects of the rule on the marketing and sale of private funds by fund managers and third party

MFA also is working with outside counsel to prepare educational materials for distribution to MFA Members regarding the impact of the final rule for private fund managers. Notably, the final rule:

- Does not create new fiduciary obligations based on persons providing valuation statement or appraisals to retirement plans, reserving that issue to a future rulemaking. As a result, the final rule does not create fiduciary obligations for normal investor reporting activities of private fund managers and related service providers.
- Confirms that an adviser marketing itself to retirement plans does not establish a fiduciary relationship with respect to those activities; though the DoL final rule does state that recommending a retirement plan invest in an investment fund in connection with the adviser's marketing activities may create fiduciary obligations.
- Revises an exception in the rule that permits making recommendations and selling activities to institutional investors with an independent fiduciary with at least $50 million in assets under management without triggering fiduciary status under ERISA, compared to the proposed rule that had a similar exception with respect to institutional retirement plans with at least 100 participants and at least $100 million in retirement plan assets under management.
- Revises the best interest contract exemption to apply to recommendations and sales of all asset types, compared to the proposed exemption, which would not have been available with respect to sales of private investment funds or publicly offered managed futures funds.

Conflict of Interest Final Rule

ESMA Issues Opinion on Loan Origination By Funds

The European Securities and Markets Authority (ESMA) released on April 13 an opinion on the Key Principles for a European framework on loan origination by funds, which sets the regulator's view on the elements that should be considered to develop a common European framework for loan origination by investment funds. Following the release of the opinion, ESMA Spokeswoman Catherine Sutcliffe noted that, "Investment funds which originate loans — issue credit — to borrowers can be an important, alternative source of nonbank funding for businesses… ESMA considers that a common framework at EU level for loan origination by funds could contribute to a level playing field, reduce the potential for regulatory arbitrage and encourage investment funds to take up loan origination."

Although ESMA is supportive of a common approach to loan origination, its opinion highlights a number of issues that should be considered when devising a structured framework:

- **Exemptions/national regimes**: ESMA advises the European Commission to take into account the experience of existing national regimes – and their relative success – when designing a possible framework in this regard, and advises consideration on whether or not exemptions should be granted (assuming EU legislation involved mandatory authorization or at least registration) to funds already operating under national rules.
- **Registration vs. authorization of managers and funds:** ESMA advises the Commission to consider whether some form of authorization is required for managers. Under the AIFMD, mangers are either authorized or registered with their local Competent Authority (depending on the demands of national implementation). Work would have to be done by the Commission to decide which is appropriate. Similarly, ESMA recommends that consideration be given to whether or not a general authorization or opt-in framework for funds is necessary. Furthermore, ESMA recommends to assess whether, in regard to authorization of funds, a distinction should be made between the sizes of funds, whether funds should be permitted to engage only in origination or also other investment activities, as well as explore whether the authorization of loan-originating funds should be depended on the extent to which they actually originate loans.
- **Leverage:** While different national regimes around the EU have varying limits on leverage, ESMA is of the view that loan-originating funds should be allowed "to have a certain level of leverage to enable them enter the describe market niche;"
- **Types of investors**: At a general level, ESMA does not believe it to be appropriate that funds operating under a new EU framework would be able to market to retail investors.
- **Systemic risk:** ESMA recommends that the Commission assess, as part of its consultation, the need for possible measures to address systemic risk posed by such funds, which could include the use of macroprudential tools; and,
- **Organizational requirements:** Despite the aforementioned requirements on fund structure, ESMA would still like to see certain duties levied upon the fund/manager so that potential systemic risk profiles could be monitored on an ongoing basis. These include (but are not limited to): the preparation of a risk appetite statement, a collateral management policy, and a concentration and risk management policy. Regular stress testing would be necessary, as would the necessity of having a "high level of liquidity" which is appropriate to their activities.

Following ESMA's opinion, the Commission is expected to consult on this issue in "Q2 this year''.

ESMA's Opinion on Loan Origination By Funds
ESMA's Press Release on Loan Origination By Funds

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