HFM WEEK

The Political Road Ahead: Making Capital Markets Work for Investors and the Economy

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By Richard H. Baker

As president Trump prepares to address Congress, MFA president Richard H Baker sets out some ideas he hopes politicians will take on board

The tradition is almost as old as our nation itself: The president reports to Congress, often in person, occasionally via pen, on the state of our union.

The words he typically uses – the state of our union is strong – is more than a catchphrase; it conveys resilience and durability in the face of challenges. In many ways, the same can be said about the current state of US capital markets.

As active participants in these markets, hedge funds have a unique perspective on how policymakers can strengthen them for all investors, including the colleges, pensions and charitable organizations that provide two-thirds of our industry's $3trn for investment. More than 3,100 of these US-based institutional investors continue to rely on hedge funds to help diversify returns, manage risk and provide reliable returns over time.

The following policies would help ensure markets work efficiently, fairly and transparently and foster an environment that supports continued growth, capital formation and investment activity.

Creating a fair, sensible and growth-oriented tax code

Tax policy can be a catalyst that spurs investments and job creation and helps advance the health and vibrancy of the US economy. As policymakers craft tax reform, they should do so considering how proposed changes will positively impact and stimulate investment activity. A tax code that is simple, fair and provides incentives – rather than distortions – for businesses and investors to put capital to work can help grow our economy and make the US more competitive.

To bring more investments into US markets, policymakers should consider expanding existing safe-harbor provisions for non-US investors seeking to invest within the US; amending the treatment of unrelated business income tax provisions to promote investment US tax-exempt entities; and eliminating complicated tax rules, like withholding on dividends that impede investing in US companies.

In addition to helping US businesses grow, tax reform can also be a way to give US businesses a second chance. By opposing efforts to eliminate net operating loss carrybacks, our tax code can help US companies survive hardships and losses occurred during a bad year.

Modernizing the regulatory framework for capital markets and asset managers

MFA supports efforts to further modernize the existing regulatory framework to help enhance investment activity, capital formation and economic growth. Strengthening cyber and information security must be a critical part of this effort.

Fund managers currently provide regulators substantial and often sensitive information about their funds' holdings, size, leverage, liquidity, activities and other data. Information security vulnerabilities at a regulator could jeopardize not only market participants and their investors, but the US economy through the loss of domestic trade secrets and confidence in the integrity of the regulatory framework. Especially as government agencies are under a constant state of cyberattack, regulators need to review and rethink their policies and processes for collecting and protecting non-public and confidential information.

At the CFTC in particular, MFA continues to believe – as current law requires – that regulators should seek a subpoena as part of any request for access to a firm's most sensitive intellectual data. These algorithms often take years to develop and require extensive human and monetary capital. Some people call these codes the *secret sauce* and firms guard this information with the same seriousness that soft drink companies defend their patented formulas.

In addition to protecting critical information and infrastructure, a modern regulatory framework should consist of common-sense proposals that reduce operational risk, promote market transparency and guard against systemic risk without stifling legitimate market activity or imposing arbitrary designations on non-bank financial companies.

Nearly seven years after Congress passed major changes to our financial regulatory system, it is time to take stock of reporting requirements. MFA and our Members support providing information to regulators that is meaningful and helps them do their job.

But requiring firms to file duplicative reports only creates additional burdens for regulators tasked with sorting through these filings.

Simple changes like eliminating dual SEC-CFTC registration requirements for private fund managers, or combining multiple reporting mechanisms like forms PF, CPO-PQR, CTA-PR, PQR and PR into a single form would help alleviate regulatory burdens. Withdrawing the second set of the SEC's Jobs Act's proposal would also help facilitate capital formation.

Of course, members of the alternative investment industry are active market participants outside the US. In Europe, maintaining access to investors and markets across jurisdictions is important for capital markets and liquidity. And we continue to see the promise in the EU's Capital Markets Union initiative, which can help set the stage for Europe's economic resurgence by alleviating impediments to cross-border investments and developing a more diversified financial system to complement bank financing.

Just like our country, US capital markets are strong – not perfect, but strong. By creating a fair, sensible and growth-oriented tax code and modernizing our regulatory framework, our markets can further stimulate growth and help investors achieve their unique goals.

Richard H. Baker is president and CEO of the Managed Funds Association