



# 2020

## LEGISLATIVE AND REGULATORY PRIORITIES



### U.S. AGENDA

#### TAX POLICY

##### Promote and Enhance Investment in U.S. Capital Markets

MFA supports efforts to create a fair, simple, and growth-oriented tax code that promotes investment activity in the U.S., including from tax exempt investors like pensions and endowments, and non-U.S. investors.

With enactment in 2017 of the Tax Cuts and Jobs Act, MFA remains actively engaged with the Treasury Department in promoting rulemaking and guidance implementing this legislation, as well as maintaining a high level of engagement with key policymakers on Capitol Hill as they conduct oversight and craft technical corrections to the measure.

##### Apply Investment Interest Exemption to All Partnerships and Non-Corporate Partners

MFA encourages Treasury and the IRS to adopt final rules implementing the Tax Cuts and Jobs Act of 2017 that confirm that investment interest expenses paid by all partnerships, including trading partnerships, should be applied at the partnership level to all non-corporate partners, including materially participating partners.

MFA also encourages policymakers to permit tiered partnerships to aggregate both interest expense and interest income, similar to the aggregation rules for consolidated corporate groups.

The Tax Cuts and Jobs Act amended section 163(j) of the Code to generally limit the amount of business interest expense that a taxpayer can deduct to the sum of the

taxpayer's business interest income, 30 percent of the taxpayer's adjusted taxable income, and the taxpayer's floor plan financing interest expense. The TCJA excludes investment interest expense from this general limitation, which was a key MFA advocacy objective.

Treasury issued proposed rules in late 2018, which contained preamble language that would subject actively traded hedge fund partnerships to the 30 percent interest expense limitation at the fund level and also would subject partners in the fund to a second limitation under the investment interest expense rules in section 163(d).

##### Promote Non-Discriminatory Tax Policy (Enterprise Value and Carried Interest)

MFA encourages policymakers to issue guidance concerning the carried interest provisions of the Tax Cuts and Jobs Act of 2017. The guidance should clearly provide that capital amounts left in an investment fund will be treated as capital contributions for purposes of the new carried interest framework.

It is MFA's position that the statutory change to the tax treatment of carried interest was not intended to change the treatment of future allocations of income to a general partner to the extent the general partner has left the capital attributable to a prior carried interest allocation in an investment fund and subsequently earns an investment return on such capital.

MFA believes that such capital amounts left in an investment fund should be treated as a capital contribution and, therefore, will not have all future gains and losses allocated to the interest subjected to the three-year holding period requirement.



## Promote Implementation of Tax Legislation that Avoids Unintended Consequences

MFA supports implementation of the changes to rules on controlled foreign corporations (CFCs) which were included in the Tax Cuts and Jobs Act in a manner that reflects the clear legislative history and intent and avoids overly broad attribution rules that would hurt U.S. investors. The statutory changes to the CFC rules were intended to address a limited set of transactions used by some U.S. shareholders to avoid appropriate taxes. Congress clearly indicated that the changes were not intended to require broad attribution rules to apply to unrelated parties, which would subject a much broader group of U.S. shareholders to the CFC rules.

## Financial Transaction Tax

Legislative proposals for a financial transaction tax (FTT) were introduced in 2019 that apply to stocks, bonds, and derivatives traded in the U.S. or if a U.S. person is a party to the transaction and have narrow exclusions.

An FTT is unlikely to raise substantial revenues and market participants will instead turn to financial instruments not subject to the tax or trade in jurisdictions not subject to the tax. An FTT would also negatively impact the value of financial assets, to the detriment of all investors, including retail investors and pension plans, as the value of the asset would have to reflect the additional cost imposed by the tax. Additionally, the implementation of an FTT would likely decrease liquidity in the markets due to fewer transactions, leading to wider bid-ask spreads which harms investors. Several other countries including Sweden, Italy, and France have experimented with an FTT with dismal results including reduced trading volume, increased volatility, and estimated revenues plummeting after implementation.

## U.S. FINANCIAL & CAPITAL MARKETS REGULATION

### Strengthen Data Security and the Protection of Confidential Registrant Information

MFA supports efforts to provide regulators with the information needed to help oversee financial markets. Even so, MFA has strong concerns about the security of that information at the regulators, especially as it includes proprietary and market-moving information. A hack, breach, or theft of sensitive data could harm investors, create significant market volatility, destabilize markets, and result in the misappropriation of confidential proprietary information. MFA believes it is critical that regulatory agencies, as depositories of sensitive and

confidential data, implement robust policies, procedures, and practices for the protection of U.S. investors, companies, and markets.

MFA is working with policymakers on data security and the protection of confidential information and has outlined several steps regulators could take to mitigate the risk of a potential breach. MFA recommends policymakers narrow the scope of systemic risk filings and other data requests to information that is necessary to achieve their core mission; incorporate protections within the design of their forms and reporting systems to mitigate cyber breaches; enhance data security policies and procedures, and only ask for confidential, commercially-valuable intellectual property when necessary.

In 2019, MFA welcomed language included in CFTC Reauthorization legislation which was advanced by a unanimous voice vote in the House Agriculture Committee and is promoting similar language to apply to the SEC. This language would require the SEC to adopt policies and procedures after public notice and comment that would govern their collection of sensitive and proprietary information.

### Oppose U.S. Legislation and Regulation to Require Individual Short Position Disclosure

Short selling is an integral part of a carefully regulated, well-functioning market. Regulators have long recognized the vital role short selling plays in helping markets to function efficiently. Existing securities laws give the SEC the authority to gain access to trading information and to prevent market manipulation. Permitting short selling, particularly with the current robust regulatory framework, means that investors can manage risks better and markets can factor in the broadest possible views about a particular stock, bond, or index – reducing the likelihood of bubbles forming.

Short selling allows investors to say when they believe an asset is overvalued, which contributes to price discovery. The more efficient a market is at determining prices, the better it will function for investors. When long buyers and short sellers counterbalance each other, prices are more likely to reflect the actual value of the assets. Legislative proposals to require the individual disclosure of short positions would skew this balance.

### Promote a Sensible Approach to Asset Management Regulation and Reporting

Hedge fund managers are subject to robust regulations designed to oversee activities of the funds that they manage. MFA supported systemic risk reporting and we believe that systemic risk regulation should be activities-based, and data collection should be rationalized across

activities and not focused on any single metric.

Alternative investment fund managers report vast amounts of sensitive data to regulators through registrations, regulatory reporting requirements, and outdated recordkeeping requirements. Many managers are required to be registered as investment advisers with the SEC, as well as commodity pool operators and commodity trading advisors with the CFTC; and consequentially, are required to routinely file multiple forms with the SEC, CFTC, and NFA. The regulatory and filing requirements are similar, but different enough to require separate compliance and filing systems. To enhance the efficient functioning of capital markets, policymakers should eliminate outdated registration and oversight requirements, harmonize data collection, and eliminate data requests that do not further regulators' objective of monitoring systemic risk.

## Promoting Legal Market Research

MFA members believe that insider trading cannot be tolerated in capital markets. MFA is engaging with policymakers on the importance of legitimate market research to healthy capital markets and how changes in the law could impact it. Fundamental market research is crucial to the development and implementation of investment strategies used to deliver returns to hedge fund investors such as public pension plans and endowments. Among other legitimate information-gathering techniques, a financial analyst is permitted to listen to a company's executives describe the company's performance and future guidance on quarterly conference calls; review a company's public filings; engage an expert or a consultant to learn that expert's views on the industry sector, on the individual company, and on sectors related to the company in question; and, talk to former employees of the company. An analyst thereby gains the best understanding of how a company is performing and may perform in the future. The courts have sanctioned this type of data gathering, describing it as the "matrix" method of financial analysis.

Under a traditional insider trading analysis, an analyst may not, however, induce an "insider" at a company to violate that insider's fiduciary duty to the company and leak material, non-public information ("MNPI") in exchange for a personal benefit to the insider. MFA strongly supports the laws against insider trading and the enforcement of those laws. Prosecuting the use of improperly obtained information is essential to ensuring integrity, fairness, and public confidence in our capital markets. MFA members rely on fair and honest capital markets in fulfilling their fiduciary obligations to their investors. It is essential to ensure that financial analysts are able to properly gather information and conduct fundamental market research without the fear of being prosecuted for unknowingly

coming into possession of improper information.

## ENHANCE CAPITAL FORMATION, INVESTMENT, AND GROWTH

### Position Limits and Aggregation Limits

The Dodd-Frank Act authorized the CFTC to set position limits, as necessary, on commodity derivatives and economically equivalent contracts. The CFTC finalized regulation on the aggregation of position limits in 2017 and continues to work on rulemaking on position limits.

MFA opposes burdensome regulations that unnecessarily impede market participants from engaging in hedging and risk management activities. MFA seeks to work constructively with the CFTC to develop a practical and effective position limits framework that will continue to allow market participants to use the derivatives markets for risk management purposes without undue burden.

### Avoid Bank-Like Systemic Risk Rules by Advocating for Activities-Based Systemic Risk Regulation and Risk-Based Assessments of Leverage

MFA has called on the Financial Stability Oversight Council (FSOC) and policymakers in the U.S. and the EU to maintain a capital markets-based regulatory framework with respect to asset managers and avoid imposing bank-like systemic risk reporting rules on non-bank entities and activities. MFA has also advocated that regulation of systemic risk is best accomplished through activities-based regulation of markets and market participants, done on a holistic basis, after regulators analyze existing and pending regulations to determine if regulatory gaps remain.

As policymakers continue to consider how best to measure and analyze investment funds' use of leverage, MFA recommends policymakers should analyze leverage within a broader risk framework. That framework also should consider other risk factors and mitigants, including market practices and regulations that reduce the likelihood that the use of leverage by a hedge fund might create systemic risk.

## PROTECT INVESTOR RIGHTS

### Hart-Scott-Rodino (HSR) Modernization

MFA encourages policymakers to abandon an overly restrictive interpretation of the Hart-Scott-Rodino Antitrust Improvements Act (HSR). The effect of this interpretation has been to discourage appropriate

engagement between investors and public company boards and management. For years, MFA members relied on the “investment-only” exemption to the HSR filing requirements. Without any formal change in its rules, the FTC has taken a much narrower reading of the Exemption than in the past. This restrictive interpretation has chilled ordinary-course communications between shareholders and management of issuers and creates tensions with the federal securities laws’ policy of encouraging investors to engage with issuers.

MFA urges policymakers to adopt a broader and updated interpretation of the exemption with a new de minimis exemption to reduce HSR filing burdens.

## PROMOTE FAIR & STABLE SWAPS MARKETS

### CFTC Swaps Trading Framework

CFTC rules require certain swap to be executed on a swap execution facility (SEF). SEF execution is supposed to be beneficial to market participants by providing various methods of execution (e.g., central limit order book, RFQ, etc.). In practice, the current SEF regime has proven problematic for buy-side market participants as a two-tier market has developed where some SEFs cater to dealers trading with other dealers, while some SEFs facilitate trading between dealers and clients.

MFA has proactively engaged in advocacy with the goal of eliminating the two-tier market and the practice of post-trade name give-up. MFA urges policymakers to improve the legal framework for trading over-the-counter derivatives on registered SEFs by adopting rule changes that would allow investors more flexibility in how they trade swaps.

## CFTC REAUTHORIZATION

MFA supports efforts in the U.S. Senate and the U.S. House of Representative Committees on Agriculture to address reauthorization of the CFTC. Among its priorities, MFA encourages Congress to amend the Commodity Exchange Act to adopt “Dodd-Frank-like” protections for confidential, sensitive, and intellectual property of asset managers; harmonize CFTC rules for general solicitation with those of the SEC; amend the Bankruptcy Code to enhance protections of customer collateral; encourage a thoughtful approach, including the use of data-driven determinations, regarding the imposition of position limits; and, promote harmonized, global regulations.

MFA welcomed language included in the CFTC Reauthorization legislation in 2019 which was advanced by a unanimous voice vote in the House Agriculture Committee and is promoting similar language in possible Senate legislation. This language would require the CFTC and the SEC, through directed rulemaking, to adopt policies and procedures that would govern their collection of sensitive and proprietary information.

***MFA supports smart financial regulation and encourages policymakers to ‘first, do no harm’ as they work to further grow the economy and promote robust and efficient capital markets.***

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