Managed Funds Association appreciates the opportunity to testify at the Department's conflict of interest hearing. My name is Stuart Kaswell, and I am General Counsel of MFA. MFA represents the global alternative investment industry and its investors. MFA strongly supports the Department's goal of protecting benefit plans and their participants. We recognize that imposing fiduciary status on certain service providers to plans can further that goal.

We appreciate the Department's determination that valuations provided to collective investment vehicles do not create an ERISA fiduciary relationship. We also appreciate the Department's efforts to exclude sales activity to sophisticated plan investors from being deemed "providing investment advice."

We believe that tailoring of the proposal is needed to achieve these two objectives. Absent changes, we believe that the proposal could impair the ability of sophisticated retirement plan investors to invest in hedge funds and other private funds.

Background

Before discussing specific concerns about the proposal, I would like to discuss the value that hedge funds provide to sophisticated retirement plan investors. The addition of hedge funds to a retirement plan's portfolio may provide diversification, risk management, and returns that are not correlated to traditional markets. These benefits help retirement plans meet their obligations to plan participants and help sophisticated IRA holders achieve their financial goals.

It also is important to note that securities laws subject hedge funds managers to comprehensive regulation and that investment advisers are fiduciaries to their clients (though not necessarily ERISA fiduciaries). Of course, we understand that ERISA regulation of fiduciaries is not identical to regulation under the Investment Advisers Act. We note that hedge funds generally may not be sold to the general public or retail investors and are usually offered only to "accredited investors" or "qualified purchasers." These are investors who are deemed to have sufficient sophistication and ability to absorb the risks associated with making such investments.

In light of the existing regulatory frameworks applicable to private fund managers, we believe that the policy concerns about gaps in the protection of plan investors, particularly retail investors, are not applicable to private funds.

Overview

When considering the application of ERISA to hedge funds, we believe it is important to focus on the manager's investment decision-making on behalf of the fund. Accordingly, the investment adviser to a plan asset fund is a fiduciary under ERISA with respect to the investment management decisions that the adviser makes on behalf of the fund, including "funds of one" owned by a benefit plan. We believe that expanding fiduciary status to cover ancillary activities does not provide additional protections to plan investors. In fact, such a change could inadvertently harm those investors.

I now would like to address two areas of concern with the proposal – first, Statements of Value and second, Marketing Issues.

Statements of Value/Reporting to Fund Investors

First, MFA supports the Department's proposal to exclude from the scope of the rule statements of value and appraisals that are provided to collective investment vehicles.

We are concerned, however, that it is not clear whether the pooled fund carve-out would extend to all statements that are provided to all fund investors, or that are provided to a specific fund investor.

Many funds have service providers (such as administrators and data aggregators) that prepare and disseminate the fund's net asset value and transparency reports to investors with information about the fund's investments and providing verification of asset pricing. Uncertainty regarding the proposal is likely to create a disincentive for fund managers and service providers to disclose routine and relevant information to fund investors. Uncertainty also may make funds unwilling to accept plan investors in the first place. Both outcomes are detrimental to retirement plan investors.

We do not believe that managers and service providers are likely to conclude that the current exclusions for communications that are not made "in connection with a specific transaction" or that are required by law, apply to the range of communications typically provided to fund investors.

As such, a manager or a service provider to a Non-Plan Asset Fund risks being considered a fiduciary in connection with routine statements made to a plan investor, even though the manager is not an

ERISA fiduciary with respect to its investment management decisions. We respectfully submit that imposing fiduciary status on managers and service providers to Non-Plan Asset Funds is inconsistent with ERISA. Moreover, we don't believe that restricting the flow of information helps investors.

We note that the pooled fund carve-out does not take into account a "fund of one" structure that many larger plans use. Excluding funds of one could result in less information being available to investors in funds of one, interfering with the structures adopted by plan fiduciaries to prudently make and monitor plan investments.

To address these issues, we recommend that the Department revise the proposal to permit fund managers and service providers to communicate directly with plan investors by providing information relevant to their investment in the fund, and responding to investor questions, without creating fiduciary obligations. We urge the Department either to clarify that such communications are not considered "in connection with a specific transaction" regardless of what use the plan investor may make of them, or to amend the pooled fund carve-out expressly to include communications to plan investors in investment funds, including funds of one.

It is important to remember that, even under this proposed approach, the securities laws would still protect plan investors from inaccurate or misleading information. We again note that fund managers to investment funds that are deemed to hold plan assets under ERISA are ERISA fiduciaries with respect to the investment advice they provide to the investment fund, including "funds of one."

The Ability to Market One's Own Products and Services

MFA's second principal area of concern is the marketing and selling of hedge funds to retirement plan investors, which we believe should not be deemed to be fiduciary in nature.

MFA believes that asset managers should be able to market their products and services to plan investors without being deemed an ERISA fiduciary with respect to that marketing activity. When a manager, or a placement agent, is marketing a private fund, they are not making recommendations to potential investors, nor are they in a position to make a fiduciary determination regarding whether the potential investor should invest in the fund being marketed.

The Department has long recognized the distinction between communications that are intended to sell a product or service and communications that constitute investment advice. The Department's existing guidance demonstrates that a fiduciary does not engage in a prohibited transaction when it acts on its own behalf to propose that a plan buy an additional service or product from the fiduciary for additional compensation.

We are concerned that the proposal could cause the sales activities of all persons who sell or market interests in funds to be fiduciary. Absent revision, the proposal will make it difficult or impossible to market private funds to plan investors.

MFA respectfully requests that the Department amend the proposal to make clear that a fund manager is not acting as an ERISA fiduciary when it markets its private funds to a retirement plan.

Suggested Revisions to the Seller's Carveout

Alternatively, the Department could revise the Seller's Carveout to permit fund managers to market investment products to retirement plan investors without acting as fiduciaries in connection with their marketing activities.

MFA urges the Department to make the following amendments to the Sellers' Carveout:

(1) Remove the condition requiring a minimum number of plan participants, which we do not believe is a good proxy for sophistication;

(2) Clarify that the restriction on receiving a fee in connection with a transaction, does not apply to the receipt, by a fund manager or its affiliate, of an asset management or a performance fee or allocation from a fund;

(3) Conform the condition that the independent plan fiduciary have <u>$100 million in employee benefit plan assets under management</u> to existing law, namely the <u>QPAM exemption, which requires $85 million in assets under management</u>; and

(4) Apply the Seller's Carveout to marketing and sales to all retirement plan investors eligible to invest in private funds so as not to exclude to plan asset funds, IRAs, and other eligible retirement plan investors.

Suggested Revisions to Best Interest Contract (BIC) Exemption

Further revisions to the proposal also are needed to permit an adviser to use placement agents or other third-party sales persons that are compensated in connection with a sale of an interest in a private fund. Although the proposed BIC Exemption permits sales persons to receive commissions in connection with sales of certain investment products, the exemption only applies to a limited universe of investment products defined as "Assets," which we believe is too restrictive. It does not include private funds.

Because private funds are not sold to retail investors, revising the definition of "Asset" in the BIC Exemption to include privately offered funds would not permit retail investors to purchase such investments. It would allow plans and IRAs that are already eligible to invest in private funds to continue to meet their financial goals by purchasing interests in such funds and benefit from the conditions of the BIC Exemption.

Conclusion

MFA appreciates the opportunity to testify before the Department. We commend the Department for holding this hearing and carefully considering our views. We hope to play a constructive role in shaping any changes to the scope of the fiduciary status rules. I would be happy to answer any questions that you may have.