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

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Via: Electronic Filing

Office of Regulations and Interpretations
Office of Exemption Determinations
Employee Benefits Security Administration
Attn: Conflict of Interest Rule (RIN 1210-AB32) and Proposed Best Interest Contract Exemption (ZRIN 1210-ZA25)
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

Re: Conflict of Interest Rule and Proposed Best Interest Contract Exemption

Dear Sir or Madam:

Managed Funds Association ("MFA")[1] appreciates the opportunity to submit this additional response to the regulations proposed by the Department of Labor ("Department") on the definition of the term "fiduciary," Conflict of Interest Rule--Retirement Investment Advice (the "Proposed Rule")[2] and the Proposed Best Interest Contract Exemption (the "BIC Exemption")[3] (collectively, the "Proposal"). As stated in our initial July 21, 2015 letter to the Department (the "July 2015 Letter")[4] and in MFA's testimony at the August 13 public hearing on the Proposal, MFA strongly

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1 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 other regions where MFA members are market participants.

2 80 Fed. Reg. 21928 (Apr. 20, 2015).

3 80 Fed. Reg. 21960 (Apr. 20, 2015).

4 Available at: https://www.managedfunds.org/wp-content/uploads/2015/07/MFA-Comment-Letter-on-Proposed-Fiduciary-Rule.pdf.

supports the Department's goal of protecting benefit plans and their participants, and we recognize that imposing fiduciary status on certain service providers to plans can further that goal.

Also as noted in our July 2015 Letter and in our testimony, we are concerned that the Proposal may have unintended and deleterious effects on the sophisticated ERISA plans and IRAs that elect to invest in privately-offered investment funds and on the fund managers and service providers to private investment funds, regardless of whether those funds are deemed to hold plan assets for purposes of ERISA. Specifically, we remain concerned that the Proposed Rule has the potential to extend fiduciary obligations too far by: (1) making persons ERISA fiduciaries because they provide statements of value to investment fund investors that are ERISA plans, plan fiduciaries, plan participants or beneficiaries, IRAs, or IRA owners ("plan investors"); (2) fundamentally altering the sale of investment products to plan investors, including sophisticated IRA owners, by deeming the sales process itself to be fiduciary in nature; and (3) unduly limiting the scope of assets that may be sold in reliance on the BIC Exemption.

Set out below are MFA's suggested amendments to the Proposal, which we believe would address the above concerns in a targeted manner that is consistent with the Department's objectives underlying the Proposal. Absent these additional changes, the broad scope of the Proposal could unintentionally bring the investor reporting and sales activities of private investment funds within the scope of fiduciary advice, even though we believe those activities should not be characterized as providing investment advice or recommendations to plan investors.

Relevant Securities Laws Definitions for Sophisticated Investors

As noted in our July 2015 Letter and testimony, private investment funds are sold under the federal securities laws to sophisticated investors, as established under the securities laws. MFA strongly supports limiting investments in private funds to only sophisticated investors. MFA also has continually supported efforts to increase investor qualification standards over time, which ensure that only sophisticated investors with the financial wherewithal to understand and evaluate the investments are able to purchase interests in private funds. It also is important to note that, for many hedge funds, the qualified purchaser standard ($5 million in investments for individuals and $25 million for entities such as pension plans) is the minimum threshold. Further, while other private funds may be sold to accredited investors, for the adviser to charge a performance fee, each investor must be a qualified client, defined in rule 205-3 under the Investment Advisers Act of 1940 as a person with a net worth of at least $2 million (or a minimum of $1 million managed by the adviser). We believe the securities laws standards provide an appropriate framework for distinguishing between retail and sophisticated investors and we encourage the Department to use similar thresholds to promote consistency and reduce the potential for confusion among investors and managers.[5] Set out below are the most relevant portions of the accredited investor, qualified client, and qualified purchaser definitions from the federal securities laws.

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5 To the extent the Department desires to impose additional measures of sophistication on plan investors, we encourage the Department to coordinate with the Securities and Exchange Commission to update these thresholds in a consistent manner.

Accredited Investor

Rule 501 under Regulation D under the Securities Act of 1933[6] defines "accredited investor" to include, in relevant part –

> (1) Any natural person whose individual net worth, or joint net worth with that person's spouse, exceeds $1,000,000, not including the person's primary residence;
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> (2) any natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year; and
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> (3) an employee benefit plan, within the meaning of the Employee Retirement Income Security Act, if a bank, insurance company, or registered investment adviser makes the investment decisions, or if the plan has total assets in excess of $5 million.

Qualified Client

For an SEC registered investment adviser to charge fund investors a performance fee, as is typical for private funds, each investor in a private fund must be a qualified client as defined in Rule 205-3 under the Investment Advisers Act of 1940.[7] The relevant portions of the qualified client definition are:

> (1) A natural person who, or a company that, immediately after entering into the contract has at least $1,000,000 under the management of the investment adviser;
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> (2) A natural person who or a company that the investment reasonably believes has a net worth (together, in the case of a natural person, with assets held jointly with a spouse) of more than $2,000,000, not including the person's primary residence; or
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> (3) A qualified purchaser under the Investment Company Act.

Qualified Purchaser

A "qualified purchaser" is defined in section 2(a)(51) of the Investment Company Act of 1940.[8] The relevant portions of the qualified purchaser definition are:

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6 17 C.F.R. §230.501(a).

7 17 C.F.R. §275.205-3(d).

8 15 U.S.C. §80a-2(a)(51).

(1) any natural person who owns not less than $5,000,000 in investments, as defined by the Commission;

(2) any person, acting for its own account or the accounts of other qualified purchasers, who in the aggregate owns and invests on a discretionary basis, not less than $25,000,000 in investments.

Exclusion from Definition of "Investment Advice" for Investment Advisers Marketing Their Own Products and Services

MFA believes that asset managers, like other service providers, should be able to market their goods and services to plan investors without being deemed an ERISA fiduciary with respect to that marketing activity. When a manager is marketing a private investment fund or its advisory services, it is not providing investment advice as that term is ordinarily understood, nor is it in a position to make a fiduciary determination regarding whether the potential investor should invest in the fund being marketed or retain the manager to provide its advisory services. As such, imposing fiduciary obligations in connection with "self-marketing" activities by managers would have a material and adverse impact on MFA members and make it difficult for plan investors to learn about potentially appropriate investment funds or advisory services offered by the manager.

To address this concern, we respectfully request the Department amend §2510.3-21 by replacing sub-paragraph (a)(1)(iv) with the following, to permit a manager to market its own advisory services:

> "(iv) A recommendation of an unaffiliated third party who is also going to receive a fee or other compensation for providing any of the types of advice described in paragraphs (i) through (iii); and"

And by adding to the end of paragraph (a) the following new sub-paragraph (3), to permit a manager to market its investment funds to sophisticated plan investors.

> "(3) An investment adviser, as defined in section 202(a)(11) of the Investment Advisers Act of 1940, shall not be deemed to be providing investment advice under this paragraph (a) when marketing to a sophisticated plan investor an investment fund managed by the adviser or an affiliate of the adviser; provided that such adviser does not represent or acknowledge that it is acting as a fiduciary within the meaning of the Act with respect to such marketing activities."

For these purposes, (and for purposes of this comment letter generally) we would define "sophisticated plan investor" as "an employee benefit plan or IRA, or a fiduciary acting on such plan or IRA's behalf, that is an accredited investor (as defined in Rule 501(a) of Regulation D under the Securities Act of 1933), a qualified client (as defined in Rule 205-3 under the Investment Advisers Act of 1940), or a qualified purchaser (as defined in section 2(a)(51) of the Investment Company Act

of 1940)." We urge the Department to amend section (f) of the Proposed Rule as follows to add this new definition:

> "(f)(7) "Sophisticated Plan Investor" means, for purposes of §2510.3-21, an employee benefit plan or IRA, or a fiduciary acting on such plan or IRA's behalf, that is an accredited investor (as defined in Rule 501(a) of Regulation D under the Securities Act of 1933), a qualified client (as defined in Rule 205-3 under the Investment Advisers Act of 1940), or a qualified purchaser (as defined in section 2(a)(51) of the Investment Company Act of 1940)."

Amended Sellers' Carve-out

Consistent with the proposed amendment to the definition of "investment advice" suggested above, we encourage the Department to amend the Seller's Carve-out, set out in §2510.3-21(b)(1), to permit fund managers to market investment products to retirement plan investors, or marketing by paid placement agents or others performing similar functions, without acting as fiduciaries in connection with their marketing activities. Although the Seller's Carve-out is obviously intended to be limited to plan investors with a certain level of financial expertise, the carve-out is too limited and imposes new standards that are inconsistent with ERISA and other laws, particularly as applied to sales of privately offered investment funds. MFA believes that it is appropriate to use asset size, as the definitions of accredited investor, qualified client, and qualified purchaser do, as a proxy for sophistication, and respectfully requests that the Sellers' Carve-out be revised to cover, in the case of a purchase or redemption of an interest in a private fund, employee benefit plans and IRAs that are eligible under federal securities laws (including accredited investors and qualified purchasers) to invest in such funds.

To achieve that goal, we respectfully request that the Department amend §2510.3-21(b)(1)(i) as follows:

(1) revise all references to "employee benefit plan" or "plan" to include all benefit plan investors as defined in ERISA Section 3(42), and

(2) add the following clause (D) to the end of §2510.3-21(b)(1)(i) and specify that §2510.3-21(b)(1)(i) may be satisfied by meeting the requirements of one of paragraph (b)(1)(i)(B), (C), or (D):

> "(D) Such person ---
> (1) With respect to the marketing and sale of a private investment fund to plan investors, limits the sale of such private investment fund to sophisticated plan investors, as defined in 29 C.F.R. §2510.3-21(f)(7), that are eligible to invest in private investment funds under the federal securities laws.
> (2) Fairly informs the independent fiduciary that the person is not undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity; and
> (3) Does not receive a fee or other compensation directly from the benefit plan investor, or fiduciary, for the provision of investment advice (as opposed to other

> services) in connection with the transaction. For the avoidance of doubt, for purposes of this subsection, fees or other compensation paid or allocations made by the investment fund to such person that are charged in connection with the management of the fund are not deemed to be fees or other compensation for the provision of investment advice in connection with the transaction."

Amended Definition of "Assets" in BIC Exemption

In addition to the suggested changes above, we believe the definition of "Assets" in the BIC Exemption should be amended to include interests in private investment funds. As drafted, the BIC Exemption does not cover investments in private funds. Because the Proposal imposes fiduciary status on the marketing and sales process for certain market participants, absent modifications to the BIC Exemption, many IRA and self-directed defined contribution accounts of sophisticated investors could lose the ability to invest private funds. Specifically, we are concerned that an adviser to a private investment fund would be unable 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.

In the context of many private funds, investment by sophisticated investors through their IRAs or self-directed defined contribution plans could also be made by the sophisticated investor with his or her personal money, family office money, or other sources of private wealth. Because of the relatively small size of these investments, they rarely impact on the 25% plan asset test, although they are of importance to the investment strategy of the individual investor, Thus, many private fund managers and their placement agents are agnostic when marketing to individuals as to whether the individual invests personally, through his or her IRA, or through a self-directed defined contribution plan account and make no effort to influence whether the potential investor should invest with personal or benefit plan investor money. At most, the individual marketing the fund may, if asked, explain the different tax consequences of investing with various buckets of money or in an onshore or offshore fund. Without the suggested changes to the Proposal, the individual marketing a private fund to sophisticated investors potentially could be: (1) subject to the ERISA fiduciary standard (if the potential investor decides to make an investment wholly using benefit plan investor money); (2) not subject to the ERISA fiduciary standard (if the potential investor determines to invest using non-benefit plan investor resources; or (3) somewhere in between (if the investor decides to invest using both benefit plan investor money and non-benefit plan investor money).

To avoid this incongruous result and to ensure that sophisticated investors, including IRA and self-directed defined contribution accounts of sophisticated investors, have access to investment products that meet their needs, as Congress determined that they should, we encourage the Department to amend the definition of "Assets" in Section VIII(c) of the BIC Exemption to include the following new language:

> "Included within this definition is an equity interest in (1) an entity that meets the definition of "private fund" in section 202(a)(29) of the Investment Advisers Act of 1940, or an entity formed in a jurisdiction outside of the U.S. that would be a private fund if formed in the

> U.S., or (2) an entity that would be an investment company under section 3(a) of the Investment Company Act of 1940, but for one or more of the exceptions in section 3(c) of that Act, or an entity formed in a jurisdiction outside of the U.S. that would be such an entity if formed in the U.S.; provided, that, such an entity will only be included within this definition to the extent the investor acquiring such equity interest is a sophisticated plan investor, as defined in 29 C.F.R. §2510.3-21(f)(7)."

Amended Carve-out for Statements of Value Made to Collective Investment Vehicles

Finally, we believe it is important for the Department to make clear that the pooled fund carve-out in §2510.3-21(b)(5)(ii) covers communications with investors in the fund, because we do not believe that managers and service providers will likely be able to conclude that such communications are not statements made "in connection with a specific transaction" and, therefore, outside the scope of the regulation. We further believe that it is important for the Department to amend the pooled fund carve-out to include "funds of one," which are separate vehicles typically set up for large institutional investors that are intended to be substantively similar to a manager's collective investment fund, but which are used instead of the collective investment fund to meet particular requirements of the institutional investor.

Accordingly, we encourage the Department to replace proposed §2510.3-21(b)(5)(ii) with the following amended language:

> "(ii) an investment fund, or a plan or IRA, plan participant or beneficiary, or IRA, IRA owner, or a fiduciary of such plan or IRA, to the extent that such plan or IRA is invested in such investment fund, such as a collective investment fund or pooled separate account, in which one or more plans has an investment, or which holds plan assets of one or more plans under 29 C.F.R. §2510.3-101; provided, that, for purposes of this clause (ii), an investment fund with only one investor (or a group of related investors) may be treated as a collective investment fund, but only to the extent the investor is a sophisticated plan investor."

MFA strongly supports the Department's goal of protecting benefit plans and their participants, and we recognize that imposing fiduciary status on certain service providers to plans can further that goal. We believe the suggested amendments above would address MFA's concerns in a targeted manner that is consistent with the Department's objectives underlying the Proposal. If you have any questions regarding any of these comments, or if we can provide further information, please do not hesitate to contact Benjamin Allensworth or the undersigned at (202) 730-2600, or at the following e-mail addresses: ballensworth@managedfunds.org and skaswell@managedfunds.org

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
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Director, General Counsel