Managed Funds Association
The Voice of the Global Alternative Investment Industry
Washington, D.C. | New York | Brussels

April 6, 2023

Via Electronic Submission

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

Re: Notice of Proposed Rulemaking on Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer, File No. S7-12-22

Dear Ms. Countryman:

Managed Funds Association ("**MFA**")[1] submits these comments to the Securities and Exchange Commission ("**Commission**" or "**SEC**") on the proposed rulemaking to further define the terms "dealer" and "government securities dealer," as defined in Sections 3(a)(5) and 3(a)(44), respectively, of the Securities Exchange Act of 1934 ("**Exchange Act**").[2] These comments supplement our comment letters on the Proposal, dated May 27, 2022, and December 5, 2022, in which we argued that the proposed rulemaking is unnecessary and, unless substantially revised, harmful to markets and market participants.[3]

[1] MFA represents the global hedge fund and alternative asset management industry and its investors by advocating for regulatory, tax, and other public policies that foster efficient, transparent, and fair capital markets. MFA's more than 150 member firms collectively manage nearly $2.6 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time. MFA has a global presence and is active in Washington, Brussels, London, and Asia. www.managedfunds.org

[2] SEC Release No. 34-94524 (Mar. 28, 2022), 87 Fed. Reg. 23054 (Apr. 18, 2022) ("**Proposal**"), available at: https://www.govinfo.gov/content/pkg/FR-2022-04-18/pdf/2022-06960.pdf.

[3] *See* Letter from Jennifer W. Han, Executive Vice President, Chief Counsel & Head of Global Regulatory Affairs, MFA, to Vanessa Countryman, Secretary, SEC (May 27, 2022) ("**May Comment Letter**"), available at: https://www.sec.gov/comments/s7-12-22/s71222-20129911-296085.pdf; Letter from Jennifer W. Han, Executive Vice President, Chief Counsel & Head of Global Regulatory Affairs, MFA, to Vanessa Countryman, Secretary, SEC (Dec. 5, 2022) ("**December Comment Letter**"), available at: https://www.sec.gov/comments/s7-12-22/s71222-20152323-320251.pdf; and Letter from Jennifer W. Han, Executive Vice President, Chief Counsel & Head of Global Regulatory Affairs, MFA, to Vanessa

As explained in our previous comment letters, we are particularly concerned that the proposed quantitative and qualitative tests for determining who is a dealer or government securities dealer ("**Proposed Rules**") are vague, open-ended, and, in the case of the quantitative test in particular, unprecedented and overbroad. As such, if adopted, the Proposed Rules would potentially capture many entities that are not dealers, but rather are simply investors. This would subject alternative asset managers and their investors to a dealer regime that is not designed for, and is ill-suited to, private funds, which are not operating companies, have no employees or customers, and offer investors liquidity rights that are not compatible with the net capital rule applicable to dealers.[4] Because of the high cost of registering and continuing to operate as a broker-dealer and the loss of important customer protections under FINRA and SEC rules, firms may restructure their activity to avoid being required to register as a dealer.[5] As a result, the Proposal will have the unintended consequence of harming third-party fund investors who will have fewer investment opportunities, reducing market liquidity and increasing volatility in equity and U.S. Treasury markets, and generally impairing the Commission's goal of facilitating efficient markets.

To supplement our previous comments, in this letter, we discuss the ways in which the Proposed Rules would require aggregation of positions for purposes of the quantitative and qualitative tests, focusing on the implications for private funds—both within an investment fund and across investment funds. We believe the Proposed Rules are overly broad, in part, because they are based on the mistaken assumption that all trading activity occurring within a single legal entity or commonly controlled group of legal entities takes place on an integrated and coordinated basis. This is often not the case, and it can result in the Proposed Rules treating private funds with multiple portfolio managers as dealers when they are not engaged in dealing activity. Ironically, this aspect of the Proposed Rules would *require* coordination of trading activity among multiple portfolio managers in order to monitor for and comply with the new dealer tests, when those managers would otherwise trade independently of each other. The Proposal's economic analysis fails to account for these costs and consequences of this overly broad aggregation rule.[6]

For the reasons set forth below, we urge the Commission—if it intends to proceed with this unnecessary and ultimately harmful proposal—at the very least to recognize disaggregation

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Countryman, Secretary, SEC (Dec. 5, 2022) ("**Economic Study**"), available at: https://www.sec.gov/comments/s7-12-22/s71222-20152322-320250.pdf.

[4] Requiring private funds to comply with the Commission's net capital rule when they have no customers (but are typically themselves customers of broker-dealers) will not benefit investors or the markets as it will require capital to remain locked up in the broker-dealer for a substantial period of period and therefore not available for investing or to be used to satisfy investor redemption requests.

[5] *See* May Comment Letter at 9 – 11 (discussing, among other examples, Loss of Customer Protection, Loss of SEC and FINRA Sales Practice Protections, Loss of Liquidity Rights, Lost Access to the U.S. IPO Market, Lost Access to Certain Investment Strategies, and Increased Personnel and Infrastructure Costs).

[6] *See* Proposal, 87 Fed. Reg. at 23080, n. 219 ("The analysis does not aggregate affiliated firms, but counts them separately, even though they may be controlled by a common corporate parent").

by independent portfolio managers by adopting a definition of "own account" in the definitions of "dealer" and "government securities dealer" that treats trading activity conducted by separate decision-makers separately for purposes of the rule, provided there is no coordination of trading among or between them. This would at least mitigate some of the harm of the Proposal.

I. Introduction

The Exchange Act defines a "dealer" and a "government securities dealer'' as a person engaged in the business of buying and selling securities for its "own account," but not as a part of a regular business.[7] The Proposal defines "own account" as any account that is: (1) held in the name of the person, (2) held in the name of a person over whom that person exercises control or with whom that person is under common control,[8] subject to certain exceptions,[9] or (3) held for the benefit of the persons identified in the previous two categories.

The Proposal appears to be based on an assumption that all trading activity occurring within a single legal entity or commonly controlled group of legal entities takes place on an integrated and coordinated basis. However, it is quite common that a single entity (such as a fund) or group of entities (such as a family of funds) engage in trading activity through substantially (for all relevant purposes) independent portfolio managers who do not coordinate their investment activity. As described in the following sections, this can occur within an investment fund or across investment funds.

We further note that the Commission's approach in this regard departs substantially from established Commission precedent. For example, since 2007 the Commission has permitted disaggregation of trading in separate accounts if decisions regarding securities transactions for each account are made separately and without coordination of trading or cooperation among or between the accounts for purposes of Regulation M's short selling restrictions.[10] Similarly, for

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[7] Section 3(a)(5) of the Exchange Act.

[8] The Proposal would incorporate the definition of "control" under Exchange Act Rule 13h-l in determining the accounts that should be aggregated for the purpose of this definition. The Proposal also would use the Form PF definition of "parallel account structure."

[9] The following three types of accounts would be excluded from the proposed "own account" definition:

> (1) an account in the name of a registered broker, dealer or government securities dealer, or an investment company registered under the Investment Company Act;
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> (2) with respect to a registered investment adviser, an account held in the name of a client of the adviser unless the adviser controls the client as a result of the adviser's right to vote or direct the vote of voting securities of the client, the adviser's right to sell or direct the sale of voting securities of the client, or the adviser's capital contributions to or rights to amounts upon dissolution of the client; and
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> (3) with respect to any person, an account in the name of another person that is under common control with that person solely because both persons are clients of an investment adviser registered under the Advisers Act, unless those accounts constitute a parallel account structure.

[10] *See* Short Selling in Connection with a Public Offering, Release No. 34-56206 (Aug. 6, 2007), 72 Fed. Reg. 45094 (Aug. 10, 2007). Similar disaggregation principles apply to broker-dealers under Regulation

purposes of Section 13 reporting, the Commission has recognized that "certain organizational groups are comprised of many different business units that operate independently of each other" and that "the need to aggregate [for reporting purposes] may have the effect of requiring diverse business units to share sensitive information, when it is otherwise not necessary for business purposes."[11] The Commission has therefore issued guidance noting that "where the organization structure of the parent and related entities are such that the voting and investment powers over the subject securities are exercised independently, attribution may not be required for the purposes of determining whether a filing threshold has been exceeded and the aggregate amount owned by the controlling persons."[12] The Proposal does not address why it would be appropriate to depart from these and similar precedents in the dealer registration context.

II. Discussion of Aggregation Within a Fund

Funds are structured in different ways. In some cases, they have a single portfolio manager who pursues a single investment strategy or related and coordinated investment strategies. In other cases, however, a private fund manager may delegate trading authority among multiple portfolio managers, who, in turn, trade independently of each other. These "multi-strategy" funds pursue multiple investment strategies, typically by portfolio managers who pursue independent strategies without coordination with each other.[13] While such funds may establish fund-level risk management parameters that set risk limits for each portfolio manager, the trading itself is not coordinated, *i.e.*, the trading of one portfolio manager is not coordinated with that of another portfolio manager. In fact, funds often have policies and procedures that restrict or prohibit such coordination in order to, for example, comply with other regulatory obligations.

If the trading activity of these independent portfolio managers were aggregated with each other, the trading activity could be viewed—inappropriately—as being in the nature of market making, which the Commission characterizes as "dealer" activity. To take one example, if one manager were pursuing a long-only strategy and another manager were pursuing a short-only strategy, the combined trading activity of the two managers might coincidentally, but inadvertently, trigger the first qualitative test for roughly comparable purchases and sales of the same or substantially similar securities.[14] However, such multi-strategy funds are not engaged in the business of being a dealer, under any reasonable understanding of that term.

SHO. *See* 17 C.F.R. § 242.200(f); *see also* Order Granting Limited Conditional Exemption from Rule 200(c) of Regulation SHO to Magnitude Special Investments Portfolio Fund, Ltd., Rel. No. 34-80042 (Feb. 14, 2017) (extending similar treatment to an investment fund).

[11] Amendments to Beneficial Ownership Reporting Requirements, SEC Rel. No. 34-39538 (Jan. 12, 1998), 63 Fed. Reg. 2854, 2857 (Jan. 16, 1998).

[12] *Id*. at 2857.

[13] *See* Barclays, Multi-Manager Hedge Funds Review—4Q22 Update (Jan. 2023) (showing the important value of multi-manager firms for investors); *see also* Barclays, Performance by Fee Type and Level Prime Services Capital Solutions (July 2022).

[14] *See* Economic Study at 11 ("Funds and separately managed accounts ('SMAs') often follow multiple different investment, trading, and arbitrage strategies in parallel. These different strategies may be

No dealer would conduct its business using independent decision makers in this way. Dealers typically balance their buying and selling activity to remain largely flat, particularly at the end of the day, but also throughout the day, which would be impossible if a dealer had independent decision makers buying and selling securities without coordinating their trading activity. While some dealers may operate separate and independent market-making desks, such dealers may be engaged in dealing activity with respect to each such desk because each is separately engaged in market making. By contrast, some multi-strategy funds may be considered dealers under the Proposed Rules only because the separate and distinct trading activity of all the portfolio managers is inappropriately viewed together.

For this reason, the Commission should make clear that the trading activity of separate portfolio managers in a multi-strategy fund, when it is not conducted on an integrated or coordinated basis, is not "dealer" activity. The pattern of buying and selling of these independent portfolio managers does not reflect dealing activity (as understood by market participants, and as defined by the Commission, for decades), and therefore the Commission should not aggregate activity of independent portfolio managers for purposes of either the qualitative or quantitative tests.

III. Discussion of Aggregation Across Funds

Recognizing that corporate families may be organized in different ways, the Commission proposed definitions of "own account" and "control" that are "designed to focus on the trading activity occurring at the firm or legal-entity level or the trading activity that is being employed on behalf of, or for the benefit of, the entity, and limit the registration burden to those entities engaged in dealer activity."[15] The Commission also noted that the definitions are drafted to deter circumvention of the Proposal in the form of market participants changing their corporate structures for the purpose of avoiding registration.[16]

As noted in our May Comment Letter, we generally question whether it is appropriate, in the context of the "dealer" and "government securities dealer" definitions, to adopt such broad aggregation rules. We are not aware of any judicial or agency precedent interpreting the phrase "own account" in any similar manner. Rather, market participants have traditionally understood

overseen by different portfolio managers, who may be unaware of what securities the other portfolio managers are trading. In this context, one portfolio manager may purchase a security and another portfolio manager may sell the same security (or a substantially similar security) on the same day. For example, a fund could have a long-short strategy that buys a particular stock as part of its 'alpha' model, while a convertible bond arbitrage strategy is shorting the same security to delta-hedge its exposure to the equity risk attributable to the long convertible position.").

[15] Proposal at 23074.

[16] Proposal at 23076.

the phrase, in part, to refer to trading done by the particular person that is the prospective object of the dealer or government securities dealer definition.[17]

More fundamentally, mere economic interest or control rights with respect to different entities does not necessarily mean the entities are pursuing coordinated trading across those entities. In fact, it is probably more common for trading to take place independently. Regardless, in cases where the trading activity is not coordinated or integrated, aggregation would result in an inadvertent and unwarranted expansion of dealer registration to capture independent trading activities that only coincidentally satisfy the Proposal's qualitative or quantitative tests. Combining the securities buying of one entity and the securities selling of another entity when they are under common control is plainly not indicative of dealing activity when it is not coordinated or integrated. For example, combining trading activity in U.S. Treasuries across multiple entities under common control within a corporate family, when such activity is not integrated or coordinated, is plainly not indicative of dealing activity.[18]

While appropriately tailored revisions may improve the qualitative tests' description of market making,[19] such revisions would not address the fundamental problem that activity of independent portfolio managers—either within a fund or across funds—should not be aggregated together because doing so would not be indicative of dealing activity. This problem also occurs with the quantitative test, although we continue to believe that no volume test is appropriate to determine whether an entity is a dealer or government securities dealer, and therefore the quantitative test should be eliminated rather than modified.[20]

IV. Conclusion

If the Commission were to proceed with this unnecessary and harmful proposal, in order to avoid some of the negative, unintended consequences described in this letter and our previous letters, the Proposed Rules should at least only aggregate trading activity if such activity is coordinated and integrated in cases of both trading within a fund and trading across funds. If the Commission is concerned about evasion, we believe the Commission can address those concerns

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[17] *See* May Comment Letter at 33. We note that, where the Exchange Act applies on the basis of a "control" test, it does so explicitly, such as in connection with its various "associated person" definitions or in the context of applying margin requirements to foreign persons controlled by United States persons.

[18] *See* May Comment Letter (identifying other ways in which the Proposal's aggregation rule would inadvertently capture other scenarios not legitimately within the scope of dealer registration).

[19] In our December Comment Letter, we suggested ways the Commission could revise the qualitative tests to better describe market making, noting that, contrary to the intended purpose, Qualitative Test 1 would encompass many customers engaged in normal course investing (not dealing) activity, including many private funds that do not engage in dealing activity.

[20] In our December Comment Letter, we argued that proposed $25 billion threshold in the quantitative test is arbitrary and inappropriately departs from the Commission's own longstanding approach to determining dealer status. It is not indicative of market-making (or even significant, relative to other firms) activity absent other activity. And in no instance has the Commission indicated that any single factor is determinative, and there has never been a purely quantitative test for dealer or government securities dealer status.

through a more tailored measure by modifying the Proposal to require aggregation among a single entity or commonly controlled entities solely in circumstances where such entity or entities, acting together or at the direction of a person controlling them both, engage in coordinating trading activity willfully structured to evade the rule.

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MFA appreciates the opportunity to provide additional comments to the Commission on the Proposed Rules. We welcome the opportunity to discuss our views with you in greater detail. Please do not hesitate to contact Matthew Daigler, Vice President & Senior Counsel, or the undersigned, at (202) 730-2600, with any questions that you, your respective staffs, or the Commission staff might have regarding this letter.

Very truly yours,

/S/ Jennifer W. Han

Jennifer W. Han
Executive Vice President
Chief Counsel & Head of Global Regulatory Affairs

cc: The Hon. Gary Gensler, SEC Chairman
The Hon. Hester M. Peirce, SEC Commissioner
The Hon. Caroline A. Crenshaw, SEC Commissioner
The Hon. Mark T. Uyeda, SEC Commissioner
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