Focus on Funds: Today’s Funds Need Modern Portfolio Management Rules

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ICI is calling on leaders at the US Securities and Exchange Commission (SEC) to reconsider the agency’s approach to fund use of derivatives. ICI General Counsel David Blass outlines a regulatory structure that would best serve funds and their investors.

Transcript

Stephanie Ortbals-Tibbs, ICI director, media relations: Under a new administration, the US Securities and Exchange will be taking up a new agenda, and the fund industry is hoping that includes a fresh look at fund’s use of derivatives. The rules could use a refresh, as I learned from recently speaking with ICI General Counsel, David Blass.

David Blass, ICI general counsel: Last year, as part of the Mary Jo White agenda, there was a proposal on fund’s use of derivatives, and we agree in part with that proposal and we disagree, strongly, in part. The part that we disagree about [involves] the portfolio limits that are based on notional calculations of derivatives exposure—widely agreed [to be] an inaccurate, inappropriate measure of risk through derivatives instruments. We think a better approach is for the SEC to abandon and scrap the portfolio limits, and have an appropriate focus on asset segregation—and there’s a rule there that the SEC could adopt that would be very helpful to the industry and investors alike if they focus, really, on asset segregation in a derivatives risk management program.

Ortbals-Tibbs: David, one thing people might not be aware of is that this is a rule that won’t just affect complex funds, it will affect pretty plain-vanilla bond funds.

Blass: I think the SEC was surprised—I’m guessing, based on the reaction to the proposal—that that rule, if the portfolio limits had been adopted as proposed, would’ve hit ordinary bond funds *very* hard and it would’ve forced a lot of them to shut down. And if you’re an investor in one of those funds, that’s very problematic—you’ve got all kinds of penalties and consequences from that fund being forced to shut down by a regulation.

Ortbals-Tibbs: So David, there’s a real opportunity here for the SEC to reexamine this.

Blass: The SEC got tremendous volume of comment on the original proposal, a lot of pushback on the portfolio limits. We think the SEC is going to need to repropose the rule before it adopts it as final, just based on the amount of comment that it received, the changes it’s going to need to make to the rule.

Ortbals-Tibbs: David, it's also really sensible not to stick with the status quo, but to move forward on a new rule.

Blass: Yes, the portfolio limits could have impacted hundreds of billions of dollars in funds—and those are investors' dollars that in those funds—so they really should revisit the rule, go back to an asset segregation approach, and derivatives risk management, and that could be a very good rule. The law and lore here is a bit confusing—there's a lot of informal guidance that the industry has to rely on, so formalizing a lot of that guidance around asset segregation could be very helpful.

Additional Resources

- Highlights of 2017 ICI General Membership Meeting
- Letter: ICI Comments to SEC on Derivatives Proposal
- Video: ICI Outlines Measures to Enhance Economic Growth
