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Focus on Funds: SEC Derivatives Proposal Could Pack a Punch for Funds

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ICI has responded to a regulatory proposal from the U.S. Securities and Exchange Commission governing funds' use of derivatives. In the April 1, 2016, edition of *Focus on Funds*, ICI Associate General Counsel Jennifer Choi outlines the industry's concerns about the plan as proposed.

Transcript

Stephanie Ortbals-Tibbs, Director, ICI Media Relations: The U.S. Securities and Exchange Commission is proposing an important, potentially transformative look at the use of derivatives by funds. ICI has responded to their proposal. Here's a look at our top-level concerns and suggestions.

Jennifer Choi, ICI Associate General Counsel: The SEC has been looking at this issue for many years, the concept of this came out in 2011, and they've been really regulating this area through a patchwork of informal guidance, comments to registration statements, so a modernization and rationalization of this area would be very helpful for the industry.

Ortbals-Tibbs: Jennifer, we agree with the SEC on a number of things in the proposal; we also have some concerns. Can we step through those please?

Choi: The asset segregation piece, which is the area upon which they are building the current framework, we very much support. On top of that, we would support the risk management program, which would reinforce the protections that asset segregation requirements would provide. We think the twin protections of asset segregation with the risk management program really addresses the concerns that the SEC has with respect to derivative transactions but undue speculation and the funds having enough assets on hand to be able to pay for future obligations. Where we diverge from the SEC is where they're proposing portfolio limits based on notional exposure. We really think notional exposure doesn't adequately measure risk or leverage so we would strongly urge the SEC to really rethink that policy decision and go back and think about the unintended consequences of imposing such limits.

Ortbals-Tibbs: And the impact of this proposal could be huge for some funds.

Choi: Absolutely. There are firms that either will have to deregister, so even after getting exemptive orders and getting their registration statements through the SEC, they'll have to deregister and go out of business. Or they'll have to drastically change their investment strategy, which has its own cost involved.

Ortbals-Tibbs: So if the SEC does move forward on this proposal, we do make some suggestions about how they might proceed in a way that would be less harmful.

Choi: We will obviously make further comments—even though we don't agree with their proposal to impose portfolio limits, we're going to provide some constructive recommendations so that should they decide to move forward despite our concerns, that the rule is as workable as possible for the industry.

Additional Resources

Release: ICI Supports Derivatives Risk Management Program for Funds

ICI Comment Letter on Use of Derivatives by Registered Investment Companies (pdf)

ICI Viewpoints: Derivatives—Please Don't Let Them Be Misunderstood

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