

MEMO# 24545

September 15, 2010

ICI Draft Comment Letter on Definitions Related to Regulation of Swaps; Comments Due September 20

[24545]

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TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 17-10
ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 26-10
ETF ADVISORY COMMITTEE No. 38-10
EQUITY MARKETS ADVISORY COMMITTEE No. 34-10
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 36-10
FIXED-INCOME ADVISORY COMMITTEE No. 17-10
SEC RULES COMMITTEE No. 37-10 RE: ICI DRAFT COMMENT LETTER ON DEFINITIONS
RELATED TO REGULATION OF SWAPS; COMMENTS DUE SEPTEMBER 20

As we previously informed you, the Securities and Exchange Commission and the Commodity Futures Trading Commission are jointly seeking comment on the definition of certain key terms in the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) relating to the regulation of swaps and security-based swaps. [\[1\]](#) Specifically, the Commissions are seeking comment on the following terms: swap, security-based swap, swap dealer, security-based swap dealer, major swap participant (“MSP”), [\[2\]](#) major security-based swap participant, eligible contract participant, and security-based swap agreement. [\[3\]](#) The Institute has prepared a draft comment letter, which is attached and briefly summarized below.

Comments on the proposal are due to the SEC on Monday, September 20. If you have comments on the attached draft letter, please provide them to Heather Traeger via e-mail at htraeger@ici.org or by phone at 202/326-5920 by Monday, September 20 at 12:00 p.m. Eastern Time.

I. Overview

The draft letter recommends that the Commissions exclude registered investment companies (“funds”) from the definition of the term “major swap participant” because

funds do not contribute to systemic risk in the degree contemplated by the Dodd-Frank Act and funds are already subject to stringent regulatory requirements similar to those that would be required by the Act. Alternatively, it recommends that the Commissions clarify several terms in the definition of MSP, including “substantial position,” “substantial counterparty exposure,” and “highly leveraged,” to make clear that, generally, funds will not qualify as MSPs. The letter also raises concerns with the terms “swap” and “swap dealer.”

II. Exemption for Funds

The draft letter recommends that the Commissions exclude funds from the definition of MSP. It explains that funds are already subject to stringent regulatory requirements, similar or even more rigorous than those that are required by the Dodd-Frank Act. Thus, additional regulation offers no offsetting benefit to the stability of the financial system. The letter explains that funds are subject to all four federal securities acts. It specifically notes the capital, leverage, recordkeeping, reporting, registration, risk disclosure, and compliance requirements of the Investment Company Act of 1940 (“1940 Act”). It also cites to a colloquy by Congressman Lincoln expressing that it may be appropriate for the Commissions to exempt funds from the classification of MSP because of their existing regulatory framework. The draft letter concludes that current regulation of funds provides the necessary and prudent level of oversight of these swap market participants.

III. Clarification that Funds are not Major Swap Participants

The draft letter recommends that the Commissions provide additional clarification regarding the terms “substantial position,” “substantial counterparty exposure,” and “highly leveraged” as used in the definition of MSP, if the Commissions do not provide an exemption for funds from that definition. The draft letter states that the appropriate definition of MSP should, in most cases, exclude funds. It notes that in each of the prongs of the definition, the Dodd-Frank Act focuses on the quantitative size of the market participant’s role in the swaps market: “substantial position,” “substantial counterparty exposure,” and “highly leveraged.” It explains that funds should not cross these thresholds, particularly if the Commissions clarify, as dictated by the Act, that the analysis for meeting these thresholds takes into consideration a fund’s position in uncleared as opposed to cleared swaps and the value and quality of collateral held against all counterparty exposures. Specifically, the draft letter recommends that:

- a fund’s swap position or exposure should be net of segregated collateral and bankruptcy remote collateral for determining whether it is a MSP;
- a fund would not qualify as a MSP if it is in compliance with the leverage restrictions in the 1940 Act; and
- the analysis regarding these thresholds should be conducted at an individual fund level (including series level), not at the level of the asset manager with varying mandates from multiple clients.

IV. Other Swap-Related Terms

The draft letter recommends that the Commissions clarify the terms “swap” and “swap dealer.” Specifically, the draft letter recommends that the Commissions encourage the

Secretary of the Treasury to exempt foreign exchange swaps and forwards from the definition of a swap. It states that the costs and burdens of such regulation would not necessarily improve transparency or reduce systemic risk as envisioned in the goals of the Dodd-Frank Act. The draft letter also recommends that the Commissions define “swap dealer” narrowly to capture those entities whose regular business activity constitutes buying and selling swaps. Such activity would not inappropriately capture registered investment advisers who enter into swap transactions in the ordinary course of business, but who, unquestionably, are not “dealers” as that term is commonly used in the investment industry.

Heather L. Traeger
Associate Counsel

[Attachment \(in .pdf format\)](#)

endnotes

[1] See SEC Release No. 62717 (August 13, 2010), available at <http://www.sec.gov/rules/concept/2010/34-62717.pdf>.

[2] The draft letter uses the term MSP to refer to both “major swap participants” and “major security-based swap participant.”

[3] These terms are defined in Sections 721 and 761 of the Dodd-Frank Act, and with respect to the term “eligible contract participant,” in Section 1a(18) of the Commodity Exchange Act. The Act tasks the Commissions with further defining the terms.