

MEMO# 24551

September 22, 2010

ICI Comments on Definitions Related to Regulation of Swaps

[24551]

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 47-10
ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 27-10
ETF ADVISORY COMMITTEE No. 39-10
EQUITY MARKETS ADVISORY COMMITTEE No. 35-10
FIXED-INCOME ADVISORY COMMITTEE No. 18-10
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 37-10
SEC RULES MEMBERS No. 89-10 RE: ICI COMMENTS ON DEFINITIONS RELATED TO
REGULATION OF SWAPS

The Institute has prepared a comment letter in response to the Securities and Exchange Commission and the Commodity Futures Trading Commission joint request for comment on the definitions of certain key terms in the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") related to the regulation of swaps. [\[1\]](#) Specifically, the Commissions sought comment on the following terms: swap, security-based swap, swap dealer, security-based swap dealer, major swap participant ("MSP"), major security-based swap participant, eligible contract participant, and security-based swap agreement. The Institute's letter is attached and briefly summarized below.

I. Exemption for Funds

The letter recommends that the Commissions exclude registered investment companies ("funds") from the definition of the term "major swap participant" because they are already subject to stringent regulatory requirements similar to those that would be required by the Dodd-Frank Act. Thus, funds do not contribute to systemic risk as contemplated by the Act. The letter notes that existing regulatory requirements protect both the fund and the fund's counterparty from risks associated with swap transactions. The letter explains that funds are subject to all of the four major federal securities acts, highlighting 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 Senator 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 letter concludes that the current regulation of funds provides the necessary and prudent level of oversight of these swap market participants.

II. Clarification that Funds are not Major Swap Participants

The 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 letter states that the appropriate definition of MSP would exclude funds because much of the risk associated with their swap activity is mitigated by their use of collateral and asset segregation, and regulatory limits on their ability to use leverage. Specifically, the letter recommends that the Commissions provide that a fund’s swap position or exposure should be calculated net of collateralized swap transactions. It also recommends that the Commissions make clear that a fund which complies with the leverage restrictions in the 1940 Act and related guidance would not qualify as a MSP. Finally, the letter recommends that the Commissions explain that the analysis regarding whether a fund is an MSP should be conducted at an individual fund or series level, not at the level of the asset manager with varying mandates from multiple clients or the fund group itself.

III. Other Swap-Related Terms

The letter recommends that the Commissions clarify the terms “swap” and “swap dealer.” Specifically, the letter 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. The letter also recommends that the CFTC clarify that foreign exchange transactions with a short-dated maturity (i.e., F/X spot transactions) do not fall within the definition of “swap.”

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[Attachment](#)

endnotes

[1] See SEC Release No. 62717 (August 13, 2010), 75 FR 51429 (August 20, 2010) (“Release”), available at <http://www.sec.gov/rules/concept/2010/34-62717.pdf>.

should not be considered a substitute for, legal advice.