ICI VIEWPOINTS

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ICI Letter Details Benefits of Having Diversified Funds Investing in the Futures and Swaps Markets

We've just filed a letter to the Commodity Futures Trading Commission (CFTC) on the use of position limits for derivatives. Our letter urges the CFTC to establish an exemption from position limits for funds that comply with the diversification and leverage requirements of the Investment Company Act of 1940.

This issue arises out of a proposed rulemaking under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The Dodd-Frank Act, pursuing broad objectives of preventing market manipulation and sudden price fluctuations in the commodity markets, requires the CFTC to set position limits "as appropriate" across all markets.

Dodd-Frank, however, also provides the CFTC with the authority to exempt market participants from position limits. The legislative record shows that Congress provided this exemptive authority to give regulators flexibility. For example, Sen. Blanche Lincoln (D-AR), then Agriculture Committee Chairman, noted that highly-leveraged swaps trading should be distinguished from trading activity that is unleveraged (or fully-collateralized), clearinghouse guaranteed, and not systemically risky.

Our letter walks through some of the benefits of having diversified funds investing in the futures and swaps markets. It explains that diversified funds serve as a stable, long-term source of liquidity and facilitate efficient price discovery in these markets. It also explains that diversified funds are not speculators but rather are long-term investors, and that diversified funds provide small investors with a cost-effective means of diversifying their portfolio and investing in the commodity derivatives markets.

Additionally, the letter details some of the restrictions placed on funds under the Investment Company Act, noting that these restrictions limit the ability of diversified funds to speculate or contribute to systemic risk. For example, a fund is prohibited from taking on a future obligation to pay unless it "covers" the obligation by setting aside assets sufficient to satisfy the potential exposure from the derivative transaction.

- Read ICI's letter.
- Visit ICI's resource center on financial services regulatory reform.
- Learn more about limits on leverage and other investor protections in "Core Principles Underlying Regulation of Mutual Funds and Other Registered Investment Companies."

- Browse more recent ICI comment letters.
