

ICI VIEWPOINTS

September 5, 2012

Creating Derivatives Rules That Work Globally

Derivatives—which include instruments such as options, futures, and swaps—are important portfolio management tools for funds worldwide, providing options and flexibility to fund managers as they carry out investment strategies and manage risks.

Given that derivative transactions are conducted globally, regulators around the world continue to develop rules around cross-border derivatives transactions. As they do so, it is imperative that they coordinate to create rules that work globally.

ICI and [ICI Global](#) strongly emphasized this point recently in [a joint comment letter](#) to the Commodity Futures Trading Commission (CFTC). The letter concerns proposed [regulatory guidance from the CFTC](#) on how the agency would apply cross-border swaps provisions of the Commodity Exchange Act (CEA) that were enacted by the [Dodd-Frank Wall Street Reform and Consumer Protection Act](#).

As written, the CFTC's guidance could result in the imposition of the swaps provisions to entities with only a nominal connection to the United States. Specifically, the CFTC's proposed definition of "U.S. person" could include non-U.S. funds without a significant connection to the United States, requiring them to comply with swaps provisions in the CEA. For example, suppose a non-U.S. fund's only connection to the United States is that its adviser is registered as a commodity pool operator with the CFTC. Even though the activities with respect to that fund did not trigger that registration obligation, the non-U.S. fund would be subject to certain swap rules.

This broad definition also could discourage non-U.S. counterparties from engaging in derivatives transactions with these non-U.S. funds (that are deemed U.S. persons) to avoid being regulated or taking on significant compliance obligations under the Dodd-Frank Act.

A more workable approach, in our view, would be to consider funds or other entities "U.S. persons" only if they target the U.S. market. If the fund is attempting to target the U.S. market or investors, then, appropriately, it should be subject to U.S. laws.

Our letter closes with a call for regulators to harmonize their efforts on derivatives regulation. Failing to take a coordinated approach could lead to duplicative or even conflicting regulatory requirements. In turn, market participants may become reluctant to engage in cross-border derivatives transactions, thereby impeding the ability of funds to hedge their exposures effectively and efficiently. This would be harmful to the financial markets, funds, and fund investors.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.