

NEWS RELEASE

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ICI Applauds SEC's New Derivatives Rule and Recommends Additional Clarifications to Improve Its Effectiveness

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Washington, DC; April 20, 2020—The Investment Company Institute (ICI) strongly supports the new rule proposal from the Securities and Exchange Commission (SEC) governing funds' use of derivatives, according to a [comment letter](#) filed today. The new Rule 18f-4 permits funds to use derivatives in more than a minimal amount, if they implement a derivatives risk management program and if their derivatives use does not exceed specific risk-based leverage limits.

"The SEC's new proposal gives greater clarity to funds' use of derivatives, permitting funds to continue using these vital tools to deliver strong performance and manage risks for investors, while providing robust shareholder protections," said ICI President and CEO Paul Schott Stevens. "We applaud the SEC for this vast improvement over its original 2015 proposal, which would have limited a fund's use of derivatives inappropriately under a blunt gross notional exposure standard."

Funds turn to derivatives to improve efficiency, enhance liquidity, and reduce costs for shareholders. Derivatives enable funds to manage credit, currency, interest rate, and other risks. These instruments can enhance liquidity efficiently, for example, by enabling corporate bond funds to sell interest rate or credit derivatives with a few transactions instead of selling corporate bonds individually. With derivatives, funds also can access assets that are difficult to obtain—such as emerging market stocks or bonds—at lower cost and without materially greater risk.

ICI Advises Recommendations to Improve the Rule

ICI wholly supports the general framework of the SEC's new rule for funds' derivatives use and urges several recommendations to improve the effectiveness and clarity of the rulemaking and to mitigate the risk of market disruption. They include:

- **Exclude Certain Instruments from the Derivatives Definition:** ICI recommends excluding certain instruments—those with relatively short settlement periods and fixed, known obligations and those whose yields are determined on the date of delivery based on prevailing market rates—from the definition of "derivatives"

transactions.” Otherwise, funds that invest primarily in those instruments—which neither create leverage nor pose the same risks as derivatives—may have to unnecessarily implement derivatives risk management programs and leverage limits designed to mitigate those risks.

- **Reflect Fund Investment Strategies in the Relative Value-at-Risk (VaR) Test:** ICI recommends modifying the proposed relative VaR leverage limit, which requires that a fund compare its VaR to the VaR of a “designated reference index” that reflects the markets or asset classes in which the fund invests. ICI recommends a standard that requires the index to reflect the fund’s investment strategies. This approach is better aligned with an investor’s expectation that a fund will have volatility and risk similar to its designated reference index.
- **Raise Leverage Limits That Take Market Data into Account:** In addition, ICI strongly urges increasing the proposed leverage limits to a 200 percent relative VaR limit and a 20 percent absolute VaR limit, as VaR-based limits do not isolate leverage attributable only to derivatives. The Commission estimated, based on year-end 2018 data, that only 0.04 percent of the funds that would be subject to the proposed rule would fail the proposed VaR tests. In contrast, based on ICI’s 2019 survey data, 6.7 percent of respondents over the course of 2019 and 9.3 percent of respondents during a stressed period would exceed the proposed VaR limits. More recently, during the midst of the COVID-19 crisis, 15.7 percent of respondents in a smaller sample would have exceeded the proposed VaR limits.

For further information on these and ICI recommendations on proposed Rule 18f-4 and the proposal’s public reporting requirements, sales practices requirements, and compliance dates, please see [ICI’s letter](#) to the SEC.