COMMENT LETTER

September 22, 2010

ICI Comments on Definitions Related to Regulation of Swaps (pdf)

September 20, 2010 Ms. Elizabeth M. Murphy Secretary Securities and Exchange Commission 100 F Street, N.E. Washington, D.C. 20549 Mr. David A. Stawick Secretary Commodity Futures Trading Commission Three Lafayette Centre 1155 21st Street, N.W. Washington, D.C. 20581 Re: Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act (File No. S7-16-10) Dear Ms. Murphy and Mr. Stawick: The Investment Company Institute1 welcomes the opportunity to comment on the definitions of key terms in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act" or "Act") related to the regulation of swaps.2 Our members – registered investment companies – use multiple types of derivatives as a means to pursue their stated investment objectives, policies, and strategies, often by hedging their investments from a decline in value, for efficient portfolio

1 The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $11.66 trillion and serve almost 90 million shareholders. 2 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. Throughout this letter, we will use the term "swaps" to refer to both swaps and security-based swaps. Likewise, we will use the term "major swap participant" or "MSP" to refer to both major swap participants and major security-based swap participants. management purposes, and for securing at low cost assets they wish to acquire.3 Consequently, we have a strong interest in ensuring that the derivatives markets are highly competitive and transparent. The regulatory structure that governs these markets should encourage liquidity, fairness, and transparency. Consistent with these goals, we have supported reform efforts, including Title VII of the Dodd- Frank Act, that would improve the fair and orderly operation of the derivatives markets. The value of these reforms, however, will depend greatly on the interpretations of many of the defined terms contained in that legislation; depending on how it is implemented, the legislation may provide important protections for the markets, or may impose costs well in excess of the benefit sought to be achieved. From the fund industry's perspective, the potential sweep of the term "major swap participant" provides a primary example of the need to evaluate how the new legislation may overlap with existing regulation. Funds are already subject to stringent regulatory requirements similar to those that would be required by the Dodd-Frank Act, and therefore do not contribute to systemic risk as contemplated by

the Act. Existing requirements protect both the fund and the fund's counterparty from risks associated with swap transactions. Notably, funds already must "cover" their derivatives positions with liquid or highly liquid assets, rendering moot concerns of systemic margin calls that cannot be met by funds. As a result, we strongly recommend that the Securities and Exchange Commission and the Commodity Futures Trading Commission exclude registered investment companies from the definition of the term "major swap participant." Alternatively, we recommend that the Commissions clarify several terms in the definition of MSP including "substantial position," "substantial counterparty exposure," and "highly leveraged." Additional recommendations with certain key terms in the Dodd- Frank Act are discussed below. I. Executive Summary The Institute strongly recommends that the Commissions exclude registered investment companies from the definition of MSP under the Dodd-Frank Act. The Institute believes that current regulation of funds provides the requisite and prudent level of oversight of these swap market participants. If the Commissions do not provide a categorical exemption for funds from the definition of MSP, the Institute recommends that they provide additional clarification regarding the terms "substantial position," "substantial counterparty exposure," and "highly leveraged" as used in that definition – to make clear that, generally, funds will not qualify as MSPs. The Institute believes that

3 See Report of the Task Force on Investment Company Use of Derivatives and Leverage, Committee on Federal Regulation of Securities, ABA Section of Business Law, July 6, 2010. The terms discussed in the Release impact all registered investment companies, including mutual funds, closed-end funds, and ETFs. For purposes of this letter, we will refer to registered investment companies as "funds."

much of the risk associated with funds' swap activity is mitigated by their use of collateral and asset segregation, and regulatory limits on their ability to use leverage. The Institute also recommends that the CFTC clarify that foreign exchange transactions with a short-dated maturity ("F/X spot") do not fall within the definition of "swap." Finally, the Institute recommends that the Commissions define "swap dealer" narrowly to capture those entities whose regular business activity constitutes buying and selling swaps. II. Purpose of Dodd-Frank Act Numerous regulators and legislators have concluded that the recent financial crisis was exacerbated by certain financial parties' trading of derivatives, and in particular over-the-counter derivatives (i.e., swaps).4 These policymakers have focused on the opacity in the swaps markets surrounding, for example, the interconnections between market participants, and on the ability of swaps to facilitate significant leverage rather than serving as a risk management or asset management tool.5 Title VII of the Dodd-Frank Act was designed, therefore, to reduce risk and ensure financial stability in the derivatives markets, and the financial system generally, by expanding transparency for trading and oversight of swaps and mitigating the impact of a performance failure by a party with a substantial swaps position obligation. In furtherance of this purpose, the Act authorizes the Commissions to regulate swap dealers and MSPs by subjecting them to capital and margin requirements, requiring them to conform to business conduct standards, and requiring them to meet recordkeeping and reporting requirements.6 Importantly, in formulating regulation and further defining the term MSP, among others, the Commissions were advised to focus on risk factors that contributed to the recent financial crisis such as excessive leverage and under-collateralization of swap positions.7 The Commissions also were advised that it would be appropriate to consider the nature and current regulation of swap market participants.8

4 CFTC Chairman Gary Gensler has commented on several occasions that "over-the-counter derivatives in particular were at the center of the 2008 financial crisis." See, e.g., Remarks of Gary Gensler, Chairman, Commodity Futures Trading Commission, IOSCO Annual Conference, Montreal, Canada, June 10, 2010. 5 See, e.g., Remarks of Mary L. Schapiro, Chairman, Securities and

Exchange Commission, 37th Annual Securities Regulation Institute, Coronado, California, January 20, 2010. 6 Section 731 of the Dodd-Frank Act outlines the registration and regulation requirements for swap dealers and MSPs. 7 See Congressional Record, S5907, July 15, 2010 ("Lincoln Colloquy"). In a colloquy related to the passage of the Dodd- Frank Act, Senator Lincoln voiced her opinion on the definition of MSP. 8 Senator Lincoln stated that, "it may be appropriate for the [Commissions] to consider the nature and current regulation of the entity when designating [it a MSP.]" Id. Ms. Elizabeth M. Murphy Mr. David A. Stawick September 20, 2010 Page 4 of 14 III. Exemption for Registered Investment Companies from the Definition of Major Swap Participant We strongly recommend that the Commissions exclude registered investment companies (and their registered investment advisers with respect to a managed fund's investments) from the definition of MSP. Funds are already subject to stringent regulatory requirements similar to those that are required by the Dodd-Frank Act.9 In fact, the requirements applicable to funds with respect to asset coverage for derivative obligations are more rigorous than would be required by the Act. Moreover, as discussed in detail below, funds remain the most regulated financial institutions under the federal securities laws. Current regulation of funds provides the necessary and prudent level of oversight of these swap market participants; applying the MSP provisions of the Dodd-Frank Act to funds does not address the intent or spirit of the legislation. A. Comprehensive Regulatory Framework Funds are the only financial institutions that are subject to all of the four major federal securities laws. The Securities Act of 1933 ("the 1933 Act") and the Securities Exchange Act of 1934 ("the 1934 Act") regulate the public offering of shares and ongoing reporting requirements, respectively. The Investment Company Act of 1940 ("the 1940 Act") regulates a fund's structure and operations, and addresses fund capital structures, custody of assets, investment activities (particularly with respect to transactions with affiliates and other transactions involving potential conflicts of interests), and the composition and duties of mutual fund boards. All investment advisers to funds are required to be registered under, and are regulated by, the Investment Advisers Act of 1940 ("Advisers Act"), which, among other things, imposes recordkeeping requirements on advisers and regulates their custodial arrangements. As an additional layer of regulation, the federal securities laws provide the SEC and Financial Industry Regulatory Authority inspection authority over funds and their investment advisers, principal underwriters, distributing broker-dealers, and transfer agents.

9 Senator Lincoln specifically noted that "entities such as registered investment companies and employee benefit plans are already subject to extensive regulation relating to their usage of swaps under other titles of the U.S. Code. They typically post collateral, are not overly leveraged, and may not pose the same types of risks as unregulated major swap participants." See Lincoln Colloquy supra note 7. Ms. Elizabeth M. Murphy Mr. David A. Stawick September 20, 2010 Page 5 of 14 B. 1940 Act Regulation of Funds The 1940 Act imposes stringent regulation on funds, which is not imposed on other financial institutions or products under the federal securities laws. These regulations address many of the same concerns targeted in the Dodd-Frank Act to preserve the integrity of the U.S. financial system, including the transparency and stability of funds as market participants and investment vehicles. 1. Capital and Margin The Dodd-Frank Act imposes capital and margin requirements on MSPs for certain uncleared swaps to address leverage, collateralization, and exposure concerns. Likewise, the 1940 Act contains multiple provisions designed to address funds' stability with respect to investment activities. First, funds face limitations on their capital structure. Under Section 14(a) of the 1940 Act, they are subject to minimum capital requirements.10 Under Section 18 of the 1940 Act, they are subject to limitations on their structural complexity that ensure that shareholder interests' are not subordinated to senior security holders and share pro rata in the returns on a fund's investments.11 Second, funds are subject to significant limitations on their ability to use

leverage. These limitations ensure that a fund can neither cause nor contribute to systemic risk through its use of derivatives. Specifically, under Section 18 of the 1940 Act and later SEC and staff guidance, a fund is prohibited from taking on a future obligation to pay unless it "covers" the obligation by setting aside, or earmarking, assets sufficient to satisfy the potential exposure from the derivative transaction.12 The assets used for "covering" such obligations must be liquid, marked to market daily, and held in custody (as discussed below).13 The SEC has explained that these coverage requirements: (1) function as a practical limit on both the amount of leverage undertaken by a fund and the potential increase in the 10 Under Section 14(a), no registered fund and no principal underwriter of a fund may publicly offer a fund's shares unless the fund meets the applicable minimum capital requirements. Further, this capital must be provided with a bona fide investment purpose, without any present intention to dispose of the investment, and must not be loaned or advanced to the fund by its promoters. 11 See Rule 18f-3 under the 1940 Act. 12 Under certain circumstances, a fund may also enter into transactions that offset the fund's obligations. See Dreyfus Strategic Investing and Dreyfus Strategic Income, SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) 48,525 (June 22, 1987). 13 See Merrill Lynch Asset Management, L.P., SEC No-Action Letter, 1996 WL 429027 (July 2, 1996) and Investment Company Act Release No. 10666 (April 18, 1979), 44 FR 25128 (April 27, 1979) ("Release 10666"). speculative character of the fund's outstanding shares; and (2) assure the availability of adequate funds to meet the obligations arising from such activities.14 Third, funds are subject to custody requirements for the safeguarding of their investment securities. Under Section 17(f) of the 1940 Act, funds must "place and maintain" their assets in the custody of a bank, or subject to certain SEC rules, a member of a national securities exchange or the fund itself.15 In particular, Rule 17f-6 under the 1940 Act explains how assets should be maintained in connection with commodity futures or commodity option contracts. Fourth, funds are subject to limits on exposure to certain counterparties. Specifically, under Section 12(d)(3), funds' exposure to securities and other instruments of securities-related businesses are subject to certain percentage limitations. These limitations are designed to prevent funds from exposing their assets to the entrepreneurial risks of securities-related businesses, further a fund's ability to maintain the liquidity of its portfolio, and eliminate the possibility of certain reciprocal practices between funds and securities-related businesses.16 2. Registration, Reporting and Recordkeeping Similar to Section 8 of the 1940 Act, which requires funds to register with the SEC, the Dodd- Frank Act imposes registration requirements on MSPs. The Dodd-Frank Act also imposes reporting and recordkeeping requirements on MSPs. We do not believe that additional regulation of funds would further the aim of the Act. The books and records requirements in the Dodd-Frank Act provide for inspection and examination by the Commissions as well as daily trading records of swaps. Funds are already subject to similar requirements under Sections 30 and 31 of the 1940 Act. Section 30 provides for periodic and interim reporting to ensure reasonably current information is available regarding funds. Section 31 sets forth the general recordkeeping requirements for funds, providing that such records are subject to examination by the SEC. It also specifically requires records of a fund's daily purchases and sales of securities, among other records, be maintained, in some cases, permanently. In addition, registered investment advisers to funds are subject to their own recordkeeping and reporting requirements under Section 203 of the Advisers Act, and are also subject to inspection and examination. 14 See Release 10666 supra note 13. 15 As a practical matter, this option is rarely used; most fund assets are maintained with a bank custodian. 16 See Regulation of Investment Companies, Lemke, Lins and Smith, Lexis, Volume 1, September 2009. 3. Business Conduct

Standards and Risk Disclosure The Dodd-Frank Act establishes business conduct standards so that MSPs avoid fraud and manipulation and exercise diligent supervision of their businesses. In certain circumstances, MSPs must disclose to counterparties in swap transactions information about the risks and characteristics of the particular swap and any material incentives or conflicts of interest the MSP may have in connection with the swap. The manner in which MSPs must communicate information about swaps must be fair and balanced following the principles of fair dealing and good faith. In addition, each MSP must designate a chief compliance officer. There are numerous parallels between these requirements and the requirements imposed on funds by the 1940 Act. For example, Form N-1A (the registration form used by funds to register under the 1940 Act), requires funds to disclose their investment strategies and risks, including temporary defensive investment positions the fund might take, as well as portfolio turnover, and portfolio holding information. Also, a fund's derivative transactions must be consistent with its investment objectives and policies set forth in the fund's registration statement.17 For example, Rule 35d-1 under the 1940 Act requires a fund that has a descriptive name that reflects its investment to invest at least 80 percent of the fund's assets according to its name, including derivatives. A fund's investment adviser must file and update periodically its Form ADV with the SEC to disclose material information regarding its investment practices, polices, and potential conflicts, among other things. Under Rule 38a-1 under the 1940 Act, each fund must adopt policies and procedures reasonably designed to prevent violations of the federal securities laws (e.g., fraud and manipulation) and to provide for oversight of the fund. A fund also is required to have a chief compliance officer who is approved by the fund's board of directors and who must annually provide the board a written report on the adequacy of the compliance policies and procedures of the fund and its investment adviser, principal underwriter, administrator, and transfer agent, as well as on the effectiveness of the implementation of these policies and procedures and any material compliance matters. Pursuant to Section 17(j) of the 1940 Act, funds and their registered investment advisers are required to have written codes of ethics to prohibit fraudulent or manipulative conduct. Finally, Section 36 of the 1940 Act sets forth the regulatory framework for addressing a breach of fiduciary duty with respect to a fund. Funds' investment advisers are also subject to the foregoing requirements.18

17 The SEC recently provided additional guidance to funds to ensure that their derivatives-related disclosure is sufficient and provides investors with the information necessary to evaluate a fund's derivatives activities. See Letter to Karrie McMillan, General Counsel, Investment Company Institute, from Barry D. Miller, Associate Director, Division of Investment Management, Securities and Exchange Commission, July 30, 2010. 18 Under Section 206 of the Advisers Act, it is unlawful for investment advisers to engage in fraudulent, deceptive, or manipulative conduct. Specifically, as fiduciaries, investment advisers have an affirmative duty of care, loyalty, honesty, and good faith to act in the best interest of their clients.

C. Exemption From Definition of Major Swap Participant Warranted We believe the far-reaching regulatory framework imposed on funds ensures that their swap activities do not threaten the U.S. financial system. Funds are already subject to a comprehensive array of rules and regulations – and subject to substantially higher levels of transparency in their operations – under the federal securities laws that set them apart from other types of financial entities. Moreover, as discussed above, these restrictions specifically address funds' margin, capital, leverage, risk disclosure, recordkeeping, registration, and business conduct. Application of the requirements in the Dodd-Frank Act designed to create regulatory oversight of leverage, volatility, and collateral related to swap trading to funds would unnecessarily subject them to duplicative or potentially inconsistent regulatory requirements at significant additional costs to fund investors with no corresponding systemic benefits.19 Regulating funds as MSPs is unnecessary to achieve the stated goals of the Dodd-Frank Act. The current regulatory regime for funds provides a myriad of protections with respect to the operation of funds in the U.S. financial system. IV. Clarifications of Definition of Major Swap Participant If the Commissions do not provide an exemption for funds from the definition of MSP, it is critical that they provide additional clarification regarding the terms “substantial position,” “substantial counterparty exposure,” and “highly leveraged” as used in that definition. With each of these terms, the Dodd-Frank Act focuses on the quantitative size of the market participant’s role in the swaps market to identify MSPs (i.e., entities that may contribute to systemic risk in the U.S. financial system). We believe the appropriate analysis of these terms and interpretation of the 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.20 Specifically, to supply clarity when evaluating whether a fund is a MSP, we recommend that the Commissions provide that a fund’s swap position or exposure should be calculated net of collateralized swap transactions, as the collateral serves the same protective purpose as the legislation. The Commissions also should make clear that a fund which complies with the leverage restrictions in the 1940 Act and related guidance, which generally prevents a fund from engaging in leveraged transactions 19 The recent ABA task force report on funds’ use of derivatives commented on the value of the existing regulatory framework, identifying some areas in which the framework could be further strengthened. The report concluded that the framework has worked well and will continue to provide an appropriate structure for funds’ investment in derivatives, particularly with some additional clarifications and guidance as recommended by the task force. See supra note 3. 20 In discussing the definition of “substantial position,” Senator Lincoln stated that, “Entities that are not excessively leveraged and have taken the necessary steps to segregate and fully collateralize swap positions on a bilateral basis with their counter-parties should be viewed differently.” See Lincoln Colloquy supra note 7. Ms. Elizabeth M. Murphy Mr. David A. Stawick September 20, 2010 Page 9 of 14 in excess of one-third of its net assets, would not qualify as a MSP. Finally, we recommend that the Commissions explain that the analysis regarding these thresholds 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. A. “Substantial Position” and “Substantial Counterparty Exposure” As discussed above, the swap provisions of the Dodd-Frank Act were designed to address systemic risk in the U.S. financial system.21 Accordingly, the legislation was constructed to provide transparency to the operations of those market participants that could affect the stability of the financial markets because they hold a “substantial position” in swaps or have “substantial counterparty exposure” to swaps. We believe that the Commissions should clarify that only a fund’s net uncollateralized swap exposure should be taken into consideration when evaluating whether or not a fund holds a “substantial position” in swaps or has “substantial counterparty exposure” in their swap transactions.22 The analysis for evaluating these thresholds should be applied on an individual fund level in recognition of the fact that, with a few exceptions, the market and the SEC apply the provisions of the federal securities acts to funds at the individual entity level, treating individual funds and series funds as if the separate portfolios were separate investment companies because they each represent a separate group of shareholders with independent investment objectives.23 1. Use of Collateral and “Asset Coverage” Numerous factors can be used to evaluate the value of collateral and thus the degree to which it reduces the risk of counterparty exposure. Segregating assets and keeping assets with a third-party, for example, are both means to further reduce the risk associated with a swap transaction. Funds regularly 21 “Because over the counter derivatives trading lacked meaningful transparency, investors lacked the information needed to price derivatives accurately – bringing natural market corrections, and regulators could not appreciate the risks multiplying throughout the system." See Remarks by Mary L. Schapiro, Chairman, Securities and Exchange Commission, Compliance and Legal Society, Securities Industry and Financial Markets Association 2010 Annual Seminar, May 6, 2010. 22 Funds should not cross these thresholds, particularly if the Commissions clarify, as dictated by Section 721(a)(16) the Act, that the analysis for meeting the thresholds takes into consideration an entity's position in uncleared as opposed to cleared swaps and the value and quality of collateral held against all counterparty exposures. See Section 1a(33)(B) of the Commodity Exchange Act, as amended by the Dodd-Frank Act. 23 See Legal Considerations in Forming a Mutual Fund, Philip H. Newman, ALI-ABA Course Materials, June 2010. Some state laws specifically provide a statutory "safe harbor" for treating series funds as individual entities. See, e.g., Section 2- 208.2 of MD General Corporation Law (stating that the assets from one series cannot be used to satisfy the liabilities of another series fund if separate records are maintained for each series and the assets for each series are separately accounted for). decrease their exposure to counterparty and other risks in swap transactions by covering assets as a part of their regulatory obligations and market practices and directly holding (through the fund's custodian) collateral pledged to the fund by the counterparty. Collateralization is a standard mechanism to limit exposure to counterparty risk by providing the collateral receiver with recourse to a pledged asset in the event of default on a swap transaction. In addition, many funds post collateral through tri-party arrangements. In these agreements, the independent tri-party agent assumes certain responsibilities with respect to safeguarding the interests of both counterparties, including maintaining custody of the collateral, and is involved in effecting the transfer of funds and securities between the two parties.24 Consequently, these agreements provide even greater certainty to the quality and safe-keeping of collateral than bilateral collateralization, further avoiding market disruptions in the case of a default or other event necessitating access to the collateral. We believe the Commissions should acknowledge this activity and the strong effect it has on reducing the potential for adverse effects on the stability of the market. Funds should be permitted to exclude collateralized swap positions from the calculation of a fund's net swap positions and exposures for determining "substantial position" and "substantial counterparty exposure" as such terms relate to whether a fund is a MSP.25 Moreover, by permitting funds to exclude such exposure from their net positions, the Commissions will openly encourage collateralization, further minimizing risk in the system. 2. Individual Funds and Series The Commissions should specify that netting of swap positions and exposures should be conducted at the individual fund, or series, level when determining whether an entity is a MSP. Aggregating positions by fund families or asset managers would not accurately account for the potential systemic risk posed by funds entering into swap transactions, would overstate the risks to regulators, and would impose disproportionate regulatory burdens and costs on funds whose investment activity does not significantly threaten market stability.

24 Collateral agreements are negotiated on a bilateral basis between the parties to a derivatives transaction. A tri-party arrangement is between the pledgor, secured party, and custodian. See, e.g., Market Review of OTC Derivative Bilateral Collateralization Practices, ISDA, March 1, 2010. 25 We believe that collateralized swap positions would include swap positions that are contractually subject to collateral arrangements that are conservative in nature and utilize low exposure thresholds for triggering rights to receive collateral – i.e., swaps subject to a netting agreement where collateral requirements are not determined on an individual position basis and net exposures need to be above certain levels to trigger collateral calls.

 In creating funds, a sponsor may establish each fund as a new, separately organized entity under state law or as a new "series company," that has the ability to create multiple sub-portfolios (i.e., individual mutual funds), or series.26 As with a stand-alone fund, many funds file a separate Form N-1A for each series fund (under the same registrant number as the series company).27 In addition, each fund and each series must be identified under the 1933 Act although the shares of all series may be registered under a single registration statement.28 Regulation S-X regarding financial statements requires that financial data for funds or series companies be provided on a fund or series-by-series basis, respectively.29 Subchapter M specifically states that each series is treated as a separate corporation and a shareholder's exchange of shares of one series for shares of a different series is treated as a taxable exchange of property.30 Similarly, under an ISDA master agreement, each individual fund and each series within a fund trust stands alone.31 Finally, funds also must segregate collateral for derivative instruments on an individual fund or series basis.32 These requirements safeguard the assets in an individual portfolio from market or other risks that may negatively affect another portfolio, and consequently the shareholders invested therein and the fund complex more broadly. For example, liquidation of one fund series is isolated to that series. Shareholders must look solely to the assets of their own portfolio for redemption, earnings, liquidation, capital appreciation, and investment results.33 The protection provided by segregation of assets and collateral as well as the separate treatment of funds and fund series, distinct from each other and their

26 Series funds are effectively independent in economic, accounting, and tax terms but share the same governing documents and governing body. See supra note 23. 27 Each series is separately identifiable in the SEC's EDGAR system by its specific Central Index Key ("CIK") number. The CIK number is used to identify corporations and individual people who have filed disclosure with the SEC. See, also, Form N-1A, General Instructions, Definitions: "Fund" means the registrant or a separate series of the registrant. 28 Form N-1A under the 1933 Act. 29 Rule 6.03(j) of Regulation S-X. 30 26 U.S.C. Section 851(g). 31 In other words, an individual portfolio is liable for its obligations under the ISDA agreement and the swap dealer may not pursue remuneration from another portfolio in the fund trust. See, e.g., ISDA 2002 Master Agreement. 32 See Section 17(f) of the 1940 Act. 33 See Regulation of Series Investment Companies under the Investment Company Act of 1940, Joseph R. Fleming, Business Lawyer, August 1989. asset managers, severely limits the ability of a fund or related funds to significantly impact the U.S. financial system. B. "Highly Leveraged" Unlike other market participants, funds are significantly limited in their ability to use leverage. As discussed above, Section18 of the 1940 Act and later SEC and staff guidance restrict a fund's use of derivatives, including swaps, by requiring funds to segregate, or earmark, assets in an amount sufficient to cover their potential obligations under derivative positions. One effect of this provision is to help ensure the availability of assets to meet payment obligations that could arise from such transactions. It also limits the ability of funds to incur leverage on an uncollateralized basis for entering into potentially speculative transactions. This regulatory restriction ensures that a fund cannot be "highly leveraged relative to the amount of capital it holds."34 Thus, funds which comply with the leverage provisions in the 1940 Act and related guidance should not qualify as a MSP, and we recommend that the Commissions incorporate this position into their definitions of MSP. V. Other Swap-Related Terms Under the Dodd-Frank Act In addition to MSP, there are a number of terms that the Dodd-Frank Act tasks the Commissions with further defining, including "swap dealer" and "swap." We offer several recommendations below to provide necessary clarity to these terms. A. Swap Dealer Under the Dodd-Frank Act, a "swap dealer" would include any entity that: (1) holds

itself out as a dealer in swaps; (2) makes a market in swaps; (3) regularly enters into swaps with counterparties as an ordinary course of business for its own account; or (4) engages in any activity causing the entity to be commonly known in the trade as a dealer or market maker in swaps. We are concerned that a broad interpretation of "swap dealer" could inappropriately capture funds or 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.35

34 See Section 1a(33)(A)(iii) of the Commodity Exchange Act, as amended by the Dodd-Frank Act. 35 In discussing "derivatives dealers," CFTC Chairman Gary Gensler spoke about the entities that make markets in derivatives and rely on their own risk management practices and profit motives to determine how much capital to keep and what other business decisions to make. See Testimony of Gary Gensler, Chairman, Commodity Futures Trading Commission, Before the Financial Crisis Inquiry Commission, July 1, 2010. This description reflects what is commonly understood in the financial industry as a dealer, in this case a derivatives dealer, who enters into derivatives transactions as its ordinary course of business. Under the 1934 Act, the term dealer is generally defined as "any person engaged in the business of buying and selling securities for such person's own account through a broker or otherwise." Additionally, the 1934 Act clarifies that, "[t]he term 'dealer' does not include a person that "buys or sells securities for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business." This definition is meant to capture entities whose business is to deal securities and not those entities whose buying and selling of securities is incidental to their primary business. A true dealer acts as a middleman by buying and selling securities with its own funds and fills sale or purchase requests from its own holdings in order to profit off of the bid-ask spread and, therefore, is typically party to both sides of a trade. Accordingly, we believe that the Commissions should take the same approach in defining the term "swap dealer." Such definition should be tailored to capture those entities whose regular business activity constitutes buying and selling swaps and be based upon the well-established definition of "dealer" in existing federal securities laws. We do not believe that this definition should be broadly defined so as to unintentionally include funds or registered investment advisers who enter into swap transactions as one of many tools in their primary business of managing assets. B. Swap The Dodd-Frank Act provides that foreign exchange swaps and forwards shall be considered "swaps" unless the Secretary of the Department of the Treasury determines otherwise based on certain listed criteria and findings. While the Treasury's determination of whether foreign exchange swaps and forwards is beyond the scope of this comment letter, we do recommend that the CFTC clarify that foreign exchange transactions with a short-dated maturity, or FX spot transactions, do not constitute foreign exchange forwards. F/X spot transactions, which have a relatively short settlement cycle (T+6 or less), are typically entered into to hedge currency risk presented in the settlement of non-U.S. dollar- denominated security purchases and sales, dividend payments, and other similar transactions. The short-dated nature of such FX spot transactions presents little speculative opportunity and is likely to raise significantly less risk than that of more longer-dated swaps. Moreover, from a practical perspective, the collateralization of such FX spot transactions is not market practice and would present significant challenges in terms of the frequency of valuations, collateral transfers, and collateral returns, with such challenges not commensurate with the risk arising from such product. * * * * * If you have any questions on our comment letter, please feel free to contact me directly at (202) 326-5815, Heather Traeger at (202) 326-5920, or Ari Burstein at (202) 371-5408. Sincerely, /s/ Karrie McMillan Karrie McMillan General Counsel cc: The

Honorable Mary L. Schapiro The Honorable Kathleen L. Casey The Honorable Elisse B. Walter The Honorable Luis A. Aguilar The Honorable Troy A. Paredes Robert W. Cook, Director James Brigagliano, Deputy Director Division of Trading and Markets Andrew J. Donohue, Director Division of Investment Management Meredith Cross, Director Division of Corporation Finance U.S. Securities and Exchange Commission

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