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MANAGED FUNDS ASSOCIATION Policy Brief

March 2016

MFA, AIMA Submit Comment Letter to SEC on Derivatives Rule



On March 28, MFA and AIMA submitted a joint comment letter to the U.S. Securities and Exchange Commission on the Commission’s proposed rule on the use of derivatives by mutual funds and other registered investment companies. While generally supporting several aspects of the SEC’s proposal, including asset segregation requirements and an activities-based approach to regulation, the Associations expressed concerns with the adverse effects of the rule’s imposition of a new notional-based leverage limit on registered funds.

The letter also questions the SEC’s attempt to redefine and regulate derivatives as “senior securities” under Section 18 of the Investment Company Act of 1940.

In a statement following the letter’s submission, MFA President and CEO Richard H. Baker explained, “Both institutional and retail investors have shown increasing demand for registered funds that offer alternative strategies using derivatives. Many of these strategies provided substantial benefits to investors during the global financial crisis and continue to do so today. While we support many aspects of the SEC’s proposal, the Commission’s policy objective to protect investors would be well-served by establishing a better balance between authorizing funds to use derivatives for hedging, risk-mitigation and investment purposes, and imposing reasonable, practical restrictions that address the risks derivatives may present to funds and their investors.”

The letter suggests alternative options for the Commission’s consideration and provides qualitative and quantitative support for the Associations’ main concern – that a new notional-based limit is “unnecessary and inappropriate, because it lacks sufficient justification given the practical effect of the Commission’s proposed asset segregation requirements and the potential reinforcing effect of the Commission’s other related regulations after their adoption.” The letter also notes that basing a fund’s portfolio leverage limit on the aggregate notional amount of a fund’s derivatives is too blunt of a measure because it has inherent problems as an accurate measure of risk and leverage.

To address these and other concerns with the proposed rule, MFA and AIMA made several recommendations, including that:

- A broader scope of liquid assets with appropriate regulatory haircuts be allowed as qualifying coverage assets for asset segregation purposes – rather than restricted only to cash and cash equivalents – so the proposed rule would not strain a fund’s ability to hold sufficient cash and cash equivalents in reserve to satisfy the payment obligations under its derivatives transactions;
- A fund’s board should be authorized to base the proposed risk-based coverage amount on no less than the required initial margin for each of the derivatives transactions in the fund’s portfolio;
- A fund should have the flexibility to determine which types of derivatives transactions may properly offset other derivatives transactions in calculating derivatives exposure. For example, a fund should be permitted to offset a futures contract against an option, if the offset reduces exposure and risk; and
- If the Commission decides to impose a notional-based limit in its final rule, the letter explains the merits of allowing funds to use risk adjustments to notional exposure based on a derivatives transaction’s underlying asset class to determine more accurate measures of a fund’s actual derivatives exposure.



[MFA, AIMA Press Release on Comment Letter to SEC on Derivatives Rule](#)
[MFA, AIMA Comment Letter on SEC Derivatives Rule](#)

MFA Submits Comment Letter to CFTC on Regulation AT

MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK



March 16, 2016

Via Website Submission

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: RIN 3038-AD52; Proposed Regulation Automated Trading

Dear Mr. Kirkpatrick:

Managed Funds Association ("MFA") appreciates the opportunity to submit comments to the Commodity Futures Trading Commission (the "CFTC" or the "Commission") on its notice of proposed rulemaking on Regulation AT ("Regulation AT").² MFA supports the Commission's goal of modernizing regulatory oversight of automated trading with risk controls, transparency measures, and other safeguards with respect to U.S. designated contract markets ("DCMs"). The Commission has been thoughtful in proposing Regulation AT and the Proposing Release provides many regulatory considerations and examples of market practice for public comment.

On March 16, MFA submitted comments to the CFTC on its proposed Regulation AT regarding automated trading. While supporting the CFTC's goal of modernizing regulatory oversight of automated trading with risk controls, transparency measures, and other safeguards, MFA raised many concerns with Regulation AT, as proposed. Despite the numerous new and prescriptive risk requirements, MFA is concerned that the Regulation AT framework would not provide for safer, more efficient or effective futures marketplaces. In fact, we are concerned that it would create new risks, impose greater regulatory burdens, and substantially raise costs, putting the U.S. futures markets out-of-reach for many U.S. and foreign end-users looking to hedge or manage risk. In our letter, we provided a number of recommendations and comments, including:

- **Adopt Centralized Marketplace Risk Controls** – MFA recommended that in lieu of adopting Regulation AT as proposed, the Commission adopt regulation requiring centralized pre-trade risk controls at designated contract markets (DCMs) and clearing member futures commission merchants. MFA believes that such controls at the DCM and clearing FCM-levels would be highly effective in preventing marketplace disruptions. This approach would share responsibilities along functional lines. In addition, MFA believes that the Commission should address other derivatives marketplace concerns identified in Regulation AT through separate rulemakings and in different stages.
- **Adopt a More Flexible Framework rather than a One-Size-Fits-All Approach** – MFA is concerned that Regulation AT has a one-size-fits-all framework, which singularly regulates all market participants who use any automation in trading without taking into consideration the type of automation or the different category, business, or operational size of the market participant.
 - MFA recommended that the Commission narrow the focus and scope of Regulation AT to exclude commodity trading advisors (CTAs) and commodity pool operators (CPOs). Instead, to address concerns relating to CTAs/CPOs, MFA recommends that the Commission direct the National Futures Association to promulgate CTA/CPO regulatory requirements on operational systems risk controls; and to report to the Commission on data that it collects from an amended CTA/CPO Self-Examination Questionnaire that includes questions on operational systems risk controls.
 - Should the framework apply to all categories and sizes of market participants and different types of algorithmic trading functions, MFA believes the Commission should identify specific marketplace concerns with respect to algorithmic trading activities and require market participants to prevent disruptions by: (1) using execution systems with pre-trade risk controls (when and if using algorithmic execution systems); (2) adopting development and testing standards reasonably designed to prevent operational systems risks and marketplace disruptions; (3) retaining source code; and (4) adopting monitoring, compliance and training programs reasonably designed to prevent operational systems risks and marketplace disruptions.
- **Adopt a Source Code Retention Requirement** – MFA has strong concerns with Regulation AT's source code repository requirement and recommends that the Commission replace it with a source code retention requirement.
- **Retain the Current Self-Trade Surveillance System** – MFA believes that the current DCM rules regarding self-trading are effective, and that the data does not justify the creation of an entirely new federal regulatory regime on self-trading.
- **Require Greater Disclosures with respect to Market Making and Trading Incentive Programs** – MFA supports regulation requiring DCM disclosures and surveillance of market making and trading incentive programs.

[MFA Comment Letter to the CFTC on Regulation AT](#)

[MFA Comment Letter to the CFTC with Request for Extension on Regulation AT](#)

MFA, AIMA Submit Joint Comment Letter to the FCA on MiFID II Implementation

On March 8, MFA and AIMA submitted a joint letter to the FCA on MiFID II Implementation. Among other issues, the response encouraged the FCA to: (1) implement the MiFID II requirement on non-discriminatory access to Organised Trading Facilities (OTFs) and Multilateral Trading Facilities (MTFs) in such a way that eliminates current barriers to access; (2) calibrate and transpose pre- and post-trade transparency requirements in a manner that advances the MiFID II goal of furthering market transparency while maintaining liquidity; (3) clarify that MiFID II transaction reporting requirements do not apply to Alternative Investment Fund Managers (AIFMs) or managers of Undertakings for Collective Investment in Transferable Securities (UCITS); and, (4) ensure that additional regulatory safeguards are put in place to protect confidential transaction data.

[MFA, AIMA Submit Joint Comment Letter to the FCA on MiFID II Implementation](#)

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Managed Funds Association

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