



1401 H Street, NW, Washington, DC 20005-2148, USA  
202/326-5800 www.ici.org

July 28, 2016

Mr. Brent J. Fields  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Re: *Use of Derivatives by Registered Investment Companies and Business Development Companies* (File No. S7-24-15)

Dear Mr. Fields:

I am writing on behalf of the Investment Company Institute<sup>1</sup> and our members to provide additional comments on the Securities and Exchange Commission's proposed rule for funds' use of derivatives.<sup>2</sup> Specifically, we recommend that the Commission revise the proposed rule's portfolio limit tests to provide a simple and effective risk-adjustment schedule for calculating the notional amount of a derivative instrument. Figure 1 below provides the specific schedule we recommend.

Our recommended schedule takes appropriate account of the risk of different types of derivatives and is a far superior methodology than mere reliance on gross notional exposure. The schedule is based on well-founded risk determinations that prudential and other regulators have made for very similar purposes, and is easy to administer. It also should satisfy the Commission's stated goal of limiting undue speculation through funds' use of derivatives.<sup>3</sup>

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<sup>1</sup> The Investment Company Institute is a leading, global association of regulated funds, including mutual funds, exchange-traded funds ("ETFs"), closed-end funds, and unit investment trusts in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's U.S. fund members manage total assets of \$17.9 trillion and serve more than 90 million U.S. shareholders.

<sup>2</sup> *Use of Derivatives by Registered Investment Companies and Business Development Companies*, Release No. IC-31933, 80 Fed. Reg. 80884 (Dec. 28, 2015), available at <https://www.gpo.gov/fdsys/pkg/FR-2015-12-28/pdf/2015-31704.pdf>.

<sup>3</sup> See proposing release at 80901 (portfolio limits are designed primarily to address undue speculations concerns).

Immediately following the schedule below, we explain briefly how we envision funds will use the schedule in connection with the recommendation in our March letter that the limits be revised to 200 percent (for the exposure-based portfolio limit) and 350 percent (for the risk-based portfolio limit).<sup>4</sup> We then explain why we believe the SEC should adopt the schedule.

**Figure 1 – ICI’s Recommended Derivatives Risk-Adjustment Schedule<sup>5</sup>**

<b>Underlying Asset Category</b>	<b>Risk Adjustment to Notional Amount</b>
<b>Equity</b>	x 100%
<b>Commodity</b>	x 100%
<b>Foreign Exchange / Currency</b>	x 40%
<b>Cross Currency</b>	
0–2 year duration	x 6.7%
2–5 year duration	x 13.3%
5+ year duration	x 26.7%
<b>Interest Rate</b>	
0–1 year duration (adjusted to a 12-month period)*	x 6.7%
1–2 year duration	x 6.7%
2–5 year duration	x 13.3%
5+ year duration	x 26.7%
<b>Credit / Debt</b>	
0–2 year duration	x 13.3%
2–5 year duration	x 33.3%
5+ year duration	x 66.7%
<b>All Other</b>	x 100%

\* Funds would adjust interest rate derivatives with less than a one-year maturity to a 12-month period prior to applying the risk-adjustment multiplier. For example, a fund would divide the notional amount of a 90-day instrument by four before multiplying it by the 6.7 percent risk-adjustment multiplier.

<sup>4</sup> This letter supplements comments we submitted to the SEC in March. See Letter from David W. Blass, General Counsel, Investment Company Institute, to Brent J. Fields, Secretary, Securities and Exchange Commission, dated March 28, 2016, available at <https://www.sec.gov/comments/s7-24-15/s72415-114.pdf>. We continue to urge the SEC to adopt the recommendations in our March letter. We recommended a risk-adjusted 200 percent exposure-based limit (in place of the proposed 150 percent limit) and 350 percent risk-based limit (in place of the 300 percent limit). We also continue to recommend excluding financial commitment transactions from the portfolio limits and excluding from the portfolio limits the following types of direct hedging transactions: 1) currency derivatives that provide short exposure to a currency in which a security held by the fund is denominated, and the short exposure does not exceed the value of the security; 2) written call options on securities held in the fund’s portfolio; and 3) a purchased single-name credit default swap that provides credit protection on the issuer of a security held by the fund with gross notional exposure that does not exceed the principal amount of the security.

<sup>5</sup> Appendix A provides an annotated version of the schedule, including examples of instruments that fit within each asset category. Appendix B provides a chart showing how the risk-adjustment factor for each category was determined.

## 1. How Funds Will Use ICI's Recommended Schedule

Funds will use the schedule to adjust the notional amount of a derivative instrument that would count towards the exposure-based and risk-based portfolio limits (subject to the increases we recommended in our March letter). Funds will use a three-step process for this adjustment:

First, a fund will determine a derivative instrument's risk adjustment under the schedule first by looking to the category of the underlying reference asset and characteristics (left-hand column of the schedule). The schedule includes categories of certain derivatives that are classified by both asset class and a broad duration grouping (*i.e.*, "Foreign Exchange/Currency," "Interest Rate," and "Credit/Debt," which, in the case of "Interest Rate" and "Credit/Debt," are further categorized into 0-1 year, 0-2 year, 1-2 year, 2-5 year, and/or 5+ year groupings). For those categories, the duration of the underlying reference asset typically determines the duration of the category. When a derivative instrument does not have a reference asset with a duration (*e.g.*, credit default swaps on single-name issuers), the fund will use the maturity of the derivative instrument itself to determine the duration of the category.

Second, the fund will multiply the derivative instrument's gross notional exposure by the fixed risk-adjustment multiplier (right-hand column of the schedule) assigned to that category. The product of a derivative instrument's gross notional exposure and its risk-adjustment multiplier would be the derivative instrument's risk-adjusted notional amount.<sup>6</sup>

Third, the fund will aggregate the risk-adjusted notional amounts of all the derivatives in the fund's portfolio to determine whether the fund complies with our recommended 200 percent exposure-based limit or 350 percent risk-based limit.

## 2. Our Rationale for Recommending the Schedule

The adjustment schedule is designed to take into account the expected riskiness of the derivative instrument's reference asset. Derivatives that typically are more risky receive a smaller adjustment (or even no adjustment) than those that are less risky. Funds, for example, would multiply the gross notional exposure for equity-based derivatives by 100 percent but multiply the gross notional exposure of 10-year interest rate derivatives by 26.7 percent.

As we expressed in our March letter, portfolio limits based on gross notional exposures are not the proper yardstick for determining whether a fund is unduly speculative. As the Commission fully recognizes, gross notional exposure could vastly overstate a fund's obligation under, and the economic

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<sup>6</sup> As explained in the "General Notes" to the annotated schedule in Appendix A, there are some exceptions to the calculation methodology described above. The risk-adjusted notional amount for complex derivatives, for example, would equal the aggregate risk-adjusted notional amounts of derivatives, excluding other complex derivatives, reasonably estimated to offset substantially all of the market risk of the complex derivative instrument.

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risks and leverage associated with, a derivatives transaction.<sup>7</sup> Since we submitted our letter, other regulators have voiced similar concerns with gross notional exposure. For example, in evaluating whether current methods for measuring leverage effectively assess financial stability risk, the Financial Stability Oversight Council observed that a gross notional exposure measure “does not capture differences in risk exposures across different classes of derivatives.”<sup>8</sup> Similarly, the Chairman of the Commodity Futures Trading Commission remarked that gross notional exposure “includes derivatives, but not in a manner that accurately measures risk . . . [and] does not take into account a variety of factors that affect risk, such as product type [or] offsetting positions. . . .”<sup>9</sup>

Restricting derivatives usage based on gross notional exposures, therefore, does not meet the Commission’s intent of properly distinguishing funds that are “unduly speculative” from other funds and would expose many funds to unnecessary restrictions that could inhibit a fund’s ability to mitigate risks in its portfolio, achieve its investment goals and efficiencies, enhance liquidity, and lower costs in the best interest of shareholders. Our March letter discussed the results of an ICI study showing that the proposed rule’s portfolio limits would have a restrictive impact on a substantial number of funds in general, and on “plain vanilla” taxable bond funds and alternative funds in particular. The proposed rule would affect these funds because the portfolio limits would count exposure, for example, to interest rate derivatives the same as exposure to more economically risky or volatile derivatives.

Our recommended schedule addresses some of the shortcomings with gross notional exposure and the adverse and unintended consequences for large numbers of funds. The schedule applies the limits in a more sensible manner that considers the economic risk and volatility of a derivative instrument and addresses concerns regarding undue speculation in a more rational and tailored fashion.<sup>10</sup> We continue to believe strongly that, if the Commission adopts portfolio limits restricting a fund’s use of derivatives, the Commission should not base those portfolio limits on gross notional exposures but on risk-adjusted notional amounts to limit undue speculation more appropriately and

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<sup>7</sup> The Commission noted that a test based on gross notional amounts “could be viewed as a relatively blunt measurement in that different derivatives transactions having the same notional amount but different underlying reference assets . . . may expose a fund to very different potential investment risks and potential payment obligations.” See proposing release at 80903.

<sup>8</sup> See Financial Stability Oversight Council, Update on Review of Asset Management Products and Activities (April 18, 2016) at 16, available at <https://www.treasury.gov/initiatives/fsoc/news/Documents/FSOC%20Update%20on%20Review%20of%20Asset%20Management%20Products%20and%20Activities.pdf>. The FSOC also noted that, “aggregating notional derivative amounts to measure synthetic leverage [leverage from derivatives] is likely to overstate leverage.” *Id.*

<sup>9</sup> See CFTC, Statement of Chairman Timothy Massad on the Financial Stability Oversight Council’s Update on its Review of Asset Management Products and Activities (April 18, 2016), available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/massadstatement041816>.

<sup>10</sup> This proposed schedule is intended to be used to apply the SEC’s proposed portfolio limits in a more sensible manner but is not intended to measure a fund’s overall “leverage.”

preserve the benefits derivatives provide to investors. We recognize, however, that the schedule will not resolve all of the concerns with the portfolio limits for funds, and certain funds may need to change substantially their investment strategies or de-register as funds registered under the Investment Company Act of 1940.<sup>11</sup>

We based our schedule on the prudential regulators' and CFTC's "Initial Margin Schedule" for uncleared swaps.<sup>12</sup> The Initial Margin Schedule already reflects industry input through the review and comment process under both the prudential regulators and CFTC proposals. That schedule also provides a realistic view of the relative risks of different asset classes and sets out appropriate risk adjustments. As described below, we made one refinement to the schedule that is consistent with the approach of the SEC's Division of Economic and Risk Analysis for short-term interest rate instruments.

Other approaches to a risk-adjustment schedule exist. We pointed out in our March letter, for example, that the SEC has adopted a "Swap Registration Schedule" that itself is risk adjusted for purposes of the security-based swap dealer registration rule.<sup>13</sup> That schedule serves as a SEC precedent for a risk-adjustment approach, but we believe the Initial Margin Schedule provides a better model for purposes of the current proposal.<sup>14</sup> First, the Initial Margin Schedule is more conservative in how it assigns the riskiness of an instrument generally (under the Swap Registration Schedule, for example, interest rate derivatives with less than one-year maturity would have a 0 percent adjustment factor). Second, the Initial Margin Schedule is used in rules that serve a similar purpose as that of the proposed derivatives rule – limiting risk. The Swap Registration Schedule, in contrast, was designed to measure a

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<sup>11</sup> Several funds, for example, invest in derivatives whose reference assets are based on an equity or commodity index. Those derivatives would receive no risk-adjustment to their gross notional exposure and would continue to apply their full gross notional exposure toward the portfolio limits. To the extent such a fund exceeds its portfolio limits, the fund may need to significantly change its investment portfolio to comply with the limits or de-register. In this regard, the SEC requested comment on whether funds that currently exceed the portfolio limits or that have received exemptive relief to operate leveraged or inverse ETFs should be "grandfathered" from the proposed rule's requirements. This approach may warrant further consideration and analysis, and we stand ready to assist the SEC in these efforts.

<sup>12</sup> See *Margin and Capital Requirements for Covered Swap Entities*, 80 Fed. Reg. 74839 (Nov. 30, 2015) (final rule) at Appendix A, available at <https://www.gpo.gov/fdsys/pkg/FR-2015-11-30/pdf/2015-28671.pdf>; *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 81 Fed. Reg. 636 (Jan. 2, 2016) (final rule) at Section 23.154(c), available at <https://www.gpo.gov/fdsys/pkg/FR-2016-01-06/pdf/2015-32320.pdf>. That schedule is reproduced in Appendix C. The Initial Margin Schedule specifies the minimum amount of initial margin that will need to be posted and received for uncleared swaps, if the parties to the swap do not elect to determine the initial margin under a model approved by the relevant regulator.

<sup>13</sup> See *Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and Eligible Contract Participant*, 77 Fed. Reg. 30596 (May 23, 2012), available at <https://www.gpo.gov/fdsys/pkg/FR-2012-05-23/pdf/2012-10562.pdf>.

<sup>14</sup> We also recommended in our March letter that the SEC use the Initial Margin Schedule as a basis for expanding the types of "qualifying coverage assets" eligible for segregation under the proposal.

level of derivatives activity by a market participant that would warrant such entity being required to register with the SEC (or the CFTC).

We and our members also considered whether to recommend an entirely new schedule rather than one based on the Initial Margin Schedule. A new schedule potentially could finely tailor adjustments specifically for the purposes of proposed rule 18f-4. On balance, however, we believe that the Initial Margin Schedule is the superior model. It is based on observations of market activity regarding the relative riskiness of those instruments and incorporates significant input from market participants. Any new schedule would largely reflect the judgments inherent in the Initial Margin Schedule. Further, market participants already familiar with the Initial Margin Schedule may achieve operational efficiencies through the use of a common schedule.

We now discuss the rationale for specific elements of ICI's recommended derivatives risk-adjustment schedule.

***a. Risk-Adjustment Multipliers***

We determined the risk-adjustment multipliers based on the initial margin amounts required under the Initial Margin Schedule. To avoid complications, we largely retained the categories that the prudential regulators and CFTC created for various uncleared swaps.<sup>15</sup> The categories with the highest initial margin requirements under this schedule ("Equity," "Commodity," and "Other"), each of which has an initial margin requirement of 15 percent of gross notional exposure, were assigned a risk-adjustment multiplier of 100 percent. This categorization means that derivatives that fall into the "Equity," "Commodity," and "Other" categories would apply their full gross notional exposure towards the portfolio limits. Risk-adjustment multipliers for all other categories were determined relative to the "Equity," "Commodity," and "Other" categories by multiplying their respective gross initial margin requirement by a conversion factor of  $6 \frac{2}{3}$ . The conversion factor reflects a scaling of risk to the "Equity," "Commodity," and "Other" categories and is simply the inverse of the gross initial margin ( $1/0.15 = 6 \frac{2}{3}$ ) of these categories.<sup>16</sup> For example, with respect to derivatives in the category "Foreign Exchange/Currency," which pursuant to the Initial Margin Schedule require initial margin of 6 percent of the gross notional exposure of the instrument, funds would multiply the gross notional exposure of such instruments by 40 percent (*i.e.*, initial margin amount (6 percent) x conversion factor ( $6 \frac{2}{3}$ )) to compute their risk-adjusted notional amounts. Therefore, the proposed schedule retains the relative

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<sup>15</sup>The categories in the prudential regulators' and CFTC's margin schedule are: Credit: 0-2 year duration; Credit: 2-5 year duration; Credit: 5+ year duration; Commodity; Equity; Foreign Exchange/Currency; Cross Currency Swaps: 0-2 year duration; Cross-Currency Swaps: 2-5 year duration; Cross-Currency Swaps: 5+ year duration; Interest Rate: 0-2 year duration; Interest Rate: 2-5 year duration; Interest Rate: 5+ year duration; and Other. *See* Appendix C.

<sup>16</sup>Appendix B sets out a chart showing how the risk-adjustment factor for each category was determined.

treatment of the various instruments under the Initial Margin Schedule, consistent with regulators' view of risk.

We considered a hybrid approach that would have combined the risk-adjustment multipliers derived from the Initial Margin Schedule with a duration adjustment for derivatives in the "Interest Rate" category. A duration adjustment would have scaled the risk-adjustment multipliers for interest rate derivatives based on a specified bond equivalent.<sup>17</sup> If the schedule used a 20-year bond equivalent, for example, an interest rate derivative instrument with a reference asset having a 20-year duration would have counted 100 percent of its gross notional exposure toward the limit and derivatives with shorter durations would have been scaled off of those amounts. We decided against this approach. The Initial Margin Schedule already includes an adjustment for duration because the initial margin requirements for interest rate derivatives with a 0-2 year duration (1 percent) are lower than the initial margin requirements for interest rate derivatives with a 2-5 year duration (2 percent) and a 5+ year duration (4 percent). Although scaling duration to a reference asset having a specific bond equivalent would have created finer distinctions among different fixed-income instruments, we concluded that the additional complexity of such an adjustment was not warranted. On balance, we were of the view that maintaining consistency with the Initial Margin Schedule on this point would ease operational burdens on funds and provide a more workable and uniform approach.

We generally retained the categories that the CFTC and prudential regulators derived for the Initial Margin Schedule, although we split "Interest Rate: 0-2 year duration" into "Interest Rate: 0-1 year duration" and "Interest Rate: 1-2 year duration." For derivatives in the "Interest Rate: 0-1 year duration" category, we propose dividing the notional amount of such derivatives by the appropriate 12-month time adjustment (*e.g.*, the notional amount of 90-day instruments would be divided by 4 because the duration of such instruments is  $\frac{1}{4}$  of one year), then multiplying that amount by the risk-adjustment multiplier of 6.7 percent – the same multiplier for "Interest Rate: 1-2 year duration" derivatives. This treatment, adjusting for duration for such short-term instruments, is consistent with the treatment of short-term futures contracts in the DERA white paper that accompanied the proposing release.<sup>18</sup> We support this slight change to address the concern identified by DERA that the magnitude of a fund's investment exposure in short-term interest rate derivatives (*i.e.*, one year or less) is overstated, which unintentionally could impair the use of these low-risk derivatives.

#### ***b. Asset Class Categories and Classifications***

We considered refining the Initial Margin Schedule even further to account for more granular distinctions in the various asset classes. We analyzed, for example, whether derivatives in the category "Credit/Debt" should be further classified into "High Yield" and "Investment Grade" to reflect the

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<sup>17</sup> ICI members considered using both a 10-year bond equivalent and a 20-year bond equivalent.

<sup>18</sup> See Daniel Deli, Paul Hanouna, Christof Stahel, Yue Tang & William Yost, *Use of Derivatives by Registered Investment Companies*, Division of Economic and Risk Analysis (2015), available at <https://www.sec.gov/dera/staff-papers/white-papers/derivatives12-2015.pdf>. See also, proposing release at 80908.

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differing characteristics of those assets. Ultimately, we determined to recommend a more straightforward and streamlined bucketing approach for ease of use that is largely consistent with the Initial Margin Schedule. We are of the view that consistency with the Initial Margin Schedule would allow funds entering into derivatives with counterparties using the Initial Margin Schedule to classify their derivatives in the same manner as they would for determining initial margin. This would ease burdens on funds and potentially allow for a uniform classification of derivatives to develop. A less granular approach also keeps the categorizations simple, robust and unambiguous, while reducing the need for continuous updating.

ICI's recommended annotated version of the schedule lists several examples of instruments under each of the seven main asset classes to illustrate the proper categorization and to assist with the consistent application of the portfolio limits. The examples are not intended to cover all types of derivatives and are not intended to be codified into the rule. Instead, funds can use them as an effective guide for classifying many common types of derivatives.<sup>19</sup> Funds and their derivatives risk managers should be equipped to classify newly developed types of derivatives into the seven broad categories, including the category "Other," which pursuant to the proposed schedule would require funds to count 100 percent of their gross notional exposure toward the limit.<sup>20</sup>

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<sup>19</sup>The Commission, for example, could discuss the categorization in its adopting release to provide funds guidance on how they would classify different instruments.

<sup>20</sup>Although the relative riskiness of various derivatives could vary over time, we believe that the conservative nature of the ICI's recommended schedule would provide the Commission with a sufficient amount of "cushion" before necessitating any change to the amounts in the schedule.



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We appreciate the opportunity to provide further recommendations on the proposal. If you have any questions regarding ICI's recommended derivatives risk-adjustment schedule or would like any additional information, please feel free to contact me at (202) 326-5815; Dorothy Donohue, Deputy General Counsel at (202) 218-3563; Jennifer S. Choi, Associate General Counsel at (202) 326-5876; or Kenneth C. Fang, Assistant General Counsel at (202) 371-5430.

Sincerely,

/s/ David W. Blass

David W. Blass  
General Counsel

cc: The Honorable Mary Jo White, Chair  
The Honorable Kara M. Stein  
The Honorable Michael S. Piwowar

David W. Grim, Director  
Diane C. Blizzard, Associate Director  
Division of Investment Management

## APPENDIX A

### Annotated Version of ICI's Recommended Derivatives Risk-Adjustment Schedule

Asset Class	Risk-Adjustment Multiplier	Examples of Instruments Covered
Equity	Notional x 100%	Futures on a single-name equity security, equity index, ETF, or convertible bond
		Total return swap on a single-name equity security, equity index, convertible bond, portfolio of equity securities, or portfolio of convertible bonds
		Written options on a single equity security, single name equity future, equity index, equity index future, ETF, ETF future, or convertible bond <sup>1</sup>
Commodity	Notional x 100%	Futures on a single commodity, commodity index, or commodity index excess return
		Commodity index options <sup>1</sup>
		Commodity index swaps
		Commodity index forward swaps
		Options on commodity futures <sup>1</sup>
Foreign Exchange/Currency	Notional x 40%	FX/currency forwards (including non-deliverable forwards) <sup>2</sup>
		FX/currency futures
		Currency options <sup>1</sup>
Cross-Currency	For cross-currency swaps and cross-currency basis swaps, the maturity of the derivative instrument determines the duration category	
	0-2 years: Notional x 6.7%	Cross-currency swaps
	2-5 years: Notional x 13.3%	Cross-currency basis swaps
	5+ years: Notional x 26.7%	
Interest Rate	For futures and total return swaps, the duration of the underlying reference asset determines the duration category	
	For swaptions, the maturity of the underlying swap determines the duration category	
	For interest rate swaps, caps, floors, collars, swaps on CPI, swaps on an index, and forward rate agreements, the maturity of the derivative instrument determines the duration category	

Asset Class	Risk-Adjustment Multiplier	Examples of Instruments Covered
	0-1 year: (Notional ÷ Appropriate Calendar Adjustment) <sup>3</sup> x 6.7%	Interest rate futures (e.g., Eurodollar, Fed funds futures)
	1-2 years: Notional x 6.7%	Interest rate caps, floors and collars
	2-5 years: Notional x 13.3%	Investment grade government bond futures (e.g., U.S. Treasury, UK Gilts, Euro-Bund)
	5+ years: Notional x 26.7%	Interest rate swaps
		Swaps on investment grade government bonds, investment grade government bond indexes, or investment grade government bond ETFs
		Forward rate agreements
		Swaps on CPI
		Options on interest rate futures <sup>1</sup>
		Swaptions <sup>4</sup>
<b>Credit/Debt</b>	For futures and total return swaps on covered instruments, the duration of the underlying reference asset determines the duration category	
	For credit default swaps and swaps on an index, the maturity of the swap determines the duration category	
	0-2 years: Notional x 13.3%	Corporate bond and non-investment grade government bond futures
	2-5 years: Notional x 33.3%	Credit spread futures
	5+ years: Notional x 66.7%	Swaps on corporate bonds and non-investment grade government bonds; corporate bond and non-investment grade government indexes; and corporate bond and non-investment grade government bond ETFs
		Credit spread swaps
	Credit default swaps on single name or index <sup>5</sup>	
	Total return swap on a single fixed-income security or portfolio of fixed-income securities	
<b>Other</b>	Notional x 100%	Complex derivatives (e.g., volatility instruments, variance swaps, non-standard options) <sup>6</sup>

### General Notes:

1. Funds would treat written options on these underlying asset classes on a delta-adjusted basis. For example, exposure on a written FX option will be notional x 40 percent x option delta. Purchased options are excluded.
2. We note that the Initial Margin Schedule will exclude foreign exchange swaps and forwards from any initial margin requirements. These instruments generally are not regulated as “swaps” under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act and the Commodity Exchange Act. *See Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act*, 77 Fed. Reg. 69604 (Nov. 20, 2012), available at <https://www.gpo.gov/fdsys/pkg/FR-2012-11-20/pdf/2012-28319.pdf>. Consistent with this approach, the Commission could choose to exclude foreign exchange swaps and forwards from counting toward any portfolio limit requirements.
3. Funds would adjust interest rate derivatives with less than a one-year maturity to a 12-month period prior to applying the risk-adjustment multiplier. For example, a fund would divide the notional amount of a 90-day instrument by four before multiplying it by the 6.7 percent risk-adjustment multiplier.
4. Funds would risk adjust swaptions based on the maturity of the underlying swap, then treat them on a delta-adjusted basis.
5. “Sold” CDS protection only. For purchased CDS protection, the sum of future premium payments would apply to the Commission’s proposed portfolio limits.
6. The risk-adjusted notional amount for complex derivatives would be an amount equal to the aggregate risk-adjusted notional amounts of derivatives, excluding other complex derivatives, reasonably estimated to offset substantially all of the market risk of the complex derivative instrument.

## APPENDIX B

### Computation of Risk-Adjustment Multipliers

<b>Asset Class</b>	<b>Gross Initial Margin (% of Notional Exposure)</b>	<b>Conversion Factor</b>	<b>Risk-Adjustment Multiplier</b>
Credit: 0–2 year duration	2%	x 6 2/3	13.3%
Credit: 2–5 year duration	5%	x 6 2/3	33.3%
Credit: 5+ year duration	10%	x 6 2/3	66.7%
Commodity	15%	x 6 2/3	100.0%
Equity	15%	x 6 2/3	100.0%
Foreign Exchange/Currency	6%	x 6 2/3	40.0%
Cross Currency Swaps: 0–2 year duration	1%	x 6 2/3	6.7%
Cross-Currency Swaps: 2–5 year duration	2%	x 6 2/3	13.3%
Cross-Currency Swaps: 5+ year duration	4%	x 6 2/3	26.7%
Interest Rate: 0–2 year duration*	1%	x 6 2/3	6.7%
Interest Rate: 2–5 year duration	2%	x 6 2/3	13.3%
Interest Rate: 5+ year duration	4%	x 6 2/3	26.7%
Other	15%	x 6 2/3	100.0%

\* Funds would adjust interest rate derivatives with less than a one-year maturity to a 12-month period prior to applying the risk-adjustment multiplier. For example, a fund would divide the notional amount of a 90-day instrument by four before multiplying it by the 6.7 percent risk-adjustment multiplier.

## APPENDIX C

### Standardized Minimum Initial Margin Requirements for Uncleared Swaps and Uncleared Security-Based Swaps

Asset Class	Gross Initial Margin (% of Notional Exposure)
Credit: 0–2 year duration	2%
Credit: 2–5 year duration	5%
Credit: 5+ year duration	10%
Commodity	15%
Equity	15%
Foreign Exchange/Currency	6%
Cross Currency Swaps: 0–2 year duration	1%
Cross-Currency Swaps: 2–5 year duration	2%
Cross-Currency Swaps: 5+ year duration	4%
Interest Rate: 0–2 year duration	1%
Interest Rate: 2–5 year duration	2%
Interest Rate: 5+ year duration	4%
Other	15%

**Sources:** *Margin and Capital Requirements for Covered Swap Entities*, 80 Fed. Reg. 74839 (Nov. 30, 2015) (final rule) at Appendix A; *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 81 Fed. Reg. 636 (Jan. 2, 2016) (final rule) at Section 23.154(c).