

## ICI Submits Comment Letter on CFTC Concept Release Re OTC Derivatives, September 1998

September 11, 1998

Ms. Jean A. Webb  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, D.C. 20581

### Re: Over-the-Counter Derivatives Concept Release

Dear Ms. Webb:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("CFTC") concept release on over-the-counter ("OTC") derivatives (the "Concept Release").<sup>2</sup> As significant end-users of OTC derivatives, the investment company industry has a keen interest in the regulation of participants in the OTC derivatives market. Accordingly, we believe that any regulatory proposals affecting the OTC derivatives market should be very carefully considered with input from all interested parties before making any changes.

As the Concept Release notes, use of OTC derivatives has grown substantially over the past few years. In part, the growth in the use of OTC derivatives reflects the strong growth of the U.S. financial markets during this period. In addition, this growth reflects the significant benefits to institutional investors, including mutual funds, of OTC derivatives, which allow investors to manage risks associated with their business activities and financial assets. In particular, investment advisers to mutual funds use OTC derivatives to manage volatility in fund portfolios caused by interest rate or foreign exchange rate fluctuations. OTC derivatives also allow funds to obtain exposures to different assets without directly taking a position in such assets, thus helping to manage the funds' liquidity.

The Concept Release indicates that the CFTC is reexamining its approach to OTC derivatives and is seeking public comment on various questions and issues in order to assist the CFTC in determining whether to continue or modify its current regulatory approach. The Institute is concerned with these developments and believes that the CFTC should reconsider undertaking the initiative with respect to OTC derivatives contemplated in the Concept Release. Numerous witnesses at the recent Congressional hearings have indicated that the Concept Release may cause the OTC markets to react unfavorably because of the legal uncertainty that the Concept Release has created. As a result, many OTC market participants are concerned that the OTC markets may move overseas to avoid an uncertain U.S. legal environment. If this were to happen, it could negatively impact many mutual funds that participate in these markets, since funds could spend greater time and resources evaluating the application of foreign law and foreign counterparty creditworthiness and could incur greater risk than they currently do. There is also substantial disagreement over whether the CFTC has the authority and jurisdiction to regulate OTC derivatives under the Commodity Exchange Act ("CEA").

The Institute is also very concerned that many of the proposals considered in the Concept Release could lead to duplicative and unnecessary regulatory burdens on dealers, intermediaries, and end-users, including mutual funds.<sup>3</sup> The Concept Release appears to be predicated on the assumption that participants in the OTC derivatives market are substantially unregulated, and that therefore greater regulation may be needed. In fact, mutual fund participants in the OTC derivatives market are already heavily regulated under the federal securities laws by the Securities and Exchange Commission. It would be highly burdensome and redundant for the CFTC to impose an additional layer of regulation on mutual funds and their service providers under the CEA as a prerequisite to participation in these markets. Broker-dealers, banks, pension funds, insurance companies, and other market participants are also subject to comprehensive regulatory schemes administered by federal and state regulatory authorities, which regulatory schemes should be considered before determining to overhaul the regulation of the OTC derivatives market.

Given the significant impact that CFTC action could have on the OTC derivatives markets, the uncertainty as to the CFTC's jurisdiction over these markets, and the fact that participants in these markets are already subject to comprehensive regulation by federal and state regulators, the CFTC should not take further action on the Concept Release until there is a consensus among Congress and the other federal financial markets regulators on how to proceed in this area. We believe that by working through the President's Working Group on Financial Markets, or another similar multi-agency group, the CFTC can work with the other federal regulators to determine the optimal regulatory regime to govern the OTC derivatives market.

We appreciate the opportunity to comment on the Concept Release. If you have any questions, please do not hesitate to telephone me at (202) 326-5819.

Sincerely,

Joseph P. Savage  
Assistant Counsel

#### **ENDNOTES**

<sup>1</sup> The Investment Company Institute is the national association of the American investment company industry. Its membership includes 7,288 open-end investment companies ("mutual funds"), 450 closed-end investment companies, and 9 sponsors of unit investment trusts. Its mutual fund members have assets of about \$5.092 trillion, accounting for approximately 95% of total industry assets, and have over 62 million individual shareholders.

<sup>2</sup> Commodity Futures Trading Commission, Concept Release on Over-the-Counter Derivatives (May 6, 1998), 63 Fed. Reg. 26114 (May 12, 1998).

<sup>3</sup> For example, the Concept Release asks for comment on such issues as eligibility requirements for OTC derivatives market participants and transactions, and registration, capital, recordkeeping, and internal control requirements for market participants.