Refinitiv US SEF LLC
3 Times Square, New York, NY 10036
T 646 223 7397
www.refinitiv.com

REFINITIV™

March 24, 2020

Vanessa Countryman
Secretary of the Commission
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: File No. S7–24–15: Use of Derivatives by Registered Investment Companies and Business Development Companies; Required Due Diligence by Broker-Dealers and Registered Investment Advisers Regarding Retail Customers' Transactions in Certain Leveraged/Inverse Investment Vehicles

Dear Ms. Countryman:

FX Alliance LLC ("**FXall**") and Refinitiv US SEF LLC[1] ("**Refinitiv SEF**" and, together with FXall, "**Refinitiv**") welcome the opportunity to submit comments on the Securities and Exchange Commission's ("**SEC**" or "**Commission**") proposed rule on Use of Derivatives by Registered Investment Companies and Business Development Companies; Required Due Diligence by Broker-Dealers and Registered Investment Advisers Regarding Retail Customers' Transactions in Certain Leveraged/Inverse Investment Vehicles (the "**Proposed Rule**").[2]

Refinitiv appreciates the importance of the Proposed Rule to the SEC's investor protection mandate under section 18 of the Investment Company Act of 1940 ("**ICA**") in light of the fact that many registered investment companies and business development companies (collectively, "**funds**") utilize derivatives for various purposes. We believe, however, that the Proposed Rule's blunt, one-size-fits-all approach fails to appropriately distinguish certain derivatives instruments in the foreign exchange ("**FX**") asset class that do not present the risks to fund investors that are the underlying drivers of the Proposed Rule and Section 18 of the ICA. As such, we believe the Proposed Rule would inappropriately limit a fund advisor's ability to use these FX instruments to manage risk for the fund and its investors, and that a more tailored approach is required instead.

Accordingly, Refinitiv respectfully requests that any final rule adopted by the Commission exclude FX forwards, FX swaps, non-deliverable forwards involving FX ("**NDFs**"), and FX options (collectively, "**FX Derivatives**") from the definition of "derivatives transaction"

[1] In October 2018, the Financial and Risk business of Refinitiv, of which Thomson Reuters (SEF) LLC ("**TR SEF**") was a part, changed its name to Refinitiv in connection with a partial acquisition of the Financial and Risk business. As of February 28, 2019, TR SEF formally changed its name and is now doing business as Refinitiv US SEF LLC.

[2] *Use of Derivatives by Registered Investment Companies and Business Development Companies; Required Due Diligence by Broker-Dealers and Registered Investment Advisers Regarding Retail Customers' Transactions in Certain Leveraged/Inverse Investment Vehicles*, Proposed Rule, 85 Fed. Reg. 4446 (Jan. 24, 2020).

based on the distinctive nature of such instruments and the risk-mitigating purposes for which they are used by funds.[3]

I. Refinitiv's Background and Interest in the Proposed Rule

Refinitiv is a global provider of financial markets data and infrastructure. Subsidiary companies of Refinitiv are leaders in (among other things) various segments of the FX market. Our FXT solutions provide access to liquidity in OTC markets, trade execution capabilities and connections for market participants worldwide. They also offer post-trade services globally, enabling banks, brokers and electronic marketplaces to connect seamlessly with their counterparties. Refinitiv therefore offers comprehensive solutions for trade discovery and analysis, execution and post-trade services.

FXall operates an electronic trading, execution, trade processing and negotiation system for FX spots, forwards, and other FX instruments. FXall's trading system facilitates competitive pricing, internal trading controls, risk management and a granular audit trail. It has succeeded in improving efficiency and transparency, and reducing risk for important FX markets to the US and the world economy. As a result, today a large part of the FX market is traded on electronic systems such as FXall—including less liquid or infrequently traded instruments customized by end-users to meet specific commercial requirements.

Refinitiv SEF is registered as a swap execution facility ("**SEF**") with the Commodity Futures Trading Commission (the "**CFTC**"), and currently facilitates electronic trading in NDFs and FX options. Refinitiv SEF enables its market participants to trade NDFs and FX options through its request-for-quote system and an order book.

II. FX Products Should Be Excluded from the "Derivatives Transaction" Definition

The Proposed Rule would clarify and expand the existing limitations and requirements applicable to a fund's use of "derivatives transactions," which largely stem from a variety of SEC guidance and no-action letters. The rationale for these restrictions is to address the risk that funds would engage in undue speculation through derivatives transactions, and that they would not have assets sufficient to cover their obligations arising from those transactions.[4] The Proposed Rule highlights these concerns by referencing examples where funds experienced rapid losses in part due to their derivatives exposure.

We appreciate these concerns, but assert that FX Derivatives do not implicate the same theoretical dangers, nor were they the cause of any of the examples cited by the Commission as grounds for imposing the proposed limitations and requirements. This is because FX Derivatives have limited exposure to market fluctuations, short durations, and entail no material counterparty or settlement risk. This is particularly true for FX forwards and FX swaps, as described further below.

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[3] Refinitiv also requests that any final rule include rule text directly excluding purchased options (such as FX options) from the definition of a "derivatives transaction." Although this appears to be the Commission's intent, which we support, this should be stated in rule text rather than discussed in the narrative preamble.

[4] *See*, *e.g.*, Proposed Rule, 85 Fed. Reg. at 4451-52.

Refinitiv therefore requests that FX Derivatives be clearly and expressly excluded from the definition of a "derivatives transaction" in any final rule on the subject. Below, we address each type of FX Derivative, in turn.

A. The Proposed Rule Fails to Appropriately Consider the Distinguishing Characteristics of FX Forwards and FX Swaps

FX forwards and FX swaps[5] are qualitatively different from typical derivatives, and we therefore believe the Proposed Rule should treat these products differently. Importantly, unlike typical swaps or futures contracts, each counterparty to an FX forward or FX swap knows its ultimate liability at the time of execution. Additionally, under the Commission's Release 10666 (*i.e.*, the Commission's statement of policy regarding the application of Section 18 of the ICA to certain types of transactions), FX forwards and FX swaps are not "leveraged," and therefore do not raise the types of concerns that are the focus of the Proposed Rule. Specifically, Release 10666 states that "[l]everage exists when an investor achieves the right to a return on a capital base that exceeds the investment which he has personally contributed to the entity or instrument achieving a return."[6] FX forwards and FX swaps do not satisfy this definition because they require each party to deliver the full notional amount of the transaction at maturity.

(i) *The Treasury Determination*

Largely for the reasons described above, Congress, the US Department of Treasury ("**Treasury**"), the Commission and the CFTC determined to exempt FX forwards and FX swaps from nearly all regulations otherwise applicable to swaps. Specifically, pursuant to authority granted by the Congress in the Dodd-Frank Act, the Secretary of the Treasury issued a determination (the "**Determination**") that FX forwards and FX swaps should not be regulated as swaps under the regulatory regime enacted as part of Title VII of the Dodd-Frank Act.[7]

In the Determination, Treasury explained that FX forwards and FX swaps involve "a simple exchange of principal at one point in time and [for FX swaps] a reversal of that exchange at some later date."[8] As a result, the amount of the exchange by each party is known at the onset of the transaction. Because payment obligations in FX forward and FX swap transactions are fixed at the start of the contract, these payment obligations, in contrast to those for other types of

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[5] For purposes of this comment letter, we refer to FX forwards and FX swaps as defined in the Dodd-Frank Act. Specifically, an FX forward is "a transaction that solely involves the exchange of 2 different currencies on a specific future date at a fixed rate agreed upon on the inception of the contract covering the exchange," and an FX swap is (generally speaking) a combination of two FX forwards. *See* Dodd-Frank Act § 721(a)(2). *See* Sections 1a(24)-(25) of the Commodity Exchange Act ("**CEA**"), 7 U.S.C. §§ 1a(24)-(25). *See also* rule 3a69-2(c)(3)-(4) under the Securities Exchange Act of 1934 ("**Exchange Act**"); rule 1.3 under the CEA (sub-section (3) of the "swap" definition).

[6] *See* Securities Trading Practices of Registered Investment Companies, Investment Company Act Release No. 10666 (Apr. 18, 1979) [44 Fed. Reg. 25128 (Apr. 27, 1979)], at n.5 (''**Release 10666''**).

[7] *Determination of Foreign Exchange Swaps and Foreign Exchange Forwards under the Commodity Exchange Act*, 77 Fed. Reg. 69694 (Nov. 20, 2012).

[8] Determination, 77 Fed. Reg. at 69702.

derivatives, are insulated from market fluctuations.[9] In addition, most FX forward and FX swap transactions are short-term transactions, with tenors generally less than one year—and often less than seven days.[10]

Based on these significant differences in the characteristics of FX forwards and FX swaps as compared to other types of derivatives, Treasury concluded that these transactions: (1) "carry significantly lower levels or counterparty credit risk [and market risk], relative to other swaps and derivatives;"[11] and (2) bear primarily settlement risk, which is "virtually eliminate[ed]" by virtue of the settlement arrangements used for these transactions.[12] Specifically, the Determination found that:

- FX forwards and FX swaps are subject to less counterparty credit risk than other derivatives because of the short average length of the contracts;[13]

- Because FX forwards and FX swaps settle physically and payment obligations are fixed at the start of the contract, risk associated with the products is largely settlement risk;[14]

- Settlement risk for these transactions, though, has been addressed through the "extensive use of payment versus payment ("**PVP**") settlement arrangements;"[15] and

- Through the use of PVP arrangements, approximately 75 percent of the entire foreign exchange market settles without settlement risk to either party.[16]

Based on these findings, Treasury determined that FX forwards and FX swaps are "qualitatively different from other classes of swaps,"[17] and it concluded and that they should not be regulated as swaps. And, as a result of this Determination by Treasury, pursuant to rules jointly adopted by the Commission and the CFTC, FX forwards and FX swaps are not considered to be swaps.[18]

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[9] *Id.* at 69696-97. Furthermore, foreign exchange rates, upon which the risk of an FX forward or FX swap is based, historically have been less volatile (and thus less risky) than other underlying markets such as equities.

[10] Refinitiv concurs with, and supports, the comments submitted on March 28, 2016, by the Foreign Exchange Professionals Association ("**FXPA Letter**"). The FXPA Letter cites data demonstrating that a significant portion of FX forward and FX swap transactions have tenors less than seven days, with the vast majority having tenors of less than one year. FXPA Letter at 3; *see also* Determination, 77 Fed. Reg. at 69697.

[11] Determination, 77 Fed. Reg. at 69697.

[12] *Id.* at 69698.

[13] *Id.*

[14] *Id.* at 69697-8.

[15] *Id* at 69698.

[16] *Id*.

[17] *See* Dodd-Frank Act § 722(h).

[18] *Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 77 Fed. Reg. 48208 (Aug. 13, 2012) ("**Joint Product Definitions**

Just as these distinctive characteristics of FX forwards and FX swaps persuaded Treasury that they should not be considered swaps generally subject to the swap regulatory regime of the Dodd-Frank Act, so, too, they demonstrate that the Commission should not consider them to be "derivatives transactions" subject to the restrictions and requirements imposed on funds' use of derivatives. Because of their fixed and known payment obligation and short duration, FX forwards and FX swaps do not pose the types of risk identified in the Proposed Rule that are associated with other types of derivatives—*i.e.*, a risk of undue speculation causing a fund to suffer substantial and unforeseeable losses that, through the effects of leverage, render the fund unable to meet its obligations without a forced sale of other investments.[19]

The risks that FX forwards and FX swaps present to funds that trade them are limited, and, importantly, those risks are manageable. To subject them to the limitations and regulatory requirements set forth in the Proposed Rule, which are designed to address the risk to fund investors from highly-leveraged and longer-term derivatives, is unwarranted.

Accordingly, just as the Commission (and the CFTC) concluded on the basis of the Determination by Treasury that FX forwards and FX swaps should be excluded from the class of swaps subject to regulation under the Dodd-Frank Act, the Commission similarly should conclude that they should be excluded from the class of derivatives subject to VaR-based limitations and regulatory requirements when used by funds.

(ii) *The Dreyfus No-Action Letter*

We believe the Commission's current regime with regard to FX forwards and FX swaps fully addresses any exposure funds have to such instruments by requiring segregation of the full notional amount. Specifically, in its no-action letter to Dreyfus Strategic Investing and Dreyfus Strategic Income (the "**Dreyfus no-action letter**"), the Commission stated that "if a fund enters into a long, physically settled forward contract, and the contract specifies the forward price that the fund will pay at settlement, the fund would, consistent with staff positions, segregate this forward/contract price."[20]

This requirement (*i.e.*, for full segregation) eliminates any risk to the fund associated with engaging in undue speculation, or failing to have sufficient assets to cover the fund's obligations. Moreover, there is no possibility that market swings could cause a fund to have greater-than-expected exposure to an FX forward or FX swap, because the delivery obligation is known at the time of execution.

Rules"). *See* rule 3a69-2(c)(1) under the Exchange Act; rule 1.3(xxx)(3)(i) under the CEA. Although FX forwards and FX swaps thus are excluded from the definition of the terms "swap" and "security-based swap," they nevertheless remain subject to the reporting requirements and business conduct standards under the Dodd-Frank Act. *See* rule 3a69-2(c)(2) under the Exchange Act and rule 1.3(xxx)(3)(ii) under the CEA.

[19] *See*, *e.g.*, Proposed Rule, 85 Fed. Reg. at 4453. In this manner, FX forwards and FX swaps differ from a currency swap which, as stated in the Determination, "generally involves a periodic exchange of a floating amount of cash flows between the counterparties based on the value of the underlying variable(s) on which the derivative contract is based." Determination, 77 Fed. Reg. at 69702. The fixed nature of a fund's exposure under an FX forward or FX swap transaction distinguishes it from an exposure to floating metrics underlying derivatives such as currency swaps. For the avoidance of doubt, this letter is not addressing currency swaps.

[20] Dreyfus Strategic Investing and Dreyfus Strategic Income, SEC Staff No-Action Letter (June 22, 1987).

We therefore request that, if the Commission does not exclude FX forwards and FX swaps from the definition of a "derivatives transaction" entirely, it codify the policy described in the Dreyfus no-action letter. Specifically, the Commission could explicitly require funds engaging in FX forwards and FX swaps to segregate the full notional amount associated with such transactions without subjecting such funds to the VaR-based limitations, risk management requirements or Board oversight and reporting requirements set forth in the Proposed Rule.

B. The Proposed Rule Fails to Appropriately Consider the Distinguishing Characteristics of NDFs

NDFs likewise should be excluded from the definition of a "derivatives transaction" because they are economically and functionally the same as FX forwards (as defined in the Dodd-Frank Act).[21] The sole difference between these two transactions is that in an FX forward, the trade closes out at maturity upon delivery by each party to the transaction of the gross amount of the respective currency specified in the contract. In comparison, in an NDF, the trade closes out at maturity upon delivery of the net value of the underlying exchange, denominated in a pre-determined currency. For example, parties to an FX forward may exchange US dollars for, say, British pounds, and in an NDF the paying party pays the difference between the agreed-upon exchange rate for two currencies (*e.g.*, US dollars/Brazilian real) and the spot rate at settlement. In each structure, the net value transferred would be the value difference between the two currencies exchanged.

NDFs often exist because of capital controls imposed by certain emerging markets that make FX forwards impossible—and not because of any greater benefit or leverage associated with NDFs. NDFs are used almost exclusively when one of the underlying currencies cannot be physically delivered or is, as a practical matter, not deliverable offshore as a matter of local law or other local requirements. Non-deliverability is a feature of many emerging market currencies, such as the Brazilian real and Argentine peso. As the Federal Reserve Bank of New York explained, "Major NDF market trading began in the early 1990's, initially as a means for companies to hedge their exposure to currency fluctuations of emerging market countries with actual or potential foreign exchange convertibility restrictions."[22] The use of NDFs for this purpose has continued, as evidenced by the fact that "NDF markets in currencies of countries that have allowed increased capital convertibility, to the point where currency hedging is fully available onshore, have dissipated and/or disappeared."[23] This further demonstrates that NDFs and FX forwards are functionally equivalent to one another.

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[21] The Determination did not consider whether NDFs should be considered swaps because the Dodd-Frank Act only gave Treasury the authority to exempt FX forwards and FX swaps. *See* Dodd-Frank Act §§ 721(a)(2), 722(h). Similarly, in the Joint Product Definitions Rules, the Commission and the CFTC concluded only that NDFs do not fall within the "plain language in the definition of the term 'foreign exchange forward'" in the Dodd-Frank Act. *See* Joint Product Definitions Rules, 77 Fed. Reg. at 48256. We recognize that NDFs are not FX forwards. But that is a different question than whether funds that trade NDFs should be subject to the restrictions and limitations as set out in the Proposed Rule, given that NDFs are functionally and economically indistinguishable from FX forwards. For the reasons presented in text, they should not.

[22] Laura Lipscomb, "*Federal Reserve Bank of New York, An Overview of Non-Deliverable Foreign Exchange Forward Markets*," at 2 (May 2005) ("**Fed NDF Overview**").

[23] *Id.*

NDFs are a key component of FX markets in non-deliverable currencies, as FX forwards are not capable of being executed in those markets (or, in some markets, it is sufficiently impractical to physically deliver the local currency that would be traded on a forward basis). Indeed, for non-deliverable currencies, an NDF is the only viable means by which to effect a forward transaction. And, just like FX forwards, NDFs typically are of a short duration and mature in much less time than many other types of derivatives.[24] Virtually all mature in one year or less, and over 90% of volumes are transacted in tenors of three months or less.[25]

To be sure, FX forwards involve an exchange of the paired currencies at maturity, whereas NDFs involve a net payment in a specified currency based on spot exchange rates at maturity. However, the distinction between physical settlement in FX forwards and net settlement in NDFs should not be determinative with respect to the issue of limitations and restrictions on funds' ability to make use of these instruments. NDFs essentially are FX forwards where the currency itself is non-deliverable. NDFs bear the same key economic characteristics as FX forwards—short duration, limited exposure to market fluctuations, and no material counterparty or settlement risk. Were one to simultaneously enter into an FX forward and an NDF with identical underlying currencies, notional amount and maturity date, the value of the transactions would be identical throughout their tenor.

The CFTC and the European Securities Markets Authority ("**ESMA**") have recognized the low-risk profile of NDFs, as compared to other derivatives such as interest rate and credit default swaps, as they both have declined to impose a clearing mandate for NDFs pursuant to the Dodd-Frank Act. The discussion during a meeting of the CFTC's Global Markets Advisory Committee regarding a possible clearing mandate for NDFs noted "the very short date[d] nature of this market."[26] And in response to its consultation on the question, ESMA received comments stating that the average interbank maturity of NDFs is "short, around one or two months," and characterized by "reduced volatility" because "most FX rates on which NDFs trades are based are heavily managed or influenced by Central Bank activity."[27]

As with FX forwards, the risks of derivatives trading identified in the Proposed Rule—that a fund might amass through undue speculation an exposure that, over an extended period of time, imperils its ability to meet its obligations in the regular course of its operations—are not present for NDFs as with other types of derivatives. In failing to account for these fundamental differences in the characteristics of NDFs, as with FX forwards, the Proposed Rule paints with too broad a brush. NDFs, like FX forwards, should be excluded from the definition of a "derivatives transaction" in any final rulemaking.

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[24] *See* Sangita Misra and Harendra Behera, "*Non Deliverable Foreign Exchange Forward Market: An Overview*," at 30 (Winter 2006) ("for most of the [Asian NDF] currencies, there is limited liquidity in contracts with a maturity over one year.").

[25] *See* CFTC Foreign Exchange Markets Subcommittee Memorandum to CFTC Global Markets Advisory Committee, Response to request for recommendation on an FX NDF mandate, at 3 (Dec. 5, 2014), available at http://www.cftc.gov/idc/groups/public/@aboutcftc/documents/file/gmac_fxndfmandate122214.pdf.

[26] *See* Transcript, Global Markets Advisory Committee, at 50 (Oct. 9, 2014) (statement of Chris Allen, Barclays), available at http://www.cftc.gov/idc/groups/public/@aboutcftc/documents/file/gmac_100914_transcript.pdf.

[27] *See* Reply form for the Consultation Paper on the Clearing Obligation under EMIR (no. 3), Asociacion de Mercados Financieros, at 8, available at https://www.esma.europa.eu/file/12220/download?token=W-Dx5KYd.

C. The Proposed Rule Should Clarify its Exclusion for Purchased Options, and Fails to Appropriately Consider the Distinguishing Characteristics of Other FX Options

FX options traded on Refinitiv's electronic platform are limited-risk instruments. Like the other FX Derivatives discussed herein, they are also short-term transactions. Most have maturities less than one month, and virtually all have maturities less than one year. The risk of such instruments can be effectively managed by a fund's advisor without the broad-brush VaR-based limits and regulatory requirements that the Proposed Rule would impose on longer-dated, more highly leveraged, and riskier derivatives instruments.

Indeed, the preamble discussion in the Proposed Rule indicates that the Commission does not intend for purchased options to fall within the definition of a "derivatives transaction."[28] Refinitiv agrees, but believes that this conclusion is not necessarily apparent from the text of the proposed definition of the term "derivatives transaction" itself.[29] We urge the Commission to exclude purchased options (including FX options) directly in the rule text itself, rather than addressing the issue through non-contiguous passages in the lengthy preamble discussion.

We also urge the Commission to exclude written "covered calls" from the definition of the term "derivatives transaction." A fund that writes (*i.e.*, sells) a call option receives payment of a premium from the holder (*i.e.*, the purchaser) of the option, and in return must deliver the underlying asset at a pre-agreed price if the holder exercises the option. Such a call option thus would fall within the "derivatives transaction" definition under the Proposed Rule.

However, a fund that writes a covered call option owns the security or other asset underlying the option, thereby eliminating its downside risk. Because the delivered asset is in the fund's inventory, the covered call is a riskless financial obligation to the fund. Given that the fund's obligation under the call option is covered by its ownership of the asset to be delivered, writing the option cannot be considered undue speculation, nor does it present the concern that the fund will have to dispose of investments to meet its obligations under the call option as exists with respect to highly-leveraged derivatives instruments. Accordingly, since the concerns addressed by the ICA are not present in a covered call, these options should be excluded from the definition of a "derivatives transaction" that is subject to the Proposed Rule.

D. The Proposed Rule Should Entirely Exempt FX Derivatives Used for Hedging Purposes

Asset managers rely upon FX Derivatives to mitigate commercial risk associated with their investment strategies, specifically with respect to short-term fluctuations in foreign

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[28] *See*, *e.g.*, Proposed Rule, 85 Fed. Reg. at 4456 ("A derivative that does not impose any future payment obligation on a fund generally resembles a securities investment that is not a senior security, in that it may lose value but will not require the fund to make any payments in the future.").

[29] The text of the proposed definition refers both to options, and also to derivatives instruments under which a fund "may be required to make any payment or delivery of cash or other assets." Any final rule text should be clear that this language does not encompass purchased options.

currency values.[30] FX Derivatives therefore play a critical role in facilitating access to global markets (and, in the case of NDFs, to certain emerging markets in particular) for funds and their investors.

We therefore appreciate the Commission's decision to propose an exception from certain of the proposed requirements for funds that use derivatives solely for currency hedging purposes, because the Commission's prior proposed rule on the subject did not contain any such exception. However, the proposed exception extends only to funds that solely use derivatives to hedge currency risk, and would require that derivatives instruments be tied to "specific hedged investments (foreign-currency-denominated securities held by the fund)."[31]

We believe these limitations are ill-advised and will have little benefit in practice. First, we do not believe there is any policy reason to restrict funds from relying on this exception if they use derivatives for hedging and non-hedging purposes. A fund that uses some derivatives for investment purposes and FX Derivatives for hedging purposes is still merely hedging its currency risk with its FX Derivatives. Such a fund should not be required to subject those FX Derivatives to the proposed VaR-based limitations and other proposed requirements, when a fund that enters into the same FX Derivatives without the derivatives for investment purposes could rely on the Commission's proposed exception.

Second, limiting the proposed exception to hedges that are directly tied to foreign-currency-denominated securities held by a fund is too narrow to be useful. For example, a fund could wish to hedge foreign currency risk associated with incoming payment streams through the use of FX Derivatives, which would not satisfy this requirement. Additionally, though, hedges are often imperfect (as the Commission noted[32]), so any requirement that hedges be strictly related to specific securities already held by the fund may be impractical to comply with.

To the extent that the Commission is concerned that a broader hedging exception would make it difficult to confirm compliance, we respectfully disagree. Government regulations that account for (and provide exemptions or exceptions associated with) hedging activity are common in a variety of contexts. Indeed, the Commission itself has set hedging standards before. For example, in further defining the term "major security-based swap participant" pursuant to authority granted under the Dodd-Frank Act, the Commission (jointly with the CFTC) adopted a new rule specifically defining the phrase "hedging or mitigating commercial risk." The rule sets forth a general definition, and then specifically identifies certain security-based swap positions that, "[d]epending on the applicable facts and circumstances . . . may be expected" to fall within that general definition. These include positions established to manage equity or market risk in

[30] In the Determination, Treasury noted that FX forwards and FX swaps are "predominantly used as a source of funding to hedge risk associated with short-term fluctuations in foreign currency values and to manage global cash-flow needs." Determination, 77 Fed. Reg. at 69694.

[31] Proposed Rule, 85 Fed. Reg. at 4488.

[32] *See id.* at 4488 n.293.

certain circumstances, bank positions established to manage counterparty risk in connection with loans, and positions established to manage default risk in identified scenarios.[33]

As another example, the CFTC's rule governing when a non-financial entity may elect the end-user exception from mandatory clearing of interest rate and credit default swaps includes a requirement that the swap be used to hedge or mitigate commercial risk. It further provides that a swap meets that standard if it is "economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, where the risks arise from [among other things] [a]ny fluctuation in interest, currency, or foreign exchange rate exposures arising from a person's current or anticipated assets or liabilities."[34]

In Europe, the European Market Infrastructure Regulation ("**EMIR**") provides that in calculating whether it is subject to clearing requirements, a non-financial counterparty shall include OTC derivatives contracts "which are not objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity of the non-financial counterparty." ESMA was specifically directed to develop regulatory technical standards specifying criteria for establishing which OTC derivatives contracts satisfy that standard.[35] It did so in Commission Delegated Regulation 149/2013, where it concluded that a derivative contract "shall be objectively measurable as reducing risks" if, among other things, it: (1) "covers risks arising from the potential indirect impact on the value of assets . . . resulting from fluctuation of interest rates, inflation rates, foreign exchange rates or credit risk;" or (2) qualifies as a hedging contract pursuant to certain financial reporting standards adopted in the EU.[36]

We appreciate that bright-line rules can provide an attractive administrative convenience, particularly with limited agency resources. However, Refinitiv respectfully submits that if the Commission, ESMA, the CFTC, and market participants are able to apply hedging standards to determine whether a market participant is a major security-based swap participant, or is eligible for the end-user clearing exception in the US, or is subject to a clearing obligation in Europe, then hedging standards can be developed and applied to establish that FX Derivatives need not be subject to the trading limits and requirements of the Proposed Rule (even if a fund uses derivatives for other purposes, as well). Before sweeping FX Derivatives into one-size-fits-all trading limitations and regulatory requirements, it is incumbent upon the Commission to

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[33] *See* rule 3a67-4 under the Exchange Act; *see also 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).

[34] Rule 50.50(c)(1)(i)(F) under the CEA. The Commission's proposed end-user clearing exception rule similarly includes a requirement that the security-based swap be used to hedge or mitigate commercial risk, and incorporates the definition of "hedging or mitigating commercial risk" in rule 3a67-4 under the Exchange Act, discussed above. *See* proposed rule 3Cg-1 under the Exchange Act; *see also End-User Exception to Mandatory Clearing of Security-Based Swaps,* Exchange Act Release No. 63556 (Dec. 15, 2010), available at http://www.sec.gov/rules/proposed/2010/34-63556.pdf.

[35] *See* Regulation (EU) No 648/2012 of the European Parliament and of the Council, *OTC Derivatives, Central Counterparties and Trade Repositories,* Article 10 (July 4, 2012), available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32012R0648.

[36] *See* Commission Delegated Regulation (EU) No 149/2013, Chapter VII, Article 10 (Dec. 19, 2012), available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:052:0011:0024:EN:PDF.

determine whether the purposes for which funds enter into such transactions require such treatment.

III. Conclusion

In light of the unique characteristics of FX Derivatives as compared to other types of derivatives instruments, and the purposes for which FX Derivatives are used by funds as described above, FX Derivatives should be excluded from the definition of the term “derivatives transaction” in any final rulemaking in this area.

Refinitiv appreciates the opportunity to provide the Commission with its perspective on the foregoing aspects of the Proposed Rule, as well as certain of the questions posed therein. If you have any questions regarding our comments, please contact the undersigned a[redacted]

Respectfully submitted,

Michael W. Rooney

Michael Rooney
Chief Compliance Officer
Refinitiv US SEF LLC

AmericasActive:14612037.2