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March 28, 2016

## **By Electronic Mail**

Mr. Brent J. Fields  
Secretary  
Securities and Exchange Commission  
100 F Street NE.  
Washington, DC 20549–7010

*Re: Proposal Regarding Use of Derivatives by Registered Investment Companies and Business Development Companies*

Dear Mr. Fields,

Markit appreciates the opportunity to comment on the Securities and Exchange Commission (“SEC” or “Commission”) proposal regarding the Use of Derivatives by Registered Investment Companies and Business Development Companies (the “Proposal”).<sup>1</sup> Markit (NASDAQ: MRKT)<sup>2</sup> is a global financial information services company, offering independent data, valuations, risk analytics, trade processing, and related services across regions, asset classes and financial instruments.

Markit’s derivatives processing platforms are widely used by market participants, swap execution facilities (“SEFs”), and brokers to increase operational efficiency, reduce cost, and ensure legal certainty. Globally over 2,000 firms use the various Markit trade processing platforms that process, on average, 90,000 derivative transaction processing events per day. Markit’s trade processing platforms form an important element of derivatives workflows, particularly in the credit, equity, interest rate, and foreign exchange asset classes. Markit’s securities-based swap matching platform currently operates as an exempt clearing agency, as provided for under SEC rules.<sup>3</sup>

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<sup>1</sup> 80 Fed. Reg. 80,884 (Dec. 28, 2015), available at <https://www.gpo.gov/fdsys/pkg/FR-2015-12-28/pdf/2015-31704.pdf>.

<sup>2</sup> Please see [www.markit.com](http://www.markit.com) for further information.

<sup>3</sup> See, e.g., Exchange Act Release No. 34–64796 (July 1, 2011), 76 Fed. Reg. 39,963 (July 7, 2011) (providing an exemption from registration under Section 17A(b) of the Exchange Act, and stating that “[t]he Commission is using its authority under section 36 of the Exchange Act to provide a conditional temporary exemption [from clearing agency registration], until the compliance date for the final rules relating to registration of clearing agencies that clear security-based swaps pursuant to sections 17A(i) and (j) of the Exchange Act, from the registration requirement in Section 17A(b)(1) of the Exchange Act to any clearing agency that may be required to register with the Commission solely as a result of providing Collateral Management Services, Trade Matching Services, Tear Up and Compression Services, and/or substantially

Markit is also a major source of derivatives pricing and reference data. Markit's Pricing Data offers live, snapped and end-of-day price updates for approximately 2,600 CDS entities and the major credit derivatives indices, CDX and iTraxx.<sup>4</sup> Markit's Reference Entity Database ("RED") platform<sup>5</sup> has been providing legally verified reference data across asset classes, including for credit derivatives.<sup>6</sup>

## I. Executive Summary

**We recommend the Commission reconsider proposed rule 18f-4(a)(1)'s prescriptive limits on funds' use of derivatives as a mandatory aspect of funds' derivatives risk management programs because this approach is (1) counterproductive with respect to reducing the risks associated with funds, (2) unnecessary in light of the Proposal's proposed derivatives risk management program requirement, and (3) the data that would support a more informed policy in this area that would come out of yet-to-be-finalized Form N-PORT disclosure obligations set forth in the Commission's proposed rulemaking concerning "Investment Company Reporting Modernization."**

## II. Discussion

The Proposal would impose certain limits on registered investment companies, including mutual funds and exchange-traded funds, closed-end funds, and business development companies' (collectively "funds") utilization of derivatives as a part of an investment or risk hedging strategy. Specifically, the Proposal's rule 18f-4 would do this by limiting funds' ability to transact in derivatives and specific senior securities, i.e. "financial commitment transactions" and indebtedness related to senior securities transactions, if the aggregate senior securities exposure ("SSE")<sup>7</sup> of the fund exceeds one of two portfolio limitations (proposed rule 18f-4(a)(1)):

- (i) 150% of the fund's net assets; unless

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similar services for security-based swaps" (emphasis added)). The Commission has indicated that "it may consider at a later time whether rules tailored to clearing agencies that provide post-trade processing services would be appropriate." Clearing Agency Standards; Final Rule, 76 Fed. Reg. 66,220, at 66,288 (Nov. 2, 2012).

<sup>4</sup> Markit Pricing Data, <http://www.markit.com/Product/Pricing-Data-CDS>.

<sup>5</sup> Markit RED Primer, [http://www.markit.com/assets/en/docs/products/data/indices/credit-index-annexes/Markit\\_RED\\_Primer.pdf](http://www.markit.com/assets/en/docs/products/data/indices/credit-index-annexes/Markit_RED_Primer.pdf).

<sup>6</sup> For CDS, LCDS, ABCDS, Bonds and Loans.

<sup>7</sup> The SSE would be defined as the sum of (1) the aggregate notional amounts of the fund's derivatives transactions (subject to certain exceptions), (2) the aggregate obligations of the fund under its financial commitment transactions, and (3) the fund's aggregate indebtedness with respect to any other senior securities transactions.

- (ii) the fund's full portfolio Value-at-Risk ("VaR"), including derivatives positions, is less than the fund's securities VaR, excluding derivatives positions, in which case the limitation would be set at 300% of the fund's net assets.

We recommend the Commission reconsider the Proposal's one-size-fits-all limitation on funds' use of derivatives as a mandatory aspect of funds' derivatives risk management programs. We note that this proposed approach is (1) counterproductive with respect to reducing the risks associated with funds, (2) unnecessary in light of the Proposal's proposed derivatives risk management program requirement, and (3) the data that would support a more informed policy in this area that would come out of yet-to-be-finalized Form N-PORT disclosure obligations set forth in the Commission's proposed rulemaking concerning "Investment Company Reporting Modernization."<sup>8</sup>

First, the proposed rule 18f-4(a)(1)(ii) limitation on derivatives exposures in contexts where the derivatives exposure reduces the fund's overall VaR is counterproductive because applying the hard limit in those circumstances would increase the market risk of a portfolio. By limiting such risk-reducing derivatives exposures, the Commission would increase fund market risk with no discernible overall risk reduction benefit.

Second, with respect to the Proposal's derivatives risk management program requirement, we note that it applies broadly to funds, i.e. those funds with significant SSEs ( $\geq 50\%$  of net asset value ("NAV")) and those that engage in riskier, "complex derivatives transactions."<sup>9</sup> The derivatives risk management program would generally require from proposed rule 18f-4(a)(3) the assessment of "the risks associated with the fund's derivatives transactions, including an evaluation of potential leverage, market, counterparty, liquidity, and operational risks, as applicable, and any other risks considered relevant."<sup>10</sup> When and if such risks would be addressed through limits on derivatives exposures, funds could impose such limits appropriate to their portfolio. This more tailored approach would address the Commission's concerns without unnecessarily inhibiting the use of derivatives as a part of an investment or hedging strategy.

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<sup>8</sup> Investment Company Reporting Modernization; Proposed Rule, 80 Fed. Reg. 33,590 (June 12, 2015), <https://www.gpo.gov/fdsys/pkg/FR-2015-06-12/pdf/2015-12779.pdf>. We therefore agree with Commissioner Piwowar when he stated that "[a]doption of [the Investment Company Reporting Modernization Proposal] would provide investors and the Commission with a much better understanding of funds' derivatives use and exposures, which should address many of the concerns regarding funds use of derivatives for leveraging purposes. In addition, it would provide the Commission with much needed data that can be analyzed..." Dissenting Statement at Open Meeting on Use of Derivatives by Registered Investment Companies and Business Development Companies, Dec. 11, 2015, <https://www.sec.gov/news/statement/piwowar-dissenting-statement-use-of-derivatives-funds.html>.

<sup>9</sup> "Complex derivatives transactions" would be defined as derivatives providing for payments that are dependent on the value of a reference asset at multiple points in time, or on a non-linear function of the value of the reference asset.

<sup>10</sup> Proposed rule 18f-4(a)(3).

Third and finally, with respect to the Investment Company Reporting Modernization proposal (“ICRM Proposal”), that proposal would provide the Commission and the public transparency into the use of derivatives and leverage. For example, the ICRM Proposal would require:

1. Disclosure of portfolio-level calculation of duration and spread duration across the applicable maturities in the fund’s portfolio invested in debt instruments or derivatives that provide exposure to debt instruments or interest rates, if these positions represent at least 20% of the fund’s notional exposure (proposed Item B.3.);
2. Disclosures of position-level valuations and net gains or losses associated with derivatives (proposed Items B.5. and C.2.); and
3. Disclosure of counterparty- and transaction-level information and data about certain fund activities such as securities lending, repurchase agreements, reverse repurchase agreements, and derivatives contracts (proposed Item C.11.).

These disclosures would more than provide the SEC the information and data it needs to determine whether prescriptive, portfolio-level limitations are necessary and to support that finding with empirical data and analysis. Through the use of that data, the Commission would be able to use better information to establish any prescriptive portfolio limitations on derivatives and other senior securities, enabling it to set those limits at an appropriate level, if those limitations are warranted. We therefore recommend that the Commission withdraw the exposure limits set forth in proposed rule 18f-4(a)(1) in any final rulemaking.

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Markit appreciates the opportunity to provide these comments to the Commission. We would be happy to elaborate on or further discuss any of the points addressed above. If you or your respective staffs have any questions, please do not hesitate to contact the undersigned or Salman Banaei at [REDACTED].

Yours sincerely,



Marcus Schüler  
Head of Regulatory Affairs  
Markit  
[REDACTED]