Comment to SEC relative to proposal on Use of Derivatives for Mutual Funds File Number S7-24-15

ic-31933.pdf: Use of Derivatives by Registered Investment Companies and Business Development Companies

Page 89:
Should we consider permitting or requiring that the notional amounts for interest rate futures and swaps be adjusted so that they are calculated in terms of 10-year bond equivalents ***or make other duration adjustments to reflect the average duration of a fund that invests primarily in debt securities****? Would this result in a better assessment of a fund's exposure to interest rate risk? Why or why not?*

In properly dealing with interest rate futures and swaps in a fund taking into account: margin call risk (variation margin), counterparty risk and delivery risk, we believe the best consideration is to consider the interest rate risk (the duration) separately from the delivery risk. This is similar to the way in which we think about currency forwards exposure. This ensures the separation between "leverage /market risk" and "delivery obligation risk".

In using a future or swap contract to gain exposure to the market, a fund is subject to movements in interest rates over the life of the product. The change in the market value of the contract (which is affected by changes in interest rates) is, and should be, taken into account through daily margin calls and the required cash posted for this. The risk related to physical delivery requirement is a separate aspect that can be solved by allowing for a clear investment policy and standardized agreement/policy with counterparties, the same as we have been able to do with currency forwards – effectively ensuring cash, not physical, delivery prior to maturity of the contract. The duration adjustment procedure does help in calculating how the fund is exposed to daily moves in interest rate duration and margin is done daily.

That said, in addition to the ability to allow for a standardized agreement in which cash delivery is ensured, we think it is a good idea to permit the notional amounts for interest rate futures and swaps to be calculated in terms of 10-year bond equivalents.

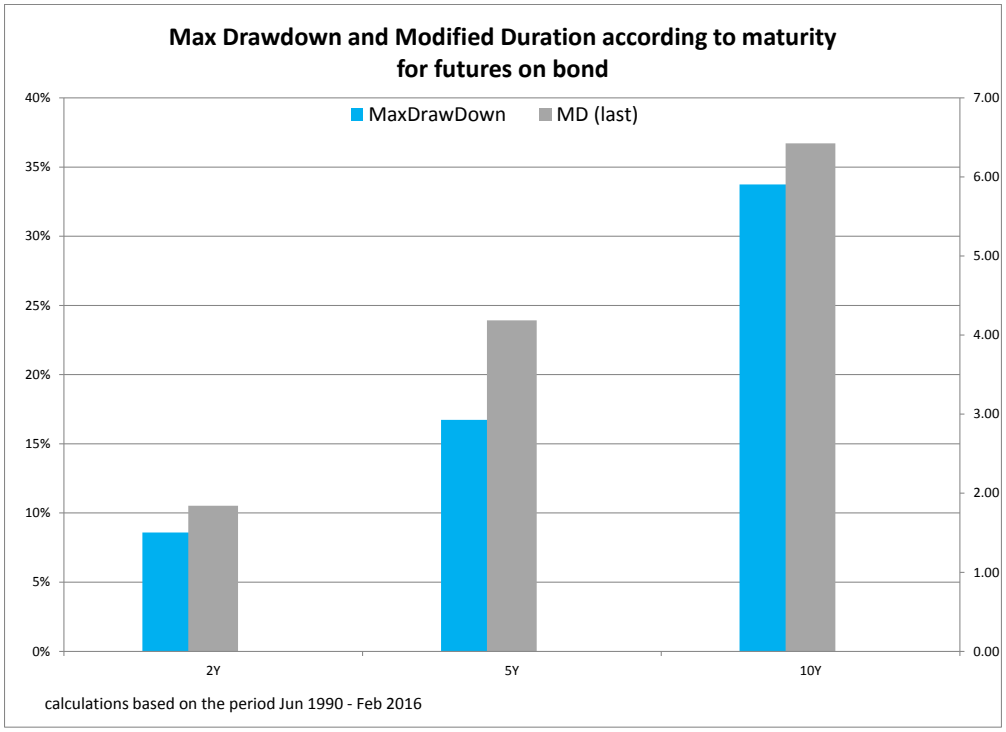
The main reason we make this recommendation is that in our strategies we look at risk on interest rate futures in modified duration terms and not necessarily in notional exposure terms.

To respect the spirit of the leverage limitation in mutual funds and to protect the investor against excessive risk or potential default by a mutual fund, it is indeed relevant to adjust for the effective maturity of interest-rate derivatives. We illustrate it with the following charts: there is a high correlation between maturity and risk (measured as maximum drawdown or volatility) that has to be recognized. So increasing exposure to a 2-year bond by a given percentage is not equivalent to increasing by the same percentage exposure to a 10-year bond.

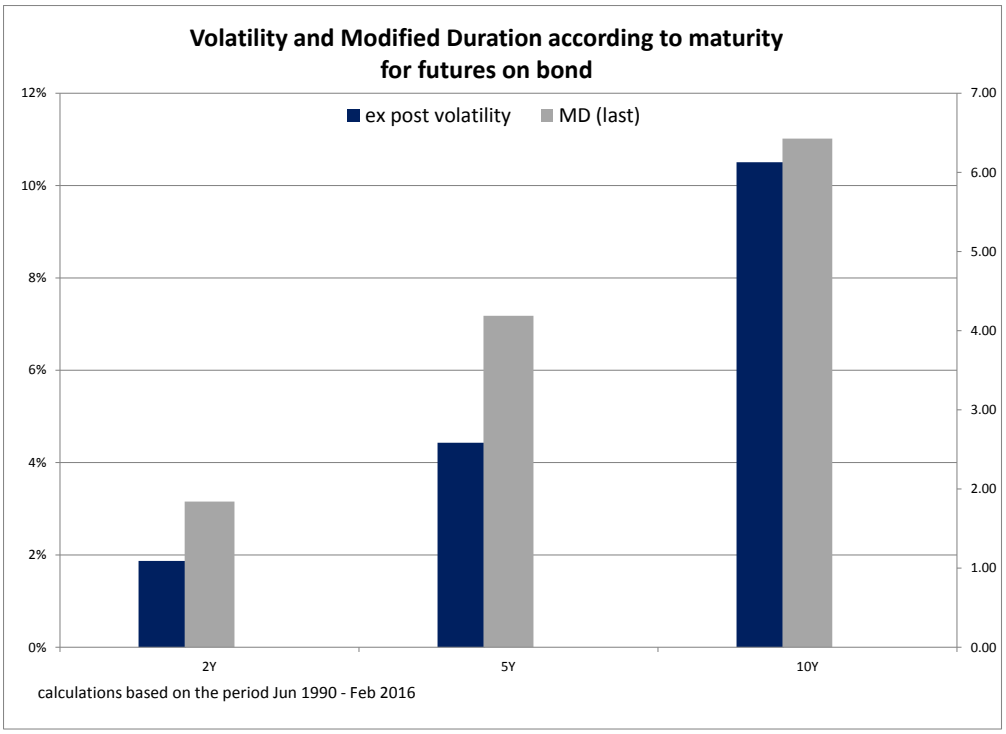
Below is a table of calculations in support of our proposal (based on a $100mm NAV)

Bottom line: an equal contribution to modified duration (MD) should result in the same exposure measurement for leverage purposes.

FUTURES				current calculation	Our proposal		
ticker	Name	Asset	# contracts	Exposure	Exposure proposal for SEC requirement	Contribution to Modified Duration (bps)	MD
TUH6	US 2YR NOTE (CBT) Mar16	US 2-year	26	**5.6%**	**1.6%**	**10**	1.77
FVH6	US 5YR NOTE (CBT) Mar16	US 5-year	21	**2.5%**	**1.6%**	**10**	4.07
TYH6	US 10YR NOTE (CBT)Mar16	US 10-year	12	**1.6%**	**1.6%**	**10**	6.29
WNH6	US ULTRA BOND CBT Mar16	US 30-year	4	**0.6%**	**1.6%**	**10**	16.9
DUH6	EURO-SCHATZ FUT Mar16	Germany 2-year	46	**5.7%**	**1.1%**	**10**	1.8
OEH6	EURO-BOBL FUTURE Mar16	Germany 5-year	15	**2.2%**	**1.1%**	**10**	4.6
RXH6	EURO-BUND FUTURE Mar16	Germany 10-year	6	**1.1%**	**1.1%**	**10**	8.9
UBH6	EURO BUXL 30Y BND Mar16	Germany 30-year	3	**0.6%**	**1.1%**	**10**	17.5
WBH6	SHORT GILT FUTURE Mar16	UK 2-year	46	**6.8%**	**1.3%**	**10**	1.5
G H6	LONG GILT FUTURE Mar16	UK 10-year	8	**1.3%**	**1.3%**	**10**	7.6
UGLH6	ULTRA LONG GILT F Mar16	UK 30-year	3	**0.5%**	**1.3%**	**10**	19.9
YMH6	AUST 3YR BOND FUT Mar16	AUSTRALIA 2-year	43	**3.6%**	**1.3%**	**10**	2.8
XMH6	AUST 10Y BOND FUT Mar16	AUSTRALIA 10-year	13	**1.3%**	**1.3%**	**10**	7.9



Amundi Smith Breeden
ASSET MANAGEMENT


Volatility and Modified Duration according to maturity for futures on bond
ex post volatility
MD (last)
12%
10%
8%
6%
4%
2%
0%
7.00
6.00
5.00
4.00
3.00
2.00
1.00
0.00
2Y
5Y
10Y
calculations based on the period Jun 1990 - Feb 2016