

Funds' Use of Derivatives

Appendix A

We are proposing a new regulatory approach for funds' use of derivatives. This includes proposed rule 18f-4 under the Investment Company Act of 1940, a new exemptive rule designed to address the investor protection purposes and concerns underlying section 18 of the Act and to provide an updated and more comprehensive approach to the regulation of funds' use of derivatives. The proposal also includes certain new proposed reporting requirements relating to funds' derivatives use. More information about our proposal is available at www.sec.gov/rules/proposed/2019/34-87607.pdf.

We are particularly interested in learning what small funds think about the requirements of proposed new rule 18f-4 and the proposed new reporting requirements. Hearing from small funds could help us learn how the proposed rule and new reporting requirements would affect these entities, and evaluate how we could address any unintended consequences resulting from the cost and effort of regulatory compliance while still promoting investor protection. We would appreciate your feedback on any or all of the following questions.

All of the following questions are optional, including any questions that ask about identifying information. *Please note that responses to these questions—including any other general identifying information you provide—will be made public.*

Item 1: General Identifying Information

Instructions: At your option, you may include general identifying information that would help us contextualize your other feedback on the proposal. This information could include responses to the following questions, as well as any other general identifying information you would like to provide. Responses to these items—like responses to the other items on this Feedback Flier—will be made public.

- a. How big is the fund in terms of net asset value? (This may be expressed in a range, for example, \$40 – \$50 million.)

- b. What is/are the principal investment strategy/strategies of the fund?

- c. Does the fund use derivatives transactions (as defined in the proposed rule) to pursue the fund's principal investment strategy/strategies? Yes No

- d. Is the fund part of a fund complex? Yes No

- e. Please include any additional general identifying information that you wish to provide, that could add context for your other feedback on the proposal.

Item 2: Derivatives Risk Management Program

Instructions: If you believe the fund would be required to adopt and implement a derivatives risk management program under the proposed rules, please answer the following questions. If you do not believe so, please proceed to Item 4.

- a. The proposed derivatives risk management program requirement would include the following seven elements. In the following chart, please indicate which of the proposed program elements you think would be the most expensive for the fund to implement and which would be least expensive to implement, by ranking the following elements from one (1) – most expensive – through seven (7) – least expensive – using each number only once. If you have any comments about the factors informing your analysis, please include.

Derivatives Risk Management Program Elements	Rank by Cost (1 – most expensive; 7 – least expensive) Use each number once	Comments
a. Risk identification and assessment		
b. Risk guidelines		
c. Stress testing		
d. Backtesting		
e. Internal reporting and escalation		
f. Periodic review of the program		
g. Board reporting and oversight		

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b. Implementation timing.

1. How many months do you think it would take the fund to adopt and implement a derivatives risk management program (check one box)?

6 – 12 months	12 – 18 months	18 – 24 months	> 24 months
<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

2. If the response above is more than 12 months, what would help to shorten that time period?

3. Please provide any explanatory notes that you would like to include.

c. Implementation cost.

1. Approximately how much do you think it would cost the fund to implement a derivatives risk management program (in terms of combined internal and external costs) (check one box)?

Estimated cost (\$)			
\$0 – \$150,000	\$150,001 – \$350,000	\$350,001 – \$500,000	> \$500,000
<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

2. Please include any explanatory notes that you would like to provide. These could describe, for example, how a fund that is part of a fund complex might share these costs, any particular cost considerations for a fund that uses sub-advisers, or the extent to which the estimated costs would arise from internal versus external costs (such as those associated with third-party service providers).

Item 3: Limit on Fund Leverage Risk

Instructions: The proposed rule would require certain funds to comply with a limit on fund leverage risk based on value at risk (“VaR”). The following questions relate to this proposed requirement.

a. Does the fund currently use VaR testing? Yes No

b. Implementation cost.

1. If you anticipate that, if the proposed rules were adopted, the fund would have to comply with the VaR testing requirement, approximately how much do you think it would cost the fund to implement the proposed VaR test requirements (in terms of combined internal and external costs) (check one box)?

Estimated cost (\$)			
\$0 – \$25,000	\$25,001 – \$50,000	\$50,001 – \$75,000	> \$75,000
<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

2. Please include any explanatory notes that you would like to provide. These could describe, for example, how a fund that is part of a fund complex might share these costs, any particular cost considerations for a fund that uses sub-advisers, or the extent to which the estimated costs would arise from internal versus external costs (such as those associated with third-party service providers).

c. Use of relative VaR test and absolute VaR test.

1. Would the fund anticipate that it would use the proposed relative VaR test or the proposed absolute VaR test (check one box)?

Relative VaR test	Absolute VaR test
<input type="radio"/>	<input type="radio"/>

2. If you anticipate that you would use the proposed relative VaR test, and you already disclose a benchmark index for performance disclosure, do you anticipate that the index would also qualify as a designated reference index under the proposed rule? Yes No

Item 4: Limited Derivatives Users

Instructions: If you believe the fund would qualify as a limited derivatives user under the proposed rule, please answer the following questions. If you do not believe so, please proceed to Item 5.

- a. Please state which basis for the proposed limited derivatives user exception you think the fund would seek to rely on (check one box):

<p>Exposure-based test (The fund's derivatives exposure does not exceed 10% of the fund's net asset value)</p>	<p>Currency hedging exception (The fund only uses derivatives for currency hedging purposes as specified in the proposed rule)</p>
<input type="radio"/>	<input type="radio"/>

- b. Should the rule include any other bases for a fund to qualify as a limited derivatives user? What alternative approach and why?

- c. Implementation cost.

1. Approximately how much do you think it would cost the fund to adopt and implement policies and procedures reasonably designed to manage its derivatives risks (in terms of combined internal and external costs) (check one box)?

Estimated cost (\$)				
\$0 – \$25,000	\$25,001 – \$50,000	\$50,001 – \$75,000	\$75,001 – \$100,000	> \$100,000
<input type="radio"/>				

2. Please include any explanatory notes that you would like to provide.
