



## U.S. Securities and Exchange Commission

### Speech by SEC Chairman: Opening Statement at SEC Open Meeting Item 1 – Use of Derivatives by Funds

*by*

**Chairman Mary Schapiro**

*U.S. Securities and Exchange Commission*

Washington, D.C.  
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Good morning. This is an open meeting of the U.S. Securities and Exchange Commission on August 31, 2011.

Today we will consider whether to issue three separate releases soliciting public comment on issues arising under the Investment Company Act of 1940.

- The first relates to the use of derivatives by mutual funds and other investment companies regulated under that Act.
- The next two are companion releases regarding who is considered to be – and not to be – an “investment company” as that term is defined under the Act. In particular, we focus on asset-backed securities issuers and issuers that are in the business of acquiring mortgages and mortgage-related instruments.

The derivatives, asset-backed and mortgage markets have undergone significant changes in recent years. And the Commission is taking this opportunity to seek public comment in order to help ensure that our regulatory approach and interpretations under the Investment Company Act remain current, relevant, and consistent with investor protection.

#### **Concept Release on Mutual Funds’ Use of Derivatives**

The first item on the agenda involves the use of derivatives by funds.

In March 2010, the Commission announced a staff review of the use of derivatives by mutual funds, exchange traded funds, and other investment companies regulated under the Investment Company Act. That review focuses on the growing use of derivatives by funds and on whether the regulatory guidance surrounding that use can be improved.

The concept release we are considering today would inform our review and help us determine whether we should update the regulatory regime for the benefit of fund investors.

## Background

We face this issue today because in 1940, when the Investment Company Act was adopted, derivatives as we now know them did not exist. The Act imposes important leverage, valuation, diversification, and industry concentration requirements to help protect fund investors. However, those limitations were written with stocks and bonds in mind, not complex financial derivatives. As a result, fund investments in derivatives are not always wholly captured by the statutory limitations and requirements. Or if captured, the measures may not be quite right.

The controls in place to address fund investments in traditional securities can lose their effectiveness when applied to derivatives. This is particularly the case because a relatively small investment in a derivative instrument can expose a fund to a potentially substantial gain or loss – or outsized exposure to an individual counterparty.

The Commission's approach to the regulation of funds' use of derivatives has developed on an ad hoc basis as new derivative instruments were introduced and new derivative hedging strategies gained popularity.

## Current Review of Funds' Use of Derivatives

The current derivatives review gives us the opportunity to re-think our approach to regulating funds' use of derivatives. We are engaging in this review with a holistic perspective, in the wake of the financial crisis, and in light of the new comprehensive regulatory regime for swaps being developed under the Dodd-Frank Act.

But we want public input to help us get it right – input from those who use derivatives, input from those who invest in funds, and input from those who manage funds with derivatives strategies.

I very much look forward to commenter input as we continue our in-depth review of the role of derivatives in fund portfolios and improvements that can be made to the regulatory regime.

Before I turn it over to the staff, I would first like to thank those who worked very hard to develop the concept release before us today.

From the Division of Investment Management: Eileen Rominger, Doug Scheidt, Nadya Roytblat, Ned Rubenstein, Steve Van Meter, and Michael Didiuk.

This group was assisted by Mark Cahn, Meridith Mitchell, David Blass, Lori Price, Bob Bagnall, and Sarah Buescher in the Office of the General Counsel; Craig Lewis, Bruce Kraus, Harvey Westbrook, Adam Glass, Kelsey Pristach, and John Niarhos in the Division of Risk, Strategy, and Financial Innovation; Jim Reese in the Office of Compliance Inspections and Examinations; Thomas Eady, Jack Habert and Gregg Berman in the Division of Trading and Markets; and Amy Starr in the Division of Corporation Finance.

<http://www.sec.gov/news/speech/2011/spch083111mls-item1.htm>

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