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SEC Proposes Significant New Restrictions on the Use of Derivatives and Other Transactions by Registered Funds and BDCs

A legal update from Dechert's Financial Services Group

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The Securities and Exchange Commission (Commission) on December 11, 2015 proposed new Rule 18f-4 (Proposed Rule) under the Investment Company Act of 1940 (1940 Act) and amendments to certain proposed forms. The proposal relates to the use of derivatives and other transactions by registered investment companies – open-end funds, including exchange-traded funds (ETFs), and closed-end funds – and business development companies (BDCs) (collectively, funds).[1]

The Proposed Rule would provide exemptive relief to "permit a fund to enter into derivatives and certain financial commitment transactions, notwithstanding the prohibitions and restrictions on the issuance of senior securities under Section 18 of the [1940 Act]," subject to various conditions. The Proposed Rule would supersede prior Commission guidance relating to the use of derivatives, notably so-called "Release 10666" and the related staff guidance, which would be rescinded upon the Commission's adoption of the Proposed Rule, subject to a transition period.[2] Accordingly, if the Proposed Rule is adopted, subsequent to the transition period, funds could only enter into derivatives transactions and financial commitment transactions (defined below) in accordance with the requirements of the Proposed Rule or Sections 18 (or 61, in the case of BDCs) of the 1940 Act.[3]

The conditions applicable under the Proposed Rule would include:

1. Alternative 150% and 300% leverage-based portfolio limitations for funds that utilize derivatives.

- The "aggregate exposure" of a fund would not be permitted to exceed (i) 150% of the value of a fund's net assets or, alternatively, (ii) 300% of the value of the fund's net assets provided that the use of derivatives by the fund reduces the fund's market risk, as determined using a value at risk (VaR) methodology.

- "Aggregate exposure" would include (i) the aggregate notional amounts of the fund's derivatives transactions (netting certain directly offsetting derivatives transactions), (ii) the aggregate obligations under the fund's financial commitment transactions and (iii) the fund's aggregate indebtedness with respect to any other senior securities transaction.

- A "financial commitment transaction" would include any reverse repurchase agreement, short sale borrowing, or any firm or standby commitment agreement or similar agreement, including certain conditional and unconditional unfunded commitments often entered into by closed-end funds and BDCs.[4]

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1 *See* Use of Derivatives by Registered Investment Companies and Business Development Companies, 80 Fed. Reg. 80,884 (Dec. 28, 2015) (Proposing Release). Comments on the Proposed Rule and proposed form amendments are due on or before March 28, 2016.

2 Proposing Release at 80,953-54; *see also* Securities Trading Practices of Registered Investment Companies, Investment Company Act Release No. 10666 (Apr. 18, 1979) (Release 10666).

3 Proposing Release at 80,953.

4 *Id.* at 80,900.

2. Uniform asset segregation requirements for derivatives and financial commitment transactions.

- A fund would be required to segregate cash and cash equivalents equal to the amount payable by the fund if the fund exits its derivatives transactions, as determined both under current and stressed conditions (with certain reductions for required margin).

- The fund would also be required to maintain cash or cash equivalents, which would include for this purpose certain assets convertible to cash or that will generate cash, with a value at least equal to the value of the fund's obligations under its financial commitment transactions (with certain reductions for amounts posted to counterparties).

3. Board-approved procedures and derivatives risk management program requirements.

The Commission states that the Proposed Rule is designed to provide an "updated and comprehensive approach" to the regulation of funds' use of senior securities and would address the "central investor protection purposes and concerns" underlying Section 18.[5] The portfolio limitation and asset segregation conditions are designed to (i) limit the leverage a fund may obtain through certain transactions and thereby avoid "undue speculation" concerns and (ii) require the fund to have assets available to meet its obligations under those transactions. In addition, the proposed condition relating to procedures and formalized risk management programs is designed to complement the portfolio limitation and asset segregation requirements.

The Commission's proposal represents dramatic changes to the regulatory regime governing funds' use of derivatives and financial commitment transactions. If adopted, the proposal's impact on many funds would be significant, particularly with respect to portfolio limitations and risk management practices. This shift in the Commission's approach to regulating funds' use of derivatives is consistent with the Commission's recent theme of addressing the "increasingly complex portfolio composition and operations of today's asset management industry."[6] Indeed, the Commission's proposal is the third of five significant regulatory initiatives originally announced by Chair Mary Jo White in December 2014. The Commission recently proposed the first two parts of this five-part plan – a proposal to modernize fund reporting and disclosure and a proposal to address funds' liquidity risk management practices.[7] The remaining proposals will include requirements for transition plans for client assets and stress tests for funds and advisers.[8] As was the case for the Liquidity Proposal, the Proposed Rule is highly technical and is based in part on information and analysis detailed in a white paper prepared by the Commission's Division of Economic and Risk Analysis (DERA) staff.[9]

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5 *Id.* at 80,885-86.

6 *See* Mary Jo White, Chair, SEC, Enhancing Risk Monitoring and Regulatory Standards for the Asset Management Industry (Dec. 11, 2014), available *here*.

7 For additional information on the proposal to modernize fund reporting and disclosure, see *Dechert OnPoint*, SEC Approves Proposal to Modernize Investment Company Reporting Regime. For additional information on the proposal to address funds' liquidity risk management practices (Liquidity Proposal), see *Dechert OnPoint*, SEC Proposes Sweeping Changes to Liquidity Risk Management Practices Used by Mutual Funds and ETFs.

8 Mary Jo White, Chair, Statement on Open-End Fund Liquidity Risk Management Programs and Swing Pricing, Securities and Exchange Commission (Sept. 22, 2015).

9 *See* Daniel Deli, Paul Hanouna, Christof W. Stahel, Yue Tang and William Yost, Use of Derivatives by Registered Investment Companies, SEC Division of Economic and Risk Analysis (Dec. 2015) (DERA White Paper).

Proposed Rule 18f-4

Background and Scope

Section 18 and Current Commission and Staff Guidance

Section 18(f)(1) and Section 18(a)(1) of the 1940 Act restrict the ability of open-end funds and closed-end funds to issue senior securities.[10] BDCs, with certain exceptions, are also subject to the limitations of Section 18(a) to the same extent as closed-end funds.[11] Section 18(g) defines a "senior security" as "any bond, debenture, note, or similar obligation or instrument constituting a security and evidencing indebtedness, and any stock of a class having priority over any other class as to distribution of assets or payment of dividends."

Among other things, the Congressional concerns underlying Section 18 include: (i) excessive borrowing and the issuance of excessive amounts of senior securities;[12] and (ii) funds operating without adequate assets and reserves.[13]

The Commission and its staff have historically taken positions that investments in many different types of derivatives and other transactions that have a leveraging impact fall within the definition of "evidence of indebtedness" and are potentially senior securities when they create leverage.[14]

In Release 10666, the Commission provided guidance that a fund could engage in transactions that may involve the issuance of senior securities if the fund maintained a segregated account of liquid assets to "cover" the transaction and limit the fund's risk of loss. Since then, the staff of the Commission's Division of Investment Management has provided guidance through no-action relief that allowed funds to "cover" derivatives transactions in a variety of ways, including through the use of offsetting transactions.[15]

Commission View on Current Practice

Currently, many funds apply a mark-to-market cover approach to certain derivatives, and some funds do so exclusively.[16] The Commission is concerned that this may not "impose an effective limit on leverage" or may fail to

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[10] Section 18(f)(1) prohibits an open-end fund from issuing or selling any senior security, except that the fund may borrow from a bank provided that immediately after any such borrowing there is asset coverage of at least 300% for all of the fund's borrowings. Section 18(a)(1) prohibits a closed-end fund from issuing or selling any "senior security that represents an indebtedness" unless it has at least 300% asset coverage for all borrowings.

[11] *See* Section 61(a). In contrast to closed-end funds, the asset coverage requirements applicable to senior securities issued by BDCs are 200% rather than 300% regardless whether the senior security is represented by indebtedness or preferred stock.

[12] Proposing Release at 80,887 n.30 (citing Section 1(b)(7) of the 1940 Act and Release 10666 n.8).

[13] *Id.* at 80,887 n.31 (citing Section 1(b)(8) of the 1940 Act and Release 10666 n.8).

[14] *See, e.g.*, Release 10666 at text accompanying n.14; Dreyfus Strategic Investing and Dreyfus Strategic Income, SEC No-Action Letter (June 22, 1987) (Dreyfus). "Leverage" means for these purposes "an obligation, or indebtedness, to someone other than the fund's shareholders [that enables] the fund to participate in gains and losses on an amount that exceeds its initial investment."

[15] *See, e.g.*, Dreyfus (permitting the use of offsetting positions); Merrill Lynch Asset Management, L.P., SEC No-Action Letter (July 2, 1996) (Merrill Lynch) (permitting the use of "any asset, including equity securities and non-investment grade debt . . . so long as the asset is liquid and marked to market daily").

[16] The Proposing Release notes that industry practices with respect to the appropriate cover amount – whether the notional amount or the mark-to-market amount currently due – and type of cover assets for various transactions have developed over time based "at least in part" on no-action letters and staff guidance. Proposing Release at 80,888-89.

require a fund to have adequate assets to meet its obligations.[17] However, the Commission acknowledges that a cover amount equal to the full notional value may cause funds to hold liquid assets in excess of the fund's potential payment obligations.[18]

Structure of Proposed Portfolio Limitations and Asset Segregation Requirements

In light of the Commission's concerns, the Proposed Rule would apply a bifurcated approach for derivatives transactions imposing both (i) a portfolio limitation requirement and (ii) an asset segregation requirement. These conditions are designed to address the Commission's undue speculation and asset sufficiency concerns, respectively.[19] The Commission believes this would be "more effective" than focusing solely on asset segregation.[20]

With respect to financial commitment transactions, the Commission believes that appropriate leverage limitations and requirements for the availability of assets were achieved under Release 10666.[21] The Proposed Rule therefore would apply an asset segregation approach similar to that taken in Release 10666 for those transactions.

Senior Securities Transactions Impacted Under the Proposed Rule

The Proposed Rule would define as a "senior security transaction":

- Derivatives transactions including any swap, security-based swap, futures contract, forward contract, option, any combination of the foregoing, or any similar instrument under which a fund may be required to make any payment or delivery.
- Financial commitment transactions (defined above).
- Transactions involving a senior security entered into pursuant to Section 18 or 61 of the 1940 Act outside of the exemption provided by the Proposed Rule (such as bank borrowings or issuance of preferred stock or senior debt).

Notably, the Proposed Rule would not apply to derivatives transactions that do not impose a payment obligation on the fund beyond its investment (i.e., the economic equivalent of leverage) such as purchased options or structured notes, or to securities lending activities. However, the Commission requests comment on whether these transactions should be covered by the Proposed Rule.[22]

Condition 1: Portfolio Limitations (150% and 300% Leverage Limits)

The Proposed Rule would require funds engaging in derivatives transactions to comply with one of two new portfolio limitations immediately after entering into any senior securities transaction.

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17 *Id.* at 80,893, 80,895.

18 *Id.* at 80,899. This is because the notional amount of a derivative often exceeds the amount of cash or assets a fund would likely need to pay or deliver thereunder. *Id.*

19 *Id.* at 80,898-99. The asset segregation requirement would also help address the undue speculation concern if funds limit derivatives use to comply with that condition. *Id.* at 80,925.

20 *Id.* at 80,899

21 *Id.* at 80,888.

22 *Id.* at 80,900-01.

Option 1: Exposure-Based Portfolio Limit (150%)

Under this option, a fund's "aggregate exposure" may not exceed 150% of the value of the fund's net assets.

Option 2: Risk-Based Portfolio Limit (300%)

This limit expands the permitted exposure amount if derivatives exposure reduces a fund's market risk. Under this option, if a fund's "full portfolio VaR" is less than the fund's "securities VaR," the fund's aggregate exposure may not exceed 300% of the value of the fund's net assets.

- "VaR" means an estimate of potential losses on an instrument or portfolio, expressed as a positive amount in U.S. dollars, over a specified time horizon and at a given confidence level, subject to certain minimum requirements for the VaR analysis (discussed below).

- "Securities VaR" means the VaR of the fund's portfolio excluding derivatives transactions.

Calculation of Exposure

Exposure would include (i) the aggregate notional amounts of the fund's derivatives transactions, (ii) the aggregate obligations under the fund's financial commitment transactions and (iii) the fund's aggregate indebtedness with respect to any other senior securities transaction. The definition would include financial commitment transactions and other senior securities transactions because the Commission believes that, "in order to address the investor protection purposes and concerns underlying Section 18, a fund relying on the exemption should be subject to an overall limit on leverage."[23] However, funds that engage in financial commitment transactions and other senior securities transactions without the use of any derivatives transactions would not be required to comply with the portfolio limitations.

The exposure contemplated under the Proposed Rule differs from the amounts measured for purposes of Commodity Futures Trading Commission (CFTC) regulations applicable to certain funds. For example, under CFTC Regulation 4.5, the notional value would include all commodity interests; however, the Proposed Rule, while including derivatives transactions in the calculation, would only include those derivatives for which a fund has future payment obligations.[24]

Notional Amount

The notional amount of a derivatives transaction would mean: (i) the market value of an equivalent position in the underlying reference asset expressed as a positive amount; or (ii) the principal amount on which payment obligations are calculated. In addition, the Proposed Rule would require the following three adjustments to the calculation of notional amount:

(i) For any derivatives transaction with return based on "leveraged" performance of the underlying, the notional amount should be multiplied by the leverage factor.

(ii) For any derivatives transaction referencing (a) a managed account or entity formed/operated primarily for purposes of investing or trading in derivatives transactions or (b) an index reflecting

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23 *Id.* at 80,906.

24 *See* CFTC Regulation 4.5; Proposing Release at 80,889.

such managed account or entity, the fund's pro rata share of the notional amounts of the derivatives transactions of such account or entity should be used (i.e., a "look-through").

(iii) For any complex derivatives transaction, the aggregate notional amount of derivatives instruments (excluding other complex derivatives transactions) "reasonably estimated to offset substantially all of the market risk" of the transaction should be used.[25]

The Commission requests comment on, among other things, whether the proposed adjustments are appropriate.

Netting to Calculate Portfolio Limitation Percentages

For purposes of calculating exposure, a fund would be permitted to net any directly offsetting derivatives transactions that are the same type of instrument and have the same underlying reference asset, maturity and other material terms. Funds could net appropriate transactions with different counterparties. The Commission believes that such offsetting transactions "are an appropriate means to eliminate or reduce market exposure."[26] However, this would not permit funds to reduce exposure calculations for hedging or risk mitigating transactions (i) that do not have the same reference asset, maturity and terms or (ii) are different types of derivatives.[27]

No Use of Cover Transactions to Offset Exposure

Except as described under "netting" above, the Proposed Rule would not permit a fund to reduce its exposure for "cover transactions."[28] This represents a significant departure from current practice by many funds, as many of the staff no-action letters dealt specifically with the use of cover transactions for derivatives. The Commission discusses the difficulty of developing "a suitably objective standard" for cover transactions, and notes that confirming compliance would be difficult for fund compliance departments and the Commission staff.[29] The Commission also notes that members of its exam staff have found that funds have expanded reliance on cover transactions, which raises concerns whether the risks under all combinations of derivatives are covered.[30]

Among other things, the Commission requests comment on whether the Proposed Rule should permit funds to reduce exposure for cover or hedging transactions and make a corresponding reduction to the percentage limits on aggregate exposure.

Commission Rationale for 150% Exposure Limitation Under Option 1

The Proposing Release states that the Commission evaluated "a range of considerations" in determining to propose a 150% limit. Those considerations included, among other things:

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25 A "complex derivatives transaction" is any transaction for which the amount payable by either party upon settlement date, maturity or exercise: (i) is dependent on the value of the underlying reference asset at multiple points in time during the term of the transaction; or (ii) is a non-linear function of the value of the underlying reference asset, other than due to optionality arising from a single strike price. A fund that uses complex derivatives transactions would be required to document the way it determined the notional amount of such transaction. Proposing Release at 80,905 n.187.

26 *Id.* at 80,906.

27 *Id.* n.192.

28 *Id.* at 80,914.

29 *Id.*

30 *Id.* at 80,915.

(i) Reasons whether or not to propose different percentage limitations, including:

(a) The amount a fund may borrow in compliance with Section 18 – 50% of the fund's net assets – and the exposure level suggested by Release 10666 – 100% of the fund's net assets.[31]

(b) That a 150% exposure limitation would allow use of derivatives at a level that "could approximate the level of market exposure that would be possible through securities investments augmented by borrowings."[32]

(c) The Commission's concern that, without the VaR test, exposures higher than 150% could allow additional speculative investment exposures beyond typical hedging arrangements and implicate the undue speculation and asset sufficiency concerns.[33]

(ii) The potential impact different limits would have on funds' ability to pursue their strategies.[34]

(iii) That the exposure limits are not designed to prevent all losses, and that the exposure limitations would be complemented by the asset segregation requirements.

The Proposing Release states that the Commission analysis indicates that "it should be possible to pursue, in some form, almost all existing types of investment strategies in compliance with a 150% exposure limitation."[35] The Proposing Release acknowledges, however, that it may be difficult for some funds to modify their portfolios to comply with the Proposed Rule.

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31 *Id.* at 80,908-09.

32 *Id*. at 80,910.

33 *Id.*

34 *Id*. The Proposing Release and the DERA White Paper contain detail regarding the Commission's analysis of the potential impact of the 150% level on funds' ability to pursue their investment strategies. The Commission found that:

(i) Other than "alternative strategy mutual funds," more than 70% of sampled mutual funds had no derivatives exposure, about 6% had aggregate exposures in excess of 50%, and about 99% had aggregate exposures less than 150% of net assets;

(ii) 52% of sampled alternative strategy mutual funds had derivatives with a gross notional amount at least equal to 50% of net assets, and approximately 73% had aggregate exposures of less than 150% of net assets. However, 11% had exposures in excess of 300% of net assets;

(iii) Other than "alternative strategy ETFs," only one of the sampled ETFs had aggregate exposure in excess of 150% of net assets;

(iv) Among sampled alternative strategy ETFs, which includes "leveraged ETFs," 45% had exposures larger than 150% of net assets. However, none of these ETFs had exposures in excess of 300% of net assets. The Commission's economic analysis indicated that leveraged ETFs have the largest aggregate exposures (e.g., the sampled inverse debt ETFs, leverage debt ETFs, inverse equity ETFs and leverage equity ETFs had average aggregate exposures as a percentage of net assets of 290%, 210%, 200% and 190%, respectively);

(v) No sampled closed-end funds had aggregate exposure in excess of 150% of net assets; and

(vi) No sampled BDCs had derivatives exposure.

Id. at 89,0910-11; DERA White Paper at 3, 14-15.

35 Proposing Release at 80,911.

In particular, the Commission believes that certain managed futures funds and currency funds may "find it impractical to reduce their exposure below the proposed limit of 150%."[36] The Proposing Release notes that certain of these funds have exposures of almost ten times net assets, and that the Commission believes that such funds "do not appear to be subject to a practical limit on leverage" as contemplated under Release 10666.[37]

In addition, certain ETFs and mutual funds "expressly use derivatives to achieve performance over a specified time that are a multiple of or inverse multiple of the performance of an index or benchmark" and have derivatives exposures exceeding 150% of net assets.[38] The Proposing Release notes that the Commission has not issued exemptive orders for leveraged ETFs since 2009, and that the Commission staff "continues not to support new exemptive relief for leveraged ETFs."[39]

Based on these considerations, the Commission believes that the 150% limitation would provide "sufficient flexibility" and "account for the variety of purposes" noted above, and would "appropriately balance" the effects on funds and their investors with concerns related to leverage.[40]

However, the Commission requests comment on, among other questions:

- Whether the 150% limit is appropriate;
- Whether the Commission should consider a higher limit for leveraged ETFs, managed futures funds and currency funds or other funds, and whether these types of exceptions would be more appropriate to consider in the exemptive application context rather than in a broadly-applicable rule. Also, how the Commission could permit such funds to obtain larger exposure "while also imposing an effective limit on leverage and on the speculative nature of such funds;"
- For managed futures funds and currency funds, whether it may be feasible for funds that do not wish to comply with the Proposed Rule to deregister, and for the fund's sponsor to offer the strategy as a private fund or as a public or private commodity pool; and
- Whether the Commission should grandfather funds that are operating in excess of the proposed portfolio limits as of a specified date, or grandfather leveraged ETFs "on the basis that they operate pursuant to the terms and conditions of exemptive orders."[41]

VaR Testing Methodology Under Option 2

The Commission views VaR as an appropriate measure of risk, because VaR testing "enables measurement of risk in a comparable and consistent manner across diverse types of instruments" and can be used to assess the effect of different positions on the overall market risk of a fund's portfolio.[42]

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36 *Id.* at 80,911-12.

37 *Id.*

38 *Id.*

39 *Id.*

40 *Id.* at 80,910-11.

41 *Id.* at 80,913.

42 *Id.* at 80,916-17.

Minimum requirements for the VaR analysis would include that the VaR model must: (i) take into account and incorporate all significant, identifiable market risk factors associated with a fund's investments; (ii) use a 99% confidence level, a time horizon of not less than 10 and not more than 20 trading days, and a minimum of three years of historical market data if using historical simulation; and (iii) be applied consistently when calculating securities VaR and full portfolio VaR.

The Commission opted to use a fund's own portfolio as the baseline comparison for the risk-based portfolio limit, rather than a "hypothetical reference portfolio" as is used by certain European mutual funds, often referred to as "UCITS funds" that use a "relative VaR" approach to comply with the UCITS risk-limitation framework.[43] The Commission believes that the proposed approach offers advantages over the European relative VaR approach – the use of a hypothetical reference portfolio may: (i) unduly impose limits on a fund's "ability to invest in risky or volatile securities investments," which is not consistent with the purpose of the 1940 Act; and (ii) create difficulties for the fund's selection of a benchmark that is "appropriate," "unleveraged," and would serve as an "appropriate baseline" against which the hypothetical reference portfolio could be measured.[44]

We note that questions have been raised as to whether it is operationally possible for a fund to run a VaR calculation each time it enters a senior securities transaction.

Commission Rationale for 300% Limitation Under Option 2

The risk-based portfolio limit reflects the Commission's belief that, where the use of derivatives will result in a portfolio that is reasonably likely to be subject to less investment risk because they reduce its market risk, derivatives use is less likely to raise potential undue speculation concerns.[45] However, the Commission believes an outside limit is important because, otherwise, a fund could "employ derivatives exposures at a level that could subject a fund to a significant speculative risk of loss if markets become stressed."[46]

In determining to propose a 300% exposure limitation, the Commission considered the extent to which surveyed funds exceeding the 150% limitation would appear to be able to satisfy the proposed VaR test. The Proposing Release notes that managed futures funds and other funds that use derivatives "primarily to obtain market exposure," which the Commission found had exposures ranging from in excess of 150% to approximately 950% of net assets, generally would not satisfy the VaR test.[47] However, other alternative strategy funds exceeding 150% that the Commission believes could potentially use derivatives in a manner that would satisfy the VaR test generally had exposures only up to just under 350% of net assets. Based on this analysis, the Commission notes that a limit higher than 300% "would not appear to further the purposes of the risk-based portfolio limit."[48]

Board Approval of Applicable Portfolio Limitation

Importantly, the Proposed Rule would require that the fund's board, including a majority of its independent directors, approve which of the portfolio limitations will apply to the fund.

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43 *Id.* at 80,918.

44 *Id.*

45 *Id.* at 80,916.

46 *Id.* at 80,923.

47 *Id.* at 80,924.

48 *Id.*

Condition 2: Asset Segregation Requirements (Availability of Assets)

The Proposed Rule would require a fund to segregate on its books an amount of "qualifying coverage assets" with respect to a fund's derivatives and financial commitment transactions. A fund would be required to determine whether segregated amounts are adequate, at least once each business day.

Asset Segregation for Derivatives Transactions

For derivatives transactions, the required amount of qualifying coverage assets would be the sum of (i) a "mark-to-market coverage amount" plus (ii) a "risk-based coverage amount."

- The mark-to-market coverage amount would mean the amount currently payable by the fund if the fund exits the derivatives transaction.
  - The mark-to-market coverage amount would be reduced by the value of any assets that represent variation margin or collateral for amounts payable to exit a transaction but not initial margin. Variation margin or collateral in excess of a fund's current liability under the transaction would not reduce the fund's mark-to-market coverage amount for other transactions except as otherwise permitted under a netting agreement.[49]
  - A fund would be permitted to calculate mark-to-market coverage on a net basis for derivatives transactions for which the fund has entered into a netting agreement allowing payment netting with respect to multiple derivatives transactions (i.e., with the same counterparty). Unlike portfolio limitation netting, this would not permit netting across different counterparties.
- The risk-based coverage amount would mean a reasonable estimate of the potential amount payable by the fund if the fund were to exit the derivatives transaction under stressed conditions.
  - This amount must be determined using board-approved policies and procedures that take into account the structure, terms and characteristics of the derivatives transaction and the underlying reference asset. A fund could use one or more financial models that take these factors into account to determine the risk-based coverage amount.
  - The risk-based coverage amount would be reduced by the value of any assets that represent initial margin or collateral to cover the fund's potential payment amounts with respect to the transaction but not variation margin. This would only reduce the risk-based coverage amount for the transaction for which the assets were posted.[50]
  - The fund can apply the same netting concept noted under mark-to-market coverage.

Asset Segregation for Financial Commitment Transactions

For financial commitment transactions, a fund would be required to maintain qualifying coverage assets with a value at least equal to the value of the fund's obligations under its financial commitment transactions.

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49 *Id.* at 80,928 n.342.

50 *Id.* at 80,930.

- Assets that have been pledged with respect to the financial commitment transactions and can be expected to satisfy such obligation can be counted as qualifying coverage assets.

"Qualifying Coverage Assets" Definition

- *Derivatives Transactions:* Qualifying coverage assets would mean:
  - Cash and cash equivalents. Cash equivalents would mean "short-term, highly liquid investments that are readily convertible to known amounts of cash and that are so near their maturity that they present insignificant risk of changes in value because of changes in interest rates."
  - In addition, if the fund may satisfy its obligations under the transaction by delivering a particular asset, that particular asset could also be a qualifying coverage asset. This would not include an offsetting derivative allowing the fund to obtain the particular asset.
- *Financial Commitment Transactions:* In this context, "qualifying coverage assets" would mean:
  - Cash and cash equivalents.
  - The particular asset that the fund may deliver to satisfy its obligations under the transaction.
  - Assets (i) convertible to cash or (ii) that will generate cash equal to the financial commitment obligation prior to the expected payment date.
  - Assets that have been pledged with respect to the financial commitment transaction and can be expected to satisfy such obligation, including collateral "sold" to a counterparty in a reverse repurchase agreement transaction.[51]
- *Limits on Qualifying Coverage Assets:* A fund's qualifying coverage assets could not exceed the fund's net assets. This means the fund could not cover with borrowed assets or assets owed to other counterparties. In addition, an asset may not be used simultaneously to cover both a derivatives transaction and a financial commitment transaction.

Limiting qualifying coverage assets to cash and cash equivalents for many purposes represents a significant departure from current practice by many funds. The Commission is not proposing to include other types of assets (except the particular asset that may be delivered to satisfy a fund's obligation under a transaction), because the Commission is concerned that other assets could decline in value at the same time the fund's potential obligations under the derivatives transactions increase, rendering the assets insufficient to cover the fund's obligations.[52] By contrast, the Commission permitted the use of liquid assets, such as cash, U.S. government securities or other high grade debt obligations as cover under Release 10666, and staff no-action guidance following Release 10666 permitted the use of any liquid asset as cover.[53]

An additional category of qualifying coverage assets – assets convertible to cash or that will generate cash – would be included for financial commitment transactions because the timing of payment obligations may be specified or

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[51] *Id.* at 80,949.

[52] *Id.* at 80,932. The Proposing Release also states that other types of assets "may be more likely to experience volatility in price or to decline in value in times of stress." *Id.*

[53] *See* Release 10666 and Merrill Lynch.

reasonably foreseeable under financial commitment transactions.[54] However, if a payment obligation is expected to arise on a short-term basis, the coverage assets also would need to be convertible to cash or able to generate cash on a short-term basis.[55]

The Proposing Release notes that, if adopted as proposed, recently proposed Rule 22e-4 (i.e., the Liquidity Proposal) would require a fund to consider the number of days within which a fund's position in a portfolio asset "would be convertible to cash at a price that does not materially affect the value of that asset immediately prior to sale."[56] Funds undertaking this analysis under proposed Rule 22e-4 could use the same analysis and related procedures for purposes of this element of Proposed Rule 18f-4.[57]

Board-Approved Procedures for Maintenance of Qualifying Coverage Assets

For funds that enter derivatives and/or financial commitment transactions, the board, including a majority of its independent directors, would be required to approve "policies and procedures reasonably designed to provide for the maintenance of qualifying coverage assets."

Requests for Comment on Coverage Amounts

Mark-to-Market Coverage Amount. Among other things, the Commission requests comment on whether the variation margin or collateral that reduces the mark-to-market coverage amount should be limited to assets that meet minimum requirements (e.g., high-quality debt). The Commission also requests comment on whether a fund should be permitted to reduce mark-to-market coverage amounts for derivatives to reflect gains in other transactions that the fund believes would mitigate such losses. In addition, the Commission requests comment on whether to issue guidance on the asset coverage rules under Section 18 (or 61) that apply when a fund enters into senior securities transactions in reliance on those provisions (e.g., issuance of preferred stock or senior debt by a closed-end fund or BDC).

Risk-Based Coverage Amount. Among other things, the Commission requests comment on whether it should require specific risk-based coverage amounts rather than requiring such amounts to be calculated in accordance with policies and procedures approved by the fund's board. Additionally, the Commission requests comment on whether a fund should be given more flexibility to reduce its risk-based coverage.

Coverage Amount for Financial Commitment Transactions. Among other matters, the Commission requests comment on whether to treat conditional financial commitment transactions differently than unconditional financial commitment transactions, and whether conditional financial commitment transactions should be treated like derivatives transactions. The Commission also requests comment on whether short sales, under which a fund's obligation can vary over time, should be treated differently than other financial commitment transactions that have a fixed obligation amount. Further, the Commission requests comment on whether to adopt a separate portfolio limitation, similar to the 150% portfolio limitation on derivatives, "rather than limiting the extent to which a fund could incur obligations under financial commitment transactions indirectly through the asset segregation requirement," and, if so, whether 100% of the fund's net assets would be an appropriate limitation.

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54 Proposing Release at 80,948.

55 *Id.*

56 *Id.*

57 *Id.* at 80,948-49

Condition 3: Board Oversight and Derivatives Risk Management Program

The third condition under the Proposed Rule would require a fund to adopt a "tailored" and written derivatives risk management program (DRM Program) unless the fund complies, and monitors compliance, with a prescribed portfolio limitation on its use of derivatives. The Commission views this as a "tailored approach" that benefits funds and investors, as funds with more substantial derivatives use would be required to establish DRM Programs while other funds with limited derivatives use could continue investing in derivatives without first establishing such a program.[58] The Commission also believes that this requirement would "serve to establish a standardized level of risk management" for applicable funds.[59] To the extent DRM Programs result in "more robust monitoring of the risks related to derivatives," the Commission believes that DRM Programs "may reduce the risk of a fund suffering unexpected losses." According to the Commission, this may also: (i) reduce adverse repercussions for others in the market, such as fund counterparties; and (ii) mitigate the risk of forced sales, thereby lowering the risk of stress on other market participants. Finally, the Commission believes that the DRM Program and related recordkeeping requirements will improve the Commission's ability to evaluate risks associated with funds' use of derivatives and funds' management of such risks.[60]

Funds Required to Adopt DRM Programs

A fund would be required to adopt a DRM Program unless the fund complies, and monitors compliance, with a portfolio limitation under which: (i) immediately after entering into any derivatives transaction, the aggregate exposure associated with the fund's derivatives transactions does not exceed 50% of the value of the fund's net assets; and (ii) the fund does not enter into complex derivatives transactions. A fund's board, including a majority of its independent directors, would be required to approve this portfolio limitation, if applicable.

50% Limitation on Derivatives Exposure. Notably, the first element of the portfolio limitation measures only derivatives transactions exposure and does not include exposure under financial commitment transactions or other senior securities transactions. The Commission views "the risks of derivatives transactions [as] often differ[ing] in magnitude and kind from the risks of other senior securities transactions"[61] and "the amount of a fund's market exposure and payment obligations under many derivatives transactions [as] often [being] more uncertain than for other types of senior securities transactions."[62] The Commission further states that "[r]equiring a fund to maintain qualifying coverage assets sufficient to cover its full obligations under a financial commitment transaction may effectively address many of the risks that otherwise would be managed through" a DRM Program.[63] The Commission believes that "a threshold analogous to the statutorily defined threshold for senior securities under Section 18 represents a level of derivatives use, which if exceeded, should be managed" through a DRM Program.[64]

The Commission seeks comment on whether it is appropriate to exclude other senior securities transactions in determining whether to require a formalized DRM Program. The Commission also requests comment on whether the risks associated with the use of derivatives are significant enough, or significantly different from securities

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58 *Id.* at 80,969.

59 *Id.* at 80,899, 80,936.

60 *Id.* at 80,969.

61 *Id.* at 80,936 n.393.

62 *Id.* at 80,937.

63 *Id.* at 80,937-38.

64 *Id.* at 80,936.

investments, that any fund engaging in any derivatives transactions should be required to implement a DRM Program, and whether a higher percentage threshold may be appropriate.

Limitation on Entering Into Complex Derivatives Transactions. The Commission states that because of their "potentially highly asymmetric and unpredictable outcomes," complex derivatives "may pose risks that are not as correlated" to the fund's exposure level, and "if a fund engages in any of these transactions, those risks should be assessed and managed" through a DRM Program overseen by a risk manager and the board.[65]

Despite these concerns, the Commission requests comment on whether funds should be permitted some small amount of exposure (such as 1% or 5% of net assets) to complex derivatives transactions before being required to implement a DRM Program.

Estimated Application of Proposed Rule. Based on its analysis of the DERA White Paper data, the Commission estimates that, under the Proposed Rule, 10% of DERA-sampled open-end funds (including mutual funds and ETFs), 9% of DERA-sampled closed-end funds, and no DERA-sampled BDCs would be required to adopt a DRM Program. Further, the Commission estimates that 52% of DERA-sampled alternative strategy funds would be required to adopt a DRM Program.[66]

DRM Programs

A fund's DRM Program would be required to consist of written policies and procedures reasonably designed to:

(i) Assess 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;

(ii) Manage the risks associated with the fund's derivatives transactions (including the risks noted above), including by:

  (a) Monitoring whether the fund's use of derivatives transactions is consistent with investment guidelines, the relevant portfolio limitation and relevant disclosures; and

  (b) Informing portfolio management or the board, as appropriate, regarding material risks arising from the fund's derivatives transactions;

(iii) Reasonably segregate the functions associated with the DRM Program from portfolio management; and

(iv) Periodically review and update the DRM Program at least annually, including any models (and specifically including any VaR calculation models used by the fund during the period covered by the review), measurement tools, or policies and procedures that are part of, or used in, the DRM Program to evaluate their effectiveness and reflect changes in risks over time.

To assess risks associated with derivatives transactions, the Commission notes that a fund should "identify the types of derivatives it currently uses, as well as any potential derivatives transactions it reasonably expects to use in the

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65 *Id.* at 80,938.

66 *Id.* at 80,937.

future," and then evaluate the associated risks.[67] Additionally, the Proposing Release provides substantial guidance on factors and issues funds might consider when evaluating each of the risks enumerated above.[68] For example:

- *Leverage risk:* Funds "could consider using metrics for measuring the extent of [the fund's] leverage, and which metrics to use," in light of factors such as fund strategy, particular investments and exposures and historical and expected correlations among fund investments.

- *Market risk:* Scenario or stress testing can serve as an important tool in assessing market risk. Effective monitoring of market risks involves periodically reviewing against actual experience the adequacy of assumptions and parameters underlying techniques for estimating potential market risk.

- *Counterparty risk:* An assessment could involve reviewing the creditworthiness or financial position of significant derivatives counterparties, understanding the level of counterparty concentration in the fund and evaluating contractual protections (such as collateral or margin requirements, netting agreements and termination rights).

- *Liquidity risk:* The Commission's recently-proposed liquidity risk management program would, if adopted, "complement" the DRM Program with respect to assessing the liquidity of a fund's derivatives. There may be some overlap between the programs, but overlapping activities need not be duplicated. Additionally, assessing liquidity risk should include an evaluation of potential liquidity demands that may be imposed on the fund in connection with its use of derivatives, such as requirements to maintain qualifying coverage assets and to post variation margin.

- *Operational risk:* This risk includes risks relating to, among other things: documentation issues, settlement issues, systems failures, inadequate controls and human error.

The Commission expresses a view that, "[t]o effectively manage its own particular risks, a fund generally should carefully review its current and planned use of derivatives [as] well as any relevant limitations . . ., and develop risk management tools and processes effectively tailored to its own circumstances."[69] According to the Commission, this may involve establishing: (i) written guidelines concerning the scope and objectives of the use of derivatives; (ii) an approved list of derivatives or strategies; (iii) a list of persons authorized to engage in derivatives transactions on behalf of the fund; (iv) investment size controls or limits; (v) risk measurement monitoring mechanisms; and (vi) clear risk management processes for approving exceptions to established limits. This may also involve evaluation of counterparties and reviewing and/or establishing new contingency plans for adverse market or system conditions.[70]

Because of perceived potential conflicts of interest, the Commission proposes to require DRM Programs to include procedures "designed to reasonably segregate" the functions associated with the DRM Program from portfolio management. The Commission states that such separation of functions can be achieved in several ways, including: (i) independent reporting chains; (ii) oversight arrangements; or (iii) separate monitoring systems and personnel. However, the Commission notes that the proposed requirement involves *reasonable* segregation, not *complete*

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67 *Id.* at 80,939.

68 *See id.* at 80,939-41.

69 *Id.* at 80,942.

70 *Id.* at 80,941-42.

segregation of functions, and should not be understood to require a strict firewall between the derivatives risk management and portfolio management functions.[71]

Derivatives Risk Managers

A fund would be required to designate an employee or officer of the fund or the adviser (Derivatives Risk Manager) responsible for administering the DRM Program. The Derivatives Risk Manager would be an employee or officer of the fund or the fund's investment adviser, but could not be a portfolio manager of the fund. As discussed below, designation of the Derivatives Risk Manager must be approved by the fund's board, including a majority of its independent directors.[72] However, in contrast to the requirements applicable to chief compliance officers (CCOs) under 1940 Act Rule 38a-1, the Commission is not proposing that the Derivatives Risk Manager be removable only by the fund's board or that the board must approve the Derivatives Risk Manager's compensation.[73]

Under the proposal, the Derivatives Risk Manager may have other roles, such as serving as the fund's CCO or chief risk officer. In all cases, the Derivatives Risk Manager "should generally be sufficiently knowledgeable about the risks and use of derivatives that he or she can effectively fulfill the responsibilities of their position."[74]

The Commission requests comment on whether, among other things: (i) there should be a prohibition on unduly influencing a fund's Derivatives Risk Manager, similar to 1940 Act Rule 38a-1(c)'s prohibition on coercing or unduly influencing the fund's CCO in the performance of the CCO's duties; (ii) the Commission should permit third parties to administer the DRM Program; and (iii) the Commission should include other administration requirements, such as a requirement for training staff responsible for day-to-day management of the DRM Program or others and/or minimum qualifications for staff responsible for carrying out the requirements of the DRM Program.[75]

Board Oversight of DRM Programs

For funds required to implement DRM Programs, the Commission proposes to require that the fund's board, including a majority of its independent directors, must: (i) approve the DRM Program initially; (ii) approve any material changes to the DRM Program; (iii) review, no less frequently than quarterly, a written report prepared by the Derivatives Risk Manager that describes the DRM Program's adequacy and effectiveness of its implementation; and (iv) approve the fund's designation of the Derivatives Risk Manager. The Commission expects the board to "understand the [DRM Program] and the risks it is designed to manage," and the approval requirements noted above are "designed to facilitate scrutiny by the board . . . of the [DRM Program] – an area where there may potentially be conflicts of interest between the investment adviser and the fund with respect to the use of derivatives by the fund."[76]

According to the Commission, in considering whether to approve the DRM Program or any material changes to it, a fund's board should generally consider: (i) the types of derivatives transactions in which the fund engages or plans to

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71 *Id.* at 80,941.

72 As noted in the Proposing Release, this proposed requirement differs from the proposed requirement in the Liquidity Proposal for a liquidity risk management program administrator. Specifically, under the Liquidity Proposal, the fund's adviser or multiple employees may be designated as the program administrator. In contrast, under Proposed Rule 18f-4, the Derivatives Risk Manager must be an individual. Proposing Release at 80,943 n.438. Additionally, the Commission notes that a fund's Derivatives Risk Manager could be an employee of the fund's sub-adviser. *Id.* at 80,943 n.440.

73 *Id.* at 80,943-44.

74 *Id.* at 80,943.

75 *Id.* at 80,944.

76 *Id.* at 80,944.

engage; (ii) the particular risks of derivatives transactions in which the fund engages or plans to engage; and (iii) whether the DRM Program sufficiently addresses the fund's compliance with its investment guidelines, any applicable portfolio limitation and relevant disclosure.[77]

In the Proposing Release, the Commission explains that a fund's board may satisfy its initial approval requirements by reviewing summaries of the DRM Program prepared by the Derivatives Risk Manager, legal counsel, or other persons familiar with the DRM Program. The summaries should familiarize the board with the DRM Program's salient features and provide the board with an understanding of how the DRM Program addresses the fund's use of derivatives.[78]

With respect to the board's consideration of the DRM Program's adequacy, the Commission states that the board should consider past experience (both the fund's and the market's experience with derivatives use) and recent compliance issues. The Commission also notes that boards may consider other fund complexes' best practices or consult with derivatives risk management experts who are familiar with the practices of similar funds or market participants.[79]

Proposed Derivatives Recordkeeping Requirements

Another condition under the Proposed Rule would require a fund to retain the following records.

Board Portfolio Limitation Determinations

A fund would be required to maintain a written record of each determination made by its board with respect to the portfolio limitations under which the fund could operate in accordance with the Proposed Rule. Written records with respect to the initial determination of applicable limitations, as well as determinations to change such limitations, would be required to be maintained for a period of at least five years, the first two years in an easily accessible place.[80]

Ongoing Compliance with Conditions of Proposed Rule 18f-4

A fund would also be required to maintain:

- A written copy of the policies and procedures approved by the board reasonably designed to provide for the fund's maintenance of qualifying coverage assets that are in effect, or at any time within the past five years were in effect, in an easily accessible place;[81]
- If the fund is required to adopt and implement a DRM Program:
  - A written copy of the policies and procedures constituting the DRM Program adopted by the fund, which are in effect, or at any time within the past five years were in effect, in an easily accessible place;

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77 *Id.*

78 *Id.*

79 *Id.* The proposal leaves an open question regarding the appropriate level of CCO oversight of the DRM Program (assuming the CCO is not the person designated as the Derivatives Risk Manager), as Proposed Rule 18f-4 is within the scope of the CCO's administration responsibilities under Rule 38a-1.

80 *See* Proposing Release at 80,950.

81 Proposed Rule 18f-4(a)(6)(ii) (concerning qualifying coverage assets for derivatives transactions); Proposed Rule 18f-4(b)(3)(i) (concerning qualifying coverage assets for financial commitment transactions); see Proposing Release at 80,950.

- Copies of any materials provided to the fund's board in connection with its approval of the DRM Program, including any material changes to the program, and any written reports provided to the fund's board relating to the program, for at least five years after the end of the fiscal year in which the documents were provided, the first two years in an easily accessible place; and

- Records documenting the periodic reviews of and updates to the DRM Program, specifically including any updates to the VaR calculation models used by the fund and the basis for any material changes to such models, for at least five years following each review or update, the first two years in an easily accessible place;[82]

– A written record demonstrating that immediately after the fund entered into any senior securities transaction, the fund complied with the applicable portfolio limitation, reflecting:

- The fund's aggregate exposure;

- The value of the fund's net assets; and

- If applicable, the fund's full portfolio VaR and its securities VaR;

maintained for at least five years following each senior securities transaction entered into by the fund, the first two years in an easily accessible place;[83]

– A written record reflecting the mark-to-market coverage amount and the risk-based coverage amount for each derivatives transaction entered into by the fund, and identifying the qualifying coverage assets maintained by the fund with respect to the fund's aggregate mark-to-market and risk-based coverage amounts, as determined by the fund at least once each business day, for at least five years, the first two years in an easily accessible place;[84] and

– A written record reflecting the amount of each financial commitment obligation associated with each financial commitment transaction entered into by the fund, and identifying the qualifying coverage assets maintained by the fund with respect to each financial commitment obligation, as determined by the fund at least once each business day, for at least five years, the first two years in an easily accessible place.[85]

Related Proposed Amendments to Proposed Forms N-PORT and N-CEN

On May 20, 2015, the Commission unanimously proposed several revisions to the investment company reporting regime, including two new forms: proposed Form N-PORT, for reporting portfolio- and position-level holdings data; and proposed Form N-CEN, for reporting census-type information. As it had done in connection with the recent Liquidity Proposal, the Commission proposes to amend proposed Forms N-PORT and N-CEN while the forms are still under consideration.

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82 Proposed Rule 18f-4(a)(6)(iii); *see* Proposing Release at 80,950.

83 Proposed Rule 18f-4(a)(6)(iv) and Proposing Release at 80,950.

84 Proposed Rule 18f-4(a)(6)(v) and Proposing Release at 80,950.

85 Proposed Rule 18f-4(b)(3)(ii) and Proposing Release at 80,950.

Proposed Amendments to Proposed Form N-PORT

Funds required to adopt and implement a DRM Program would be required to report certain risk metrics in response to proposed Item C.11.c.viii of proposed Form N-PORT.[86] This item would require relevant funds "to provide the gamma and vega for options and warrants, including options on a derivative, such as swaptions."[87]

According to the Commission, reporting of gamma "would provide the Commission and others with a more precise estimate of the effects of underlying price changes on a fund's investments, particularly for large price movements in the underlying reference asset."[88] The Commission also states that reporting of vega "would permit the Commission and others to, among other things, estimate changes in a portfolio based on changes in market volatility, as opposed to price changes."[89]

Moreover, the Commission believes that "[r]isk metrics data reported on Form N-PORT that is made publicly available also would inform investors and assist users in assessing funds' relative price and volatility risks and the overall price and volatility risks of the fund industry."[90] On the other hand, the Commission acknowledged that requiring disclosure of gamma and vega "would increase the amount and availability of public information about certain investment companies' portfolio positions and investment strategy," which could expand opportunities for third parties to exploit this information by engaging in predatory trading practices.[91]

Proposed Amendments to Proposed Form N-CEN

The Commission proposes to require funds to identify on Item 31 of Proposed Form N-CEN the portfolio limitation – *i.e.*, the exposure-based portfolio limitation or the risk-based portfolio limitation – relied upon during the reporting period. If a fund relies on one of the limitations during a portion of the reporting period and the other limitation during another portion, the fund would be required to indicate this information on Item 31 of proposed Form N-CEN.[92]

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86 Proposing Release at 80,951-52. As detailed in the earlier section on Condition 3, funds relying on Rule 18f-4 would be required to adopt a DRM Program unless the fund complies, and monitors compliance, with a portfolio limitation under which: (i) immediately after entering into any derivatives transaction, the aggregate exposure associated with the fund's derivatives transactions does not exceed 50% of the value of the fund's net assets; and (ii) the fund does not enter into complex derivatives transactions.

The Commission proposes to require only funds that must adopt and implement DRM Programs to respond to proposed Item C.11.c.viii, because of the "added burdens to reporting risk metrics" and because the Commission believes that funds required to adopt and implement DRM Programs already "currently calculate risk metrics . . . or have risk metrics calculated for them . . . ." *Id.* at 80,952.

87 *Id.* Gamma and vega are new categories of reportable risk metrics. "Gamma" is a measure of the sensitivity of an option's delta in response to price changes in the underlying instrument. "Delta" is the ratio of change in the value of an option to the change in value of the asset into which the option is convertible. "Vega" represents the amount an option contract's price changes in reaction to a 1% change in volatility of the underlying asset. *Id.* at 80,903 n.163, 80,952.

88 *Id.* at 80,952.

89 *Id.*

90 *Id.* As noted in the Proposing Release, Form N-PORT submissions would be due no later than 30 days after the close of each month, but "[o]nly information reported for the third month of each fund's fiscal quarter on Form N-PORT would be publicly available, and such information would not be made public until 60 days after the end of the third month of the fund's fiscal quarter." *Id.* at 80,951 n.488.

91 *Id.* at 80,972 (citing Investment Company Reporting Modernization Release at n.170 and accompanying and following text).

92 *Id.* at 80,952 n.505.

Requests for Comment

The Commission seeks comment on, among other things, whether:

- The proposal to limit the reporting of gamma and vega to funds that are required to implement a DRM Program is appropriate, or whether the Commission should require all funds investing in "derivatives with optionality" to report these metrics;
- The Commission should require disclosure of gamma and vega for other investment products and whether there are additional or alternative metrics that should be reported;
- There would be any benefit to requiring funds to publicly report their aggregate exposure or, for funds operating under the risk-based limit, the results of VaR tests; and
- Funds should be required to report on either proposed Form N-PORT or proposed Form N-CEN the funds' aggregate exposures or their securities VaRs and full portfolio VaRs, if applicable.[93]

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93 *Id.* at 80,952-53.