Independent Directors Council

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IDC Seeks Changes to SEC's Derivatives Proposal to Ensure Proper Oversight Role for Fund Boards

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Washington, DC, March 28, 2016—The Independent Directors Council (IDC) recommends changes to a proposal by the Securities and Exchange Commission (SEC) governing the use of derivatives by regulated funds to ensure that the board's role is one of oversight, not management, IDC said in a comment letter to the SEC today.

IDC's letter focused on the implications for fund boards of the SEC's rule proposal that would impose new constraints on funds' use of derivatives and new responsibilities on fund boards.

"Fund boards already provide robust oversight of funds' use of derivatives, and we are asking the SEC to ensure that this appropriate oversight role continues under any new requirements it adopts, including a derivatives risk management program," said Amy Lancellotta, IDC's managing director. "Fund directors should not be required to identify and manage risks associated with derivatives—which is a role the fund adviser is in the best position to undertake."

IDC Proposes Fixes to Ensure Board Will Not Be Tasked with Management Function

The proposed requirement that boards approve the particular portfolio limitation under which the fund will operate inappropriately draws fund boards too closely into a management function and is not necessary to support the Commission's policy goal, IDC said. Citing additional rationales for its stance, IDC asked the SEC to eliminate that requirement (see pages 4–8 of the letter).

Similarly, the proposed requirement that boards approve asset segregation policies and procedures, including those for determining the risk-based coverage amount, may suggest that boards engage in a greater depth of analysis concerning the appropriate "cushion" to include for each type of derivative instrument than would be appropriate for the board's oversight role, IDC's letter said (see pages 8–10). IDC recommended that the SEC make clear that a fund's board-approved asset segregation policies and procedures can assign that responsibility to the fund adviser.

Finally, IDC acknowledged that the derivatives area may warrant boards' additional attention, and expressed general support for the proposed requirement that certain funds adopt a derivatives risk management program overseen by the board. The letter recommended some modifications to the proposed program requirements, including that a board not be required to approve specific personnel serving in the role of the derivatives risk manager and that boards receive annual, rather than the proposed quarterly, reports concerning the derivatives risk management program. (For more on IDC's concerns about the proposed program, see pages 10–14 of the letter.)