

[Coalition Letter Re: Leveraged/Inverse Funds]  
February 7, 2020

Vanessa Countryman  
Secretary  
Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549-1090

Re: Use of Derivatives by Registered Investment Companies and Business Development Companies; Required Due Diligence by Broker-Dealers and Registered Investment Advisers Regarding Retail Customers' Transactions in Certain Leveraged/Inverse Investment Vehicles [File No: S7-24-15; Release No. 34-87607]

Dear Ms. Countryman:

On November 25, 2019, the Commission re-proposed rule 18f-4 under the Investment Company Act of 1940 — a rule originally proposed in 2015 during the administration of President Obama — and proposed new rule 15l-2 under the Securities Exchange Act of 1934 and new rule 211(h)-1 under the Investment Advisers Act of 1940. These rules represent a very intrusive, burdensome, expansive and expensive “solution” to a poorly defined and potentially non-existent “problem.” Not only do these rules clash with the Trump administration’s goal of freeing the economy with less red tape, they would foster further inequality in financial markets by potentially making certain mutual funds and exchange traded funds unavailable to the average American investor. We urge the Commission to withdraw these proposed rules.

The rules would require broker-dealers to obtain a great deal of information regarding their customers (including their investment objectives, employment status, annual income, estimated net worth, estimated liquid net worth, the percentage of the customer’s estimated liquid net worth that he or she intends to invest in leveraged/inverse investment vehicles, and information about the customer’s investment experience and knowledge regarding leveraged/inverse investment vehicles, options, stocks and bonds, commodities, and other financial instruments). Based on this information, the broker-dealer would be required to specifically approve or disapprove, in writing, the customer’s account for buying and selling shares of leveraged/inverse investment vehicles. Approval would be predicated on a finding by the broker-dealer that it “has a reasonable basis for believing that the customer has such knowledge and experience in financial matters that he or she may reasonably be expected to be capable of evaluating the risks of buying and selling leveraged/inverse investment vehicles.” Such an approach is a form of paternalistic merit review and inconsistent with the disclosure principles of federal securities regulation. Many broker-dealers will deny investors the ability to invest in these instruments simply because of the regulatory risk that allowing such investment entails. Thus, the proposed rules would harm investors by limiting their investment options.

The rules would also require funds to institute a specified derivatives risk management program that would have to include stress testing, backtesting, internal reporting and escalation, and program review elements. They would require funds' boards of directors to approve the fund's designation of derivatives risk manager. They would impose various reporting requirements.

The SEC Division of Economic and Risk Analysis (DERA) estimates that the total industry cost for the proposed requirements of the sales practice rule in the first year for both broker-dealers and investment advisers would be an astounding \$2.4 billion. The cost of various derivatives risk management program requirements imposed on funds would be approximately another \$450 million annually. These costs will be largely borne by investors since broker-dealers will need to recover these costs to remain profitable or to keep their profit margins competitive. Thus, the proposed rules would harm investors by increasing their costs and lowering their returns.

Moreover, DERA is "unable to quantify the effects on efficiency, competition, and capital formation because we lack the information necessary to provide a reasonable estimate." Furthermore, the proposing release makes an entirely underwhelming qualitative case for the benefits of the proposed rules. The costs of the proposed rule are very high and defined. The benefits of the rule are unclear and potentially non-existent. The rule, therefore, should be withdrawn on grounds that the costs exceed the benefits.

The recent promulgated Regulation Best Interest (effective September 10, 2019) requires that broker-dealers have "a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks, rewards, and costs associated with the recommendation and does not place the financial or other interest of the broker, dealer, or such natural person ahead of the interest of the retail customer." Certainly, the Commission should evaluate whether Regulation BI has addressed the perceived problem regarding retail investors' investment in leveraged or inverse funds before promulgating yet another expensive and intrusive rule that is more likely to harm investors than to protect them.

Sincerely,

Tim Chapman, Executive Director  
Heritage Action for America

Grover Norquist, President  
Americans for Tax Reform

Adam Brandon, President  
FreedomWorks

John Berlau, Senior Fellow  
Competitive Enterprise Institute

James Setterlund, Executive Director  
Shareholder Advocacy Forum

Brandon Arnold, Executive Vice President  
National Taxpayers Union

Harry C. Alford, President/CEO  
National Black Chamber of Commerce

James L. Martin, Founder/Chairman  
Saulius "Saul" Anuzis, President  
60 Plus Association

Andrew F. Quinlan, President  
Center for Freedom and Prosperity

Norm Singleton, President  
Campaign for Liberty