PROFUNDS
PROSHARES TRUST
7501 WISCONSIN AVENUE
BETHESDA, MARYLAND 20814

Submitted via email to: rule-comments@sec.gov

April 24, 2020

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 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)

Dear Ms. Countryman:

This letter is submitted by the Independent Trustees of ProShares Trust and ProFunds (the "Trusts") with respect to the above-referenced release proposing Rule 18f-4 under the Investment Company Act of 1940 (the "1940 Act"), Proposed Rule 15*l*-2 under the Securities Exchange Act of 1934 (the "Exchange Act") and Proposed Rule 211(h)-1 under the Investment Advisers Act of 1940 (the "Advisers Act") and related amendments to other rules and requesting comments on the proposal (collectively, the "Proposed Rules").[1]

ProShares Trust is a registered investment company consisting of 112 series portfolios, each of which is an exchange-traded fund ("ETF"). Of these ETFs, 84 are leveraged/inverse investment vehicles as defined in Proposed Rule 15*l*-2 and Proposed Rule 211(h)-1 (the "Funds").[2] ProFunds is a registered investment company consisting of 112 series portfolios. Of these, 66 are leveraged/inverse funds.

---

[1] 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, Release No. 34-87607; IA-5413; IC-33704; File No. S7-24-15; RIN: 3235-AL60 (the "Proposing Release").

[2] In this letter, we use the following terms: We refer to "leveraged/inverse investment vehicles" as "leveraged/inverse funds." We also refer to the series portfolios of ProShares Trust and ProFunds that are leveraged/inverse funds individually as a "Fund" and collectively as the "Funds." We refer to proposed rules 15*l*-2 and 211(h)-1 as the "sales practices rules."

The comments set forth in this letter solely represent our views as Independent Trustees of the Trusts. ProShare Advisors and ProFund Advisors, the investment advisers, and the Trusts, have separately submitted a comment letter on these and related matters.

Overview

We support the efforts of the Securities and Exchange Commission (the "Commission") to consolidate and update its guidance regarding investment company use of derivatives and leverage. In this letter, we focus primarily on (a) proposed sales practice rules, to which we object strongly, and (b) the role of the fund boards.

By way of background, two of us have served as independent Trustees of the Funds since their respective inceptions. One of us has served as a Trustee since 2011. We take our role as independent trustees very seriously. A major part of our oversight of the Funds involves monitoring the Funds operations for consistency with the disclosures in the Funds' prospectuses. In carrying out this responsibility, we meet regularly and review a significant amount of data that we ask the investment advisers to the Funds (the "Advisors") to provide to us, including information about disclosure, compliance, performance, risk assessment and correlation of performance to the Funds' respective indices.

Based on our experience, we believe the Funds can provide important benefits to investors, such as the ability to hedge portfolios during market downturns, or to help achieve magnified exposure to particular markets or indexes. In the years that we have overseen the Funds as trustees, we have watched the Funds perform in a variety of challenging market cycles, including the past several weeks when the markets have been rocked as a result of the coronavirus. In each case, we have been satisfied that the Funds have performed as described in the prospectuses and that investors in the Funds can understand the key characteristics and risks of these investment vehicles.

For these and other reasons, we believe that the proposed sales practices rules are unnecessary. Our experience is that the Funds operate as designed and the key features of these products are clearly disclosed and understandable. Further, we believe the proposed rules, if adopted, would have a significant negative impact on the Funds and our shareholders. The Proposed Rules would place an unprecedented burden on current shareholders, as well as potential future shareholders, to demonstrate that they are "qualified" to purchase Fund shares. We believe that this type of restriction on shares of a registered investment company is entirely novel and unnecessary. Financial intermediaries will incur significant compliance costs and potential liabilities if the Commission adopts the proposed sales practice rules. We are concerned that these additional burdens will discourage financial intermediaries from making the Funds available to their customers and clients. This could prevent investors, including current Fund shareholders, who might otherwise benefit from these products, from using them, and could drive investors seeking similar exposure to potentially riskier and more costly products and strategies that are not subject to the protection of the 1940 Act and the oversight of independent trustees. We discuss these issues in greater detail below.

With respect to other aspects of the Proposed Rules, we appreciate that the Commission envisions a more traditional oversight role for independent trustees than first proposed in 2015. We ask that the Commission clarify some aspects of the Proposed Rules in this regard.

Discussion of the Proposed Sales Practice Rules

The proposed sales practice rules are unnecessary, particularly in light of the existing protections that apply to the professional relationships between broker-dealers and investment advisers, on one hand, and their customers/clients, on the other.

Our experience is that the Funds operate as designed and the key features of these Funds are clearly disclosed and understandable. Therefore, we do not believe that the sales practice rules are necessary or appropriate. We believe this to be particularly true in light of the existing protections already in place with respect to broker-dealers, investment advisers and their customers/clients.

Just last year, the Commission adopted Regulation Best Interest,[3] which included principles-based enhancements to investor protection when broker-dealers or their associated persons recommend securities transactions to retail customers. In particular, Regulation Best Interest requires a broker-dealer to evaluate a customer's "financial situation and needs and investment objectives" in evaluating whether an investment is in a retail customer's best interest.[4]

The sales practice rules would turn this principles-based standard upside down, by prescribing specific information that broker-dealers must obtain and evaluate and a "capability" standard investors must meet before a retail customer would be permitted to invest in a leveraged/inverse fund. We believe that the principles-based framework that the Commission put into place with Regulation Best Interest adequately addresses the Commission's concerns of investor protection, and the sales practice rules applicable to broker-dealers would amount to regulatory overkill.[5]

The sales practice rules likewise should not apply to discretionary investment advisory accounts. As a fiduciary to its clients, an investment adviser has a duty of care to provide investment advice that is in the best interest of its client, including "a duty to provide advice that is suitable for the client."[6]

---

[3] Regulation Best Interest: The Broker-Dealer Standard of Conduct, Exchange Act Release No. 86031 (June 5, 2019) ("Regulation Best Interest").

[4] *Id.*, at 116, n. 248.

[5] While the Commission said that the sales practice rules were modeled after FINRA's options account approval requirements for broker-dealers, we note that the options model was established before the adoption of Regulation Best Interest. The options model addresses concerns about options that typically provide little if any risk disclosure, as compared to shares of registered investment companies, which disclose material features and risks. Moreover, certain options transactions may present potentially unlimited risk of loss, whereas the potential losses with respect to leveraged/inverse funds are limited to the amount invested.

[6] Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Release No. IA-5248 (Jun. 5, 2019) (the "Investment Adviser Guidance"), available at https://www.sec.gov/rules/interp/2019/ia-5248.pdf at p. 12-13. "The duty of care includes a duty to provide investment advice that is in the best interest of the client, including

A retail client typically hires an investment adviser for the purpose of evaluating the benefits and risks of potential investments, based on the adviser's reasonable understanding of the client's needs, financial goals and risk tolerance. An investment adviser has an existing obligation of "reasonable inquiry into the client's financial situation, level of financial sophistication, investment experience, and financial goals," which the Commission has referred to as the retail client's "investment profile."[7] Moreover, in forming a reasonable belief that its investment advice is in the best interest of a client, an investment adviser must consider, among other things, "whether investments are recommended only to those clients who can and are willing to tolerate the risks of those investments and for whom the potential benefits may justify the risks."[8]

The proposed sales practices rules disrupt the adviser-client relationship and traditional fiduciary principles. In light of an investment adviser's existing duty of care, as expressed by the Commission, it seems to us unnecessary and redundant to further require the adviser to approve a retail investor's transactions in leveraged and inverse funds only if the adviser has a "reasonable basis to believe that the investor is capable of evaluating the risks associated with these products."

The client has retained the skill and expertise of the investment adviser exactly so that the adviser can make investment decisions on the client's behalf, in a manner consistent with the investment adviser's duty of care. Said another way, the proper standard should not be whether the *investor* would fully understand the product, but whether the product is appropriate to the investor's circumstances in the *adviser's* informed assessment that clients "can and are willing to tolerate the risks of those investments."[9]

With these comprehensive regulatory and fiduciary frameworks already in place, we question the benefits of the proposed sales practice rules. [10] The sales practice rules would impose additional

---

a duty to provide advice that is suitable for the client. In order to provide such advice, an adviser must have a reasonable understanding of the client's objectives. The basis for such a reasonable understanding generally would include, for retail clients, an understanding of the investment profile, or for institutional clients, an understanding of the investment mandate. The duty to provide advice that is in the best interest of the client based on a reasonable understanding of the client's objectives is a critical component of the duty of care" (footnotes and citations omitted).

[7] Investment Adviser Guidance at 13.

[8] Investment Adviser Guidance at 15.

[9] Investment Adviser Guidance at 15.

[10] Illustrating that the Commission has the tools it needs under existing regulatory frameworks and without expansive new rules, we note that the Commission recently settled an administration proceeding against dually-registered broker-dealers and investment advisers involving recommendations of leveraged/inverse ETFs. Without admitting or denying the allegations, the respondents consented to findings that they failed to adopt policies and procedures reasonably designed to prevent and detect unsuitable recommendations and failed to supervise advisory personnel in connection with recommendations for certain leveraged/inverse ETFs, in violation of section 206(4) and Section 203(e)(6) of the Advisers Act, Section 17(a)(3) of the Securities Act, and Section 15(b)(4)(E) of the Exchange Act. *See* In the Matter of Wells Fargo Clearing Services, LLC, and Wells Fargo Advisors Financial Network, LLC, 1934 Rel. No. 88295 (Feb. 27, 2020), available at https://www.sec.gov/litigation/admin/2020/34-88295.pdf.

steps and hurdles at a significant cost, and likely would be viewed as designed to deter transactions in this particular product type.

The proposed sales practice rules are also inappropriate when the investor is acting on a self-directed basis, because they force the executing broker-dealer to intrude on the investor's informed choice of whether to invest in a registered investment company, a product already subject to multiple layers of regulation.

Applying the sales practice rules to self-directed investors would place an unprecedented barrier between a person trading for his or her own account and registered investment company shares. We are not aware of any precedent that would require a broker-dealer to determine in advance the capacity of a self-directed investor to understand the risk associated with investing in shares of a registered investment company. The closest analogy would be the accredited investor standard that applies to investments in private funds that are not publicly offered. In those situations, however, the underlying investments are not subject to the same disclosure and other investor protection requirements of the federal securities laws, including the 1940 Act, the Advisers Act and the Securities Act, and, in the case of ETFs, the listing standards of the exchanges on which their shares trade.[11]

The proposed sales practice rules are philosophically inconsistent with the longstanding principle that the Commission is not, and should not be, a "merit regulator." Investor choice and financial innovation depend on the Commission resisting the temptation to cross that line.

The federal securities laws are based on full and fair disclosure rather than a determination by a regulator on the merits of a particular investment. The Commission, through the federal securities laws, protects retail investors by ensuring that they have the important information they need to make an informed investment decision. Indeed, the Funds that we oversee are subject to rigorous disclosure requirements of the 1940 Act and the Securities Act and their regulations. The ETFs that we oversee are also subject to the listing standards on the securities exchanges on which they trade. Broker-dealers that make these leveraged/inverse funds available are subject the requirements of the Exchange Act and its rules, and the rules of FINRA, and investment advisers are subject to the requirements of the Advisers Act.

We are concerned that the sales practice rules open the door to merit-based regulation by the Commission that effectively singles out leveraged/inverse funds, including the Funds that we oversee. We do not believe there is any problem that needs to be solved with respect to leveraged/inverse funds, nor do we believe it is appropriate for the Commission to substitute its judgment of the usefulness or risks of an investment for that of the investors. We agree with the

---

[11] For further discussion on the issue whether the sales practice rules should apply to unsolicited trades in the funds, *see* the public statement of Commissioner Hester M. Peirce and Commissioner Elad L. Roisman, Statement on the Re-Proposal to Regulate Funds' Use of Derivatives as Well as Certain Sales Practices (Nov. 26, 2019) (the "Peirce-Roisman Statement"), available at https://www.sec.gov/news/public-statement/roisman-peirce-statement-funds-derivatives-sales-practices. ("To our knowledge, the Commission has not established a similar hurdle for investors attempting to buy or sell securities available in our public markets. Why would we introduce such a thing now, with respect to such a narrow subset of products?")

statement by Commissioners Peirce and Roisman that the Proposed Rules amount to a "blunt, overly-paternalistic approach to investor protection."[12] We believe that investors themselves, with their professional advisers when applicable, should decide whether to invest in shares of the Funds, and that it is not for the Commission to take on what may be considered a role of merit regulator.

We are concerned that by placing this hurdle that applies only to leveraged/inverse funds, the Commission is effectively discouraging innovation, particularly by registered investment companies that offer strategies and market exposures that the Commission disfavors for one reason or another. We believe that the Commission can more appropriately address its concerns through rigorous disclosure and financial education of market stakeholders. We are also concerned that the sales practices rules would serve as a model for a future Commission to regulate other products. A future entrepreneur developing almost any securities-based innovation, or the broker-dealer or investment adviser considering how to apply that innovation to the benefit of customers or clients, is likely to pause and be that much warier, knowing the Commission might then or later step in to selectively regulate the markets to its preference.

The costs that would result from the proposed sales practice rules, and their intrusion on the markets, will not make investors safer. The likely unintended consequence of these rules is that many investors simply will migrate to less regulated, riskier, costlier products.

The Proposing Release indicates that the proposed sales practice rules would result in significant compliance and reporting costs for broker-dealers and investment advisers.

We believe that the actual costs of compliance could be significantly higher than those estimated by the Commission.

What will flow from these costs? It seems likely that many broker-dealers and investment advisers may simply eschew accounts that invest in these funds in order to avoid significant internal and out-of-pocket compliance costs if they believe that these costs do not justify the potential benefits. Moreover, broker-dealers and investment advisers may fear potential liability if they approve an account to invest in the leveraged/inverse funds that at some point incurs a loss, even if the risk of the loss is fully disclosed in fund disclosure documents. This risk is particularly acute in the case of broker-dealers that offer self-directed brokerage accounts accessible on the internet without any involvement of broker-dealer representatives. In the case of self-directed brokerage accounts, there is little incentive for a broker-dealer to incur the significant compliance costs to allow customers to effect trades at very low (or zero) commissions and with heightened potential liability for the broker-dealer.

If investors do not have access to these channels, we are concerned that investors then will seek market exposure through alternative investments, which may more risky, less regulated, less diversified and potentially more costly. These alternatives include leveraged exchange-traded

---

[12] *See* the Peirce-Roisman Statement at n. 11. Although Commissioners Peirce and Roisman referred to the limits on geared products' use of leverage at three times the specific market index as "blunt, overly paternalistic regulation," we believe that the same applies to the sales practice rules.

notes, margin and option transactions. None of these alternatives, however, will feature the investor protections of the 1940 Act or the oversight of independent trustees. In many cases, these alternatives also lack other protections, such as mandated disclosure under the Securities Act of 1933, or the protections afforded by appropriate exchange listing standards.

Rather than impose the proposed sales practice rules, the Commission should recognize the vital and healthy role that fund trustees play in overseeing the operation of funds and the ample disclosures made in fund prospectuses and other documents.

We believe that the Trusts' boards, which provide robust oversight of the Funds and their investment advisers and other service providers, are in the best position to oversee the Funds' provision of the disclosures necessary for investors to make informed investment decisions. We believe that our board processes adequately allow us to monitor potential conflicts of interest and overall operations. We believe that the Funds' disclosures and operations are appropriate, and believe that this oversight provides a level of comfort that the Funds do what their registration statements say they do and that the risks of investing are adequately disclosed to investors.

We encourage the Commission to consider whether the proposed sales practice rules fail, as we respectfully believe they do, to take into account the cumulative benefits of this hard work and careful advocacy on behalf of fund shareholders by boards of independent trustees. In our view, any rulemaking in this area should give existing governance protections due weight. That is especially so for a rulemaking that carries the potential level of burden and intrusion on private investment activity that we see here.

Discussion of Proposed Rule 18f-4 and the Traditional Oversight Role of Fund Boards

We commend the Commission for recognizing that proposed Rule 18f-4's approach to board oversight should resemble a more traditional oversight role than the role for directors originally envisioned in its original 2015 proposal to regulate derivatives use by investment companies.[13]

We agree with the Commission's characterization that the board's oversight role "should not be a passive activity" and that the board "should view oversight as an iterative process."[14] With these concepts in mind, however, we urge the Commission to limit the board's role in the oversight of fund use of derivatives and leverage to a traditional oversight role and not require the board to approach micromanagement of a technical area that properly belongs to management.

We will leave comments on specific requirements of proposed Rule 18f-4 applicable to fund trustees to industry groups that represent fund trustees, such as the Independent Directors Council of the Investment Company Institute or the Mutual Fund Directors Forum.

* * *

---

[13] Use of Derivatives by Registered Investment Companies and Business Development Companies, Investment Company Act Release No. 31933 (Dec. 11, 2015) ("2015 Proposing Release").

[14] Proposing Release at 80.

We appreciate the opportunity to comment on the Proposing Release and the Proposed Rules, and respectfully request that the Commission consider our recommendations and suggestions. We are available to meet and discuss these matters with the Commissioners and its staff, and to respond to any questions.

Very truly yours,

William Fertig, Independent Trustee

Russell S. Reynolds III, Independent Trustee

Michael Wachs, Independent Trustee

Copy to:

Jay G. Baris, counsel to the Independent Trustees
John M. Loder, fund counsel
ProFund Advisors
ProShare Advisors