Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of	)	
	)	
Use of Derivatives by Registered	)	Release No. 34-87607
Investment Companies and Business	)	File No. S7-24-15
Development Companies; Required	)	85 Fed. Reg. 4446
Due Diligence by Broker-Dealers and	)	
Registered Investment Advisers	)	
Regarding Retail Customers'	)	
Transactions in Certain Leveraged/	)	
Inverse Investment Vehicles	)	

COMMENTS OF THE COMPETITIVE ENTERPRISE INSTITUTE

April 30, 2020

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[redacted]

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street NW
Washington, DC 20549

Dear Ms. Countryman:

On behalf of the Competitive Enterprise Institute (CEI), we respectfully submit these comments in response to the Securities and Exchange Commission's (SEC) notice of proposed rulemaking concerning the use of derivatives by registered investment companies and business development companies.[1] CEI is a nonprofit public interest organization dedicated to the principles of limited constitutional government and free enterprise. One of CEI's major projects is reducing regulatory barriers that affect access to capital and investor choice.[2] CEI has pursued this objective through policy analysis, Congressional testimony, and litigation.[3]

CEI had previously filed comments on the first proposal of rule 18f-4–under the Investment Company Act of 1940—in 2016, expressing our belief that it reduced investor choice and exceeded the SEC's Congressional grant of authority to oversee the securities market.[4] After reviewing critical comments from CEI and many others, the SEC wisely shelved that proposed rule. Unfortunately, this renewed proposal of rule 18f-4 suffers from the same defects, as do the new proposals of rule 15l-2—under the Securities Exchange Act of 1934—and rule 211(h)-1—under the Investment Advisers Act of 1940.

Together, these proposals—without any new grant of authority from Congress—would transform the SEC from a disclosure-based regulatory agency to one that

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/Inversed Investment Vehicles, *Proposed Rule*, 85 Fed. Reg. 4446 (Jan. 24, 2020) ("Proposed Rule"), https://www.govinfo.gov/content/pkg/FR-2020-01-24/pdf/2020-00040.pdf.

2. Many of the policy solutions CEI has put forward over the years were incorporated into the Jumpstart Our Business Startups (JOBS) Act, signed by President Barack Obama in 2012.

3. Christopher Culp, *A Primer on Derivatives: Their Mechanics, Uses, and Regulation* (Competitive Enter. Inst. Issue Analysis, 1995), https://cei.org/sites/default/files/A%20Primer%20on%20Derivatives.pdf; Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 561 U.S. 477 (2010) (CEI as co-counsel for petitioners).

4. Before the Securities and Exchange Commission, Comments of the Competitive Enterprise Institute In the Matter of Use of Derivatives by Registered Investment Companies and Business Development Companies, Release No. IC–31933, March 28, 2016, https://cei.org/sites/default/files/CEI%20comments%20-%20SEC%20derivatives%20rule.pdf.

conducts paternalistic merit reviews for a large section of the securities market. We urge the SEC to withdraw these proposed rules.

1. The proposed rules exceed the SEC's authority from Congress and veer into merit-based regulation

Since Congress wrote the first federal securities laws more than 80 years ago, federal regulation of securities has been disclosure-based, rather than the merit-based approach that is the practice of some state securities regulators. In 1980, for instance, Massachusetts banned its residents from investing in the initial public offering of Apple Computer, because state regulators deemed it "too risky" for individual investors. The state deemed it a "highflyer" that lacked "solid earnings foundations" because of its relatively high price-earnings ratio. Needless to say, this misguided attempt at "investor protection" prevented Massachusetts residents from participating in what literally became the investment opportunity of a lifetime.[5]

Debacles like the Apple ban prompted Congress to preempt states from banning stocks traded on U.S. exchanges via the National Securities Markets Improvement Act of 1996. This and other laws display Congress' intent for the SEC to adhere to its historic role of policing disclosures of investment risks while letting investors decide the merits of the securities they purchase.

Indeed, the SEC's own website states this as its mission. A section of the site entitled "The Laws that Govern the Securities Industry" states that the SEC strives to ensure accurate disclosure of information to enable "investors, not the government, to make informed judgments about whether to purchase a company's securities." Specifically, in its description of the Investment Company Act of 1940, the law on which proposed rule 18f-4 is based, the SEC states that "it is important to remember that the Act does not permit the SEC to directly supervise the investment decisions or activities of these companies or judge the merits of their investments."[6]

The proposed rules run counter to this mission by going beyond disclosure to sharply restrict the availability of funds that pursue certain investment strategies. Without any new authorization from Congress or even a compelling reason based on market data, the SEC is acting like the Massachusetts securities regulators in 1980 who deemed Apple stock as "too risky" for ordinary investors. If the proposed rules go through,

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5. John Berlau and Gibson Kirsch, "The SEC Wants to Be Your Nanny," *Wall Street Journal*, March 18, 2020, https://www.wsj.com/articles/the-sec-wants-to-be-your-nanny-11584573035?mod=opinion_lead_pos10.

6. "The Laws that Govern the Securities Industry," https://www.sec.gov/Article/whatwedo.html#laws.

they may usher in losses to investor welfare similar to Massachusetts' ill-fated decision.

The SEC proposes these rules "to address the investor protection purposes and concerns underlying section 18 and to provide an updated and more comprehensive approach to the regulation of funds' use of derivatives transactions and certain other transactions."[7]

However, in analyzing the costs and benefits of the proposed rules, the SEC underestimates the costs of limiting exposure to derivatives to investors in funds and business development companies. Under the proposed rules, certain types of exchange-traded funds would be made effectively unavailable to retail investors, leaving them exposed to greater risk of market volatility in boom-and-bust cycles and "black swan" economic shocks, such as the current pandemic. Most importantly, the SEC ignores statutory limits placed on its authority to regulate derivatives and futures by the Commodity Futures Modernization Act of 2000.

2. Background: The Investment Company Act and "senior securities"

The Investment Company Act of 1940 (the "1940 Act"), as amended,[8] empowers the SEC to regulate the practices of "investment companies,"[9] subject to various exceptions and limitations.[10] Among other things, Section 18 of the 1940 Act restricts the ability of certain investment companies to issue "any class of senior security."[11] A "senior security" is defined 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."[12]

7. Proposed Rule, 85 Federal Register at 4448.
8. Act of August 22, 1940, ch. 686, 54 Stat. 789, 15 U.S.C. §§ 80a-1–80a-64, http://legcounsel.house.gov/Comps/Investment%20Company%20Act%20Of%201940.pdf
9. 1940 Act § 1(a), 15 U.S.C. § 80a-1.
10. 1940 Act § 3(b)–(c), 15 U.S.C. § 80a-3(b)–(c).
11. 1940 Act § 18, 15 U.S.C. § 80a-18.
12. 1940 Act § 18(g), 15 U.S.C. § 80a-18(g).

In 1979, the SEC issued a general policy statement, known as Release 10666,[13] in which it explained that "reverse repurchase agreements," "firm commitment agreements," and "standby commitment agreements" may constitute a form of a "senior security" that "evidences an indebtedness" of an investment company.[14] The agency advised that the "issue of compliance with Section 18 will not be raised" with respect to a company that enters into such agreements so long as it "covers" them by "establishing and maintaining certain 'segregated accounts'" equal to the obligation incurred in connection with its agreements.[15] These accounts, the agency explained, must "freeze[] certain assets of the investment company" and render them "unavailable for sale or other disposition."[16]

Subsequently, through the 1970s, 1980s, and 1990s,[17] SEC staff "issued more than thirty no-action letters to funds concerning the maintenance of segregated accounts or otherwise 'covering' their obligations in connection with various transactions otherwise restricted by [ICA] section 18." [18] Although Release 10666 did not specifically address derivatives, agency staff has addressed a number of questions about derivatives in both no-action letters and other forms of guidance.[19]

The SEC now proposes to formally interpret the term "senior securities" to encompass "all derivatives transactions that create future payment obligations."[20] The agency also proposes to exercise its exemption authority under Section 6(c) of the 1940 Act, which authorizes the SEC to "conditionally or unconditionally … exempt any … classes of persons, securities, or transactions, from any provision or provisions of this title or of any rule or regulation thereunder."[21] The agency may grant such exemptions only to the extent that they are "necessary or appropriate in the public

13. Securities Trading Practices of Registered Investment Companies, *General Statement of Policy*, 44 Fed. Reg. 25128 (1979), *available at* https://www.sec.gov/divisions/investment/imseniorsecurities/ic-10666.pdf.

14. *Id.* at 25131.

15. *Id.* at 25132.

16. *Id.*

17. Proposed Rule, 80 Fed. Reg. at 4452.

18. *Id*.

19. *Id.*

20. *Id* at 4451.

21. 1940 Act § 6(c), 15 U.S.C. § 80a-6(c).

interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of [the 1940 Act]."[22]

Specifically, the agency proposes to allow an investment company to issue senior securities in the form of derivatives, provided that the company:

1. "[A]dopts and implements a written derivatives risk management program … which must include policies and procedures that are reasonably designed to manage the fund's derivatives risks and to reasonably segregate the functions associated with the program from the portfolio management of the fund;"[23]
2. Complies with the relative value at risk (VaR) test, which "means that the VaR of the fund's portfolio does not exceed 150% of the VaR of the designated reference index," or, "if the derivatives risk manager is unable to identify a designated reference index that is appropriate for the fund taking into account the fund's investments, investment objectives, and strategy, the absolute VaR test," which "means that the VaR of the fund's portfolio does not exceed 15% of the value of the fund's net assets;"[24]
3. Designates, with approval of the board of directors, a derivatives risk manager who provides the board annually a "written report providing a representation that the program is reasonably designed to manage the fund's derivatives risks," among other reports; and[25]
4. Complies with extensive recordkeeping and reporting requirements.[26]

A company is exempt from the first two preceding requirements if it is a "limited derivatives user," which means that the company's "derivatives exposure does not exceed 10 percent of the fund's net assets" or the company limits its use of derivatives transactions to certain forms of currency derivatives.[27]

Proposed rules 15l-2 and 211(h)-1 complement reproposed rule 18f-4 by restricting broker-dealers and investment advisers from selling such products unless they give investors an extensive questionnaire and investors answer questions about annual

22. *Id.*
23. Proposed Rule, 85 Federal Register at 4559.
24. *Id.* at 4558–4559.
25. *Id.* at 4560.
26. *Id.* at 4560–4561.
27. *Id.* at 4560.

income, net worth, liquid net worth, and investment experience to the SEC's satisfaction.

3. The proposed rules would hurt retail investors by depriving funds of a key risk management tool

The proposed rules purport to protect investors from excessive risk, but they would deprive investors of a key risk management tool by limiting how much leverage funds can obtain through derivatives. The proposed rules equate greater leverage with greater risk—but leverage is often an important means of *managing* risk. Although the proposed rules would partially exempt funds that use currency derivatives to hedge certain forms of currency risks, funds deploy leverage to manage risk in many ways that do not involve hedging.

In short, the proposed rules would ultimately harm investors by discouraging funds from making low-risk, low-volatility "liquid alternative" investments. These funds are plainly meeting market demand, especially as investors seek higher returns in the current low interest rate environment, as former SEC Commissioner Luis A. Aguilar has recognized.[28]

The proposed rules would make it difficult for non-accredited investors to turn to fund managers for risk management, perversely leading some investors to rely on riskier methods by themselves. For example, an investor who purchases "plain vanilla options" on a stock index fund might expose himself to far more "sudden losses" than a retail investor who purchases shares in a liquid alternative mutual fund. Yet, by curtailing the market for funds that offer alternative investments, the proposed rule could lead investors to take the riskier approach.

4. In assessing the costs and benefits of the proposed rules, the SEC's analysis is inconsistent and opportunistic

Over the past decade, courts have warned the SEC about its failure to produce comprehensive cost-benefit analyses. As one appeals court has stated, the SEC has a "statutory obligation to determine as best it can the economic implications of the rule."[29] Courts have invalidated rules for which the agency's economic analysis has

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28. Luis A. Aguilar, Commissioner, Securities and Exchange Commission, Public Statement: Protecting Investors through Proactive Regulation of Derivatives and Robust Fund Governance (Dec. 11, 2015), *available at* http://www.sec.gov/news/statement/protecting-investors-through-proactive-regulation-derivatives.html#_edn12.

29. *Chamber of Commerce v. SEC*, 412 F.3d 133, 143 (D.C. Cir. 2005).

been deficient. For instance, in 2011, the U.S. Court of Appeals for the D.C. Circuit vacated the SEC's rule for proxy access, finding that the SEC "inconsistently and opportunistically framed the costs and the benefits" of that rule.[30]

In proposed rule 18f-4, the SEC admits that it is "unable to quantify the effects on efficiency, competition, and capital formation because we lack the information necessary to provide a reasonable estimate."[31] The agency has not even attempted to obtain such information through empirical measures such as surveys of funds or more theoretical methods. The agency notes that "some investors may reduce their investments in certain funds," but does not seek to quantify the proposed rule's potential adverse effects on capital formation.[32] As for the supposed upside, the SEC insists that the rule would produce significant benefits to funds and their investors through "improved risk management"[33] and enhanced "reporting requirements."[34] This disconnect illustrates the same sort of "inconsistency" and "opportunism" that led the D.C Circuit to strike down the agency's Dodd-Frank proxy access rules in 2011.[35]

5. Reproposed rule 18f-4 still exceeds the SEC's statutory authority

i. The rule is inconsistent with Congress's intent in enacting Section 18 of the 1940 Act

To justify conditionally exempting investment companies from the limits imposed on them by Section 18, the SEC purports to explain how its proposed exemptions are "consistent with the fundamental policy and purposes underlying the Investment Company Act expressed in sections 1(b)(7) and 1(b)(8) of the Act."[36] As proposed rule 18f-4 explains, in enacting Section 18 Congress worried that "'excessive borrowing and the issuance of excessive amounts of senior securities [would] increase unduly the speculative character' of securities issued to common shareholders."[37] A 1994 letter from then-SEC Chairman Arthur Levitt to a subcommittee of Congress

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30. Business Roundtable v. SEC, 647 F.3d 1144, 1148–49 (D.C. Cir. 2011). The court invalidated the rule even though the statutory authority the SEC relied on—the Dodd-Frank Wall Street Reform and Consumer Protection Act—clearly authorized the agency to promulgate the rule.

31. Proposed Rule, 85 Federal Register at 4513.

32. *Id.* at 4527.

33. *Id.* at 4514.

34. *Id.* at 4526.

35. *Bus. Roundtable*, 647 F.3d at 1146.

36. Proposed Rule, 85 Fed. Reg. at 4451.

37. *Id.*

elaborated on this rationale for Section 18, noting that during the 1920s and 1930s, "senior securities … were sold to the public as low risk investments." [38] However, many investment companies at the time held "common stocks that did not provide the stable asset values or steady income stream necessary to support senior charges."[39] Therefore, "Senior securities tended to lead to speculative investment policies to the detriment of senior security holders."[40]

Hence, Section 18 limits the ability of closed-end companies to issue senior securities, while it contains an outright prohibition on their issuance by open-end companies (except for bank loans).[41] These restrictions aim to protect members of the public who might otherwise purchase senior securities from investment companies without realizing the risks they entail. Yet the agency now seeks to regulate investment companies' use of derivatives not because it wishes to protect the "purchasers" of these "senior securities"—the counterparties that enter into derivatives contracts with mutual funds—but instead to safeguard fund investors.[42] Ironically, in doing so, the proposed rule may well end up harming the very purchasers of so-called senior securities that Congress sought to protect with Section 18.

ii. Congress amended the 1940 Act in 2000 to explicitly restrict the SEC's authority to regulate derivatives

Not only is the proposed rule contrary to the purposes of Section 18, but it appears to exceed the SEC's authority. In 2000, Congress passed the Commodity Futures Modernization Act (CFMA),[43] which among other things amended the 1940 Act to *deny* the SEC the statutory authority to interpret the term "senior securities" in Section 18 to encompass many kinds of derivatives that the agency now seeks to regulate. The agency ignores these limits on its authority, without even attempting to explain how they can be reconciled with its proposed rule.

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38. *Mutual Funds and Derivative Instruments*, Division of Investment Management Memorandum transmitted by Chairman Levitt to Representatives Markey and Fields, at 23 (September 26, 1994), *available at* http://www.sec.gov/news/studies/deriv.txt.

39. *Id.*

40. *Id.*

41. 1940 Act § 18; 15 U.S.C. § 80a-18.

42. Proposed Rule, 85 Federal Register at 4448.

43. Pub. L. No. 106-554, app. E, 114 Stat. 2763, 2763A-365 (2000).

In 1979, when the agency issued Release 10666,[44] Congress had not specifically addressed whether derivatives fell under the definition of "security" under the 1940 Act[45]—or, for that matter, under the Act's definition of "senior security," which means any "bond, debenture, note, or similar obligation or instrument *constituting a security*."[46] To the extent that the 1940 Act's applicability to derivatives was unclear, Congress amended the Investment Company Act when it passed the CFMA in 2000, with the specific goal of clarifying the statutory authority of the SEC and other federal agencies to regulate derivatives.[47]

The CFMA amended the 1940 Act's list of items that constitute a "security," adding to this list the term "security future,"[48] which "has the same meaning as provided in section 3(a)(55)"[49] of the Securities Exchange Act of 1934 (the "1934 Act").[50] The CFMA added Section 3(a)(55) to the 1934 Act, defining a "security future" as:

> a contract of sale for future delivery of a single security or of a narrow-based security index, including any interest therein or based on the value thereof, except an exempted security under paragraph (12) of this subsection as in effect on January 11, 1983 (other than any municipal security as defined in paragraph (29) of this subsection as in effect on January 11, 1983). The term "security future" does not include any agreement, contract, or transaction excluded from the Commodity Exchange Act under section 2(c), 2(d), 2(f), or 2(g) of the Commodity Exchange Act (as in effect on December 21, 2000) or sections 27 to 27f of title 7.[51]

Congress made these changes to the 1934 Act and the 1940 Act to clarify the respective roles of the SEC and the Commodity Futures Trading Commission (CFTC) to regulate derivatives, which were clouded with considerable regulatory uncertainty in the 1990s.[52] The CFMA clarified that non-security based derivatives fell outside the scope of the SEC's authority, and that many other forms of

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44. Securities Trading Practices of Registered Investment Companies, *General Statement of Policy*, 44 Fed. Reg. 25128 (1979), *available at* https://www.sec.gov/divisions/investment/imseniorsecurities/ic-10666.pdf.

45. 1940 Act § 2, 15 U.S.C. § 80a-2.

46. 1940 Act § 18(g), 15 U.S.C. § 80a-18(g (emphasis added).

47. CFMA § 209 (amending 1940 Act § 2).

48. 1940 Act § 2(a)(36), 15 U.S.C. § 80a-2(a)(36).

49. 1940 Act § 2(a)(52), 15 U.S.C. § 80a-2(a)(52).

50. Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a–78pp).

51. 1934 Act § 3(a)(55)(A), 15 U.S.C. § 78c(a)(55)(A).

52. Kai Kramer, *Aren't We Still in the "Garden of the Forking Paths"? A Comment on Consolidation of the SEC and CFTC*, 4 HOUS. BUS. & TAX L. J. 410, 434–41 (2004).

derivatives—including over-the-counter (OTC) swaps—fell outside the scope of the both the SEC's and the CFTC's authority.[53] The CFMA also exempted from either agency's jurisdiction so-called "hybrid instruments" that involve futures contracts partially connected to bank transactions.[54]

Yet the proposed rule fails to address the CFMA's amendments to the 1940 Act. Indeed, the agency fails to explain how it possesses the authority to regulate the issuance of these instruments by investment companies—or, for that matter, how the CFMA affects its ability to regulate derivatives in general. Instead, the agency simply asserts that derivatives resemble traditional types of senior securities, without parsing the statutory definition or examining how Congress has changed its scope since Release 10666 was issued in 1979.[55] Thus, to the extent that funds subject to the 1940 Act enter into derivatives contracts that are exempted by the CFMA, the SEC has no authority to treat such contracts as "securities"—let alone "senior securities" by which issuance implicates Section 18.

Nonetheless, the proposed rule purports to regulate all forms of exchange-traded and over-the-counter derivatives used by investment companies, such as swaps, forwards, futures, and options—including both security-based and non-security-based derivatives[56]—regardless of whether they are excluded from the 1940 Act by the CFMA.[57] Thus, even if the SEC possesses the authority to treat certain kinds of derivatives as senior securities, its proposed rule is nevertheless invalid because it rests on an impermissible construction of the 1940 Act.[58]

iii. The SEC fails to justify departing from its longstanding treatment of derivatives used by investment companies

The reproposed rule also marks a major departure from the agency's longstanding practice of issuing no-action letters and allowing investment companies to enter into derivatives transactions so long as they maintain segregated accounts. As the

53. CFMA § 209; *see also* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, tit. VII 124 Stat. 1376 (2010).

54. CFMA tit. IV (codified as amended at 7 U.S.C. §§ 27–27f).

55. *Id.*

56. Proposed Rule, 85 Fed. Reg. at 4456 (defining "derivatives transaction" to mean, among other things, a "security-based swap").

57. 7 U.S.C. §§ 2, 27–27f.

58. *Cf. Abbott Labs. v. Young*, 920 F.2d 984, 988 (D.C. Cir. 1990) ("The 'reasonableness' of an agency's construction depends on the construction's 'fit' with the statutory jlanguage as well as its conformity to statutory purposes.").

reproposed rule acknowledges, the fund industry has come to rely on the agency's 41-year track record of permitting such transactions, in accordance with its 1979 general policy statement.[59] The agency now seeks to reverse course and impose significant new burdens on investment companies that wish to enter into derivatives contracts, yet the agency fails to articulate the factors justifying this proposed about-face. This runs contrary to the Supreme Court's holding that an agency's "settled course of behavior embodies" its "informed judgment that, by pursuing that course, it will carry out the policies committed to it by Congress."[60]

For example, the agency points to the "growth in the volume and complexity of derivatives markets over past decades,"[61] but does not adequately explain how these changing circumstances merit the abandonment of its established approach. Similarly, when the SEC issued its "Hedge Fund Rule" in 2004, which narrowed the exemption from registration for hedge fund advisers, the agency "cited, as justification for its rule, a rise in the amount of hedge fund assets, indications that more pension funds and other institutions were investing in hedge funds, and an increase in fraud actions involving hedge funds."[62] Yet the D.C. Circuit nevertheless vacated the rule, noting the agency's failure to cite "any evidence that the role of fund advisers with respect to investors had undergone a transformation."[63] Here, too, the agency has not shown that the increased use of derivatives by funds transforms the nature of these transactions in such a way that merits upending nearly four decades of precedent.

To be sure, the Supreme Court "normally accord[s] particular deference to an agency interpretation of longstanding' duration,"[64] recognizing that such an interpretation often rests on a "body of experience and informed judgment to which courts and litigants may properly resort for guidance."[65] But if an agency "chang[es] its course," it is "obligated to supply a reasoned analysis for the change beyond that which may be required when an agency does not act in the first instance."[66] Here, the SEC

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59. Proposed Rule, 85 Fed. Reg. at 4452, nn.53–57.

60. *Atchison, T. & S.F.R. Co. v. Wichita Board of Trade*, 412 U.S. 800, 807–808 (1973).

61. Proposed Rule, 85 Fed. Reg. at 4453.

62. *Goldstein v. SEC*, 451 F.3d 873, 882 (D.C. Cir. 2006).

63. *Id.*

64. *Alaska Department of Environmental Conservation v. EPA*, 540 U.S. 461, 487 (2004) (internal quotations and citation omitted).

65. *Id.* (quoting Bragdon v. Abbott, 524 U.S. 624, 642 (1998)).

66. *Motor Vehicle Mfrs. Association of U.S., Inc. v. State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 41–42 (1983).

proposes to change course, but it has not made the heightened showing necessary to justify departing from its established practice.[67]

Just as many investment companies have long relied on the SEC's longstanding approach to derivatives, so has Congress, which has revised federal securities laws on several occasions since 1979—including legislation specifically related to the subject of derivatives regulation.[68]

Indeed, given the "growth in the volume and complexity of derivatives markets"[69] in recent years, Congress' decision not to give the agency express authority to regulate investment companies' use of derivatives is especially telling. As the Supreme Court recently emphasized, Congress is expected to "speak clearly" if it wishes to assign to an agency decisions of vast economic and political significance.[70] If Congress wished to empower the SEC to regulate investment companies' use of derivatives, "it surely would have done so expressly," especially given the "deep 'economic and political significance'" of the question.[71] Yet Congress has declined to give the agency this authority, despite its many opportunities to do so. To the contrary, insofar as Congress has passed laws regulating derivatives, it has delegated such authority to the CFTC—not the SEC. To paraphrase from the Court's opinion in *King v. Burwell*, this is not a case for the SEC.[72]

6. Proposed rules 15l-2 and 211(h)-1 are similarly unprecedented and paternalistic

In addition to being tethered to the flawed and overreaching 18f-4, proposed rules 15l-2 and 211(h)-1 would be novel uses of SEC authority in their own right that lack Congressional authorization. The SEC has historically defined "sales practices" as the methods by which investment products are marketed. By contrast, these rules define "sales practices" based on the characteristics of products that brokers sell that

67. *Cf. Goldstein*, 451 F.3d at 883 (holding that SEC failed to "adequately to justify departing from its own prior interpretation" of a statutory provision).

68. CFMA tit. IV; Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended at scattered sections of U.S.C.).

69. Proposed Rule, 85 Fed. Reg. at 4453.

70. *Utility Air Regulatory Group v. EPA*, 134 S. Ct. 2427, 2444 (2014).

71. *King v. Burwell*, 135 S. Ct. 2480, 2489 (2015) (quoting *Utility Air Regulatory Grp.*, 134 S. Ct. at 2444).

72. *King*, 135 S. Ct. at 2489. ("It is especially unlikely that Congress would have delegated this decision to the IRS, which has no expertise in crafting health insurance policy of this sort. This is not a case for the IRS." (citation omitted)).

the SEC deems too risky. This could set a troubling precedent as other investment products, such as publicly-traded stocks, also carry many risks.

As Commissioners Peirce and Roisman point out, the mandate that brokers conduct all-encompassing questionnaires for retail investors to buy this category of funds is comparable to the SEC's "accredited investor" rule for investing in private companies. That rule has come under bipartisan criticism for restricting investing opportunities to the wealthy. But unlike that rule, these proposed rules do not have the justification of lack of full disclosure. As the commissioners write: "To our knowledge, *the Commission* has not established a similar hurdle for investors attempting to buy or sell securities available in our *public* [emphasis in original] markets. Why would we introduce such a thing now, with respect to such a narrow subset of products?"[73]

For the foregoing reasons, the proposed rules are both unwise and unlawful. We urge the SEC to refrain from issuing the rules.

Respectfully Submitted,

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73. Hester M. Peirce and Elad L. Roisman, Statement of Commissioners on the Re-Proposal to Regulate Funds' Use of Derivatives as Well as Certain Sales Practices, November 26, 2019, https://www.sec.gov/news/public-statement/roisman-peirce-statement-funds-derivatives-sales-practices.