



March 28, 2016

*Via Electronic Mail: rule-comments@Commission.gov*

Brent J. Fields, Secretary  
U.S. 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, SEC Rel. IC-31933; (File No. S-7-24-15)**

Dear Mr. Fields:

On behalf of Gateway Investment Advisers, LLC (hereinafter "Gateway"), we are writing to comment on the Securities and Exchange Commission's (the "Commission") proposed Rule 18f-4 under the Investment Company Act of 1940 (the "Act") regarding the use of derivatives (the "Proposed Rule"). Gateway commends the Commission's efforts to take a fresh look at appropriate ways for mutual funds to enter into derivative transactions while addressing investor protections and concerns underlying Section 18 of the Act. Gateway is confining its comments to a limited area of the Proposed Rule, specifically as it relates to asset segregation requirements for derivative transactions. As outlined below, Gateway is requesting the Commission to consider the following:

- Allow mutual funds to segregate liquid equity securities for purposes of covering derivative liabilities; and
- Formally clarifying that the use of custodial bank escrow receipts can be treated as a form of margin for covering derivative liabilities.

Gateway, a registered investment adviser founded in 1977, has lengthy experience with index options-based strategies and is one of the largest low volatility option-overlay managers in the U.S. For over 39 years, Gateway has endeavored to deliver low volatility equity strategies to risk-conscious investors. As of February 29, 2016, Gateway had \$11.3 billion in assets under management. The majority of such assets are held in U.S. registered investment companies. Gateway-managed funds provide a low-cost means for consumers to invest in the equities market but with markedly less volatility due to its use of index option derivatives. Although Gateway does not use leverage as part of its investment strategies, we are concerned that the use of derivatives to reduce volatility could be adversely affected as a result of the asset segregation requirements provided for in the Proposed Rule.

For example, the Gateway Fund (the “Fund”), which is a member of the Natixis Funds family and advised by Gateway, has been in existence since December 1977 and has total assets of over \$8 billion as of February 29, 2016. The Fund has the stated objective by which it “seeks to capture the majority of the returns associated with equity market investments, while exposing investors to less risk than other equity investments”.<sup>1</sup> The Fund invests in a broadly diversified portfolio of common stocks, while also selling index call options and purchasing index put options. Writing index call options reduces the Fund’s volatility, provides a steady cash flow and is an important source of the Fund’s return. The Fund also buys put options which can protect the Fund from a significant market decline that may occur over a short period of time. As seen in the Fund’s performance and standard deviation record in Appendix A, the Fund has exposed investors to less volatility than an investment in a fund that invests solely in a broadly diversified portfolio of common stocks. The Fund uses its full underlying portfolio of liquid equities to “cover” the entire notional amount of its written index calls.

The Proposed Rule states that cash is an appropriate asset with which to “cover” a fund’s derivative obligations as the Commission is concerned about the risk that equity securities “could decline in value at the same time the fund’s potential obligations under the derivatives transactions increase, thus increasing the possibility that such assets could be insufficient to cover the fund’s obligations under derivatives transactions.”<sup>2</sup> Gateway submits that segregating liquid equity securities for purposes of covering derivative liabilities for hedging purposes is also appropriate, and respectfully requests that liquid equities remain an acceptable asset class to cover liabilities that are expected to change in value. Gateway has practiced this protocol for many years and has never experienced an issue with collateral coverage, or lack of funds, to “buy back” a written call position.

Consider, for example, a written index call option. In the event that the written position is covered by a diversified equity portfolio with high correlation to the related index, *that same equity portfolio* is superior cover to cash in times of market stress referred to in the Proposed Rule. Namely, the time of market stress for a written index call is when its liability rises sharply in value, i.e., when the index is rapidly rising. In such a market environment, the related equity portfolio is rising sharply in value as well, hardly a time of market stress for the covering asset, but rather a relatively easy time to sell equities and raise cash as needed. In this case, the use of liquid equity securities to satisfy the Fund’s coverage obligations reduces the Fund’s exposure to market risk, which is precisely one of the Commission’s goals when presenting the Proposed Rule.<sup>3</sup> Please also note that the investment management team at Gateway ensures daily that the Fund (and other low-volatility option funds advised or sub-advised by Gateway) has full notional coverage using equity securities. We believe this is stronger coverage (and

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<sup>1</sup> See Gateway Fund Prospectus dated May 1, 2015, available at [www.ngam.natixis.com](http://www.ngam.natixis.com).

<sup>2</sup> The Proposed Rule at 179-180.

<sup>3</sup> *Id.* at 188.

more protection for investors) than simply having enough cash to cover a given day's mark-to-market call liability.

Limiting asset coverage to cash and cash equivalents as provided for in the Proposed Rule would also be detrimental for the Fund and other funds pursuing similar strategies for the following reasons: (i) holding excess cash for the purpose of covering initial or subsequent margin would pose a cash drag on performance, which would likely detract from the Fund's return and (ii) utilizing cash for asset segregation would also make it difficult to execute the Fund's strategy when cash needs must be calculated and available on an on-going basis.

With regard to the Commission's request for comment regarding whether to allow a fund to reduce its mark-to-market coverage amount by the value of assets that represent variation margin or collateral,<sup>4</sup> Gateway agrees that it is appropriate for the required coverage amount to be reduced by margin in some form. Specifically, Gateway would ask the Commission to clarify that, for these purposes, "margin" should include escrow receipts issued by custodial banks. Custodial receipts have been permitted by FINRA for many years as a way to satisfy Options Clearing Corporation (OCC) margin requirements.<sup>5</sup> Under such program, escrow receipts are issued by the Fund's third party custodian bank evidencing adequate cover for the Fund's index option call liability. Years of witnessing the issuance of escrow receipts by third party custodians on the full value of a fund's underlying equities has led Gateway to strongly believe that counterparties to derivatives transactions, as part of protecting their own interests, do an excellent job in demanding adequate collateral and readily accept escrow receipts as satisfactory evidence thereof. This is an example of market forces robustly addressing regulatory concerns. Although it does not appear that escrow receipt protocols are explicitly contemplated in the Proposed Rule, we ask the Commission to clarify that escrow receipts will be permitted to be treated as margin for purposes of reducing a fund's segregation requirements.

In conclusion, Gateway understands the Commission's objective to limit the extent of a mutual fund's exposure to market risks; however, we believe the type of low volatility

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<sup>4</sup> *Id.* at 164.

<sup>5</sup> FINRA Rule 4210 (f)(2)(i)(iv) (2010) (Where a listed or OTC put or call option or stock index warrant is carried "short" in the account of a customer, against an escrow agreement, that is in a form satisfactory to FINRA, is issued by a third party custodian bank or trust company (the "custodian"), either is held in the account at the time the put or call is written, or is received in the account promptly thereafter, and is in compliance with the requirements of Rule 610 of The Options Clearing Corporation, no margin need be required on the put or call...In the case of a call option or warrant on a broad index stock group, the escrow agreement must certify that the custodian holds for the account of the customer as security for the agreement either cash, cash equivalents, one or more qualified securities, or any combination thereof, having an aggregate market value, computed as at the close of business on the day the call is written, of not less than 100 percent of the aggregate index value computed as at the same time and that the custodian will promptly pay the member the exercise settlement amount in the event the account is assigned an exercise notice.)



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funds managed by Gateway were not the type of funds the Commission envisioned as a potential risk to investors when proposing Rule 18f-4. We ask the Commission to consider the unintentional consequences faced by mutual funds that strive to lower market risks for investors through the use of derivatives as a hedging strategy (as opposed to the use of derivatives for leverage) when finalizing this Proposed Rule.

We hope our comments are helpful to the Commission and staff, and we will be pleased to discuss them in more detail. Questions about this letter may be directed to Donna Brown at ( [REDACTED] ).

Respectfully,



Paul R. Stewart  
President and CEO



Donna M. Brown  
General Counsel and CCO

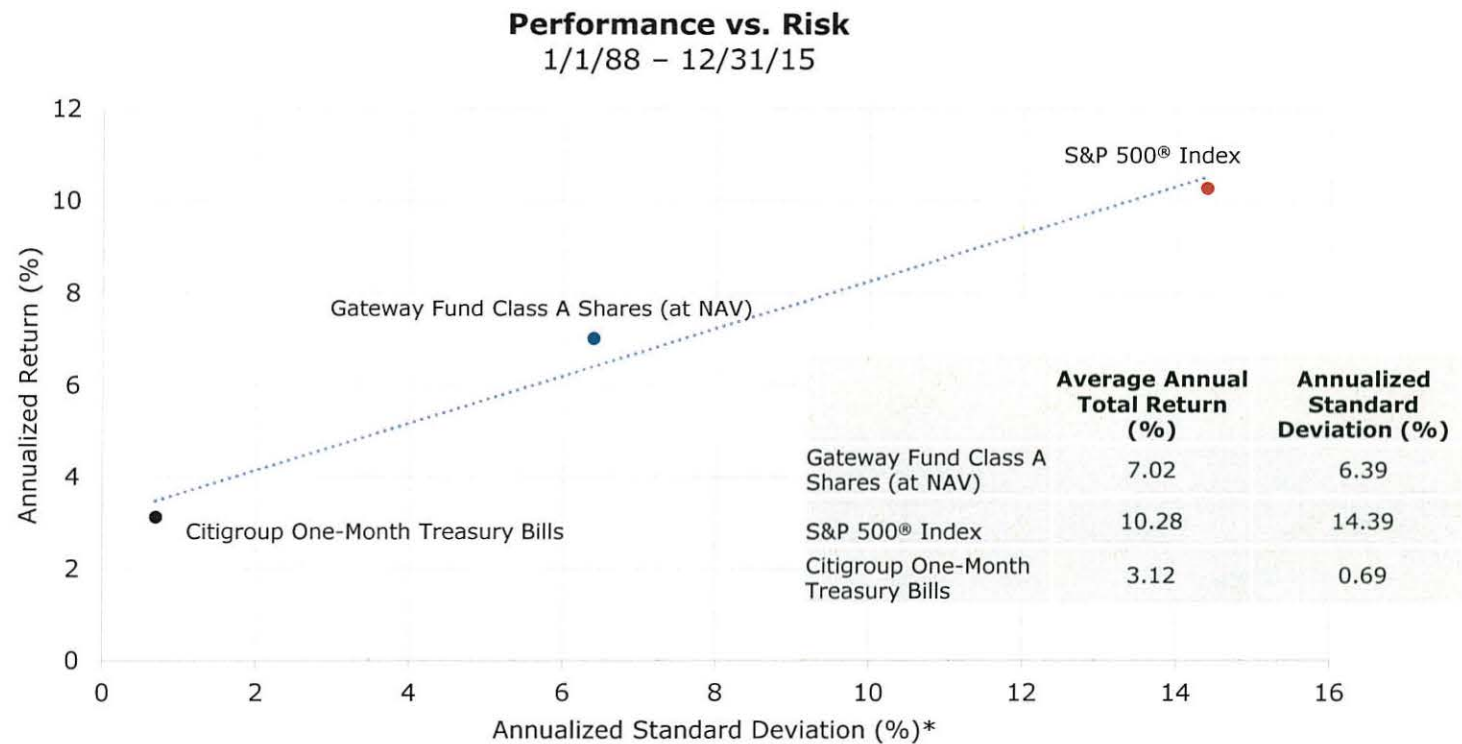
enclosure: Appendix A – Performance and Standard Deviation of the Gateway Fund

cc: The Honorable Mary Jo White  
The Honorable Kara M. Stein  
The Honorable Michael S. Piwowar

David W. Grim, Director  
Diane C. Blizzard, Associate Director  
Division of Investment Management

Russell Kane, Chief Compliance Officer, Natixis Funds

## Lowering volatility with index option overwriting has historically improved risk-adjusted return



Implied volatility's premium over realized volatility has contributed to the Gateway Fund's higher return per unit of risk over combinations of T-bills and the S&P 500® Index.

\*Based on monthly returns  
Datasource: Morningstar Direct<sup>SM</sup>

Performance data shown represents past performance and is no guarantee of, and not necessarily indicative of, future results.