March 28, 2016

VIA ELECTRONIC DELIVERY

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: **Investment Company Act Release No. IC-31933 (File No. S7-24-15)**

Proposed Rule on the Use of Derivatives by Registered Investment Companies and Business Development Companies (collectively, "RICs")

Dear Mr. Fields:

Campbell & Company, LP and Campbell & Company Investment Adviser, LLC (collectively "Campbell") welcome the opportunity to comment on the proposed rulemaking of the Securities and Exchange Commission ("**Commission**" or "**SEC**") regarding its proposed rule on the "Use of Derivatives by Investment Companies and Business Development Companies" (the "**Proposed Rule**").[1]

We generally support the Commission's efforts to provide an updated and more comprehensive approach to the regulation of Funds' use of derivatives and other transactions that raise "senior securities" issues under Section 18 of the Investment Company Act of 1940 (the "**1940 Act**"). However, we have significant concerns with certain aspects of the Proposed Rule, particularly the notional-based exposure limits, which have the potential to substantially restrict, or eliminate altogether, the ability of Funds to offer managed futures strategies to retail and other non-accredited investors in the regulated and board-supervised format of a mutual fund (such Funds, "**Managed Futures Funds**"). As discussed below, Managed Futures Funds have been an increasingly important choice for investors seeking returns that historically have not been correlated with other asset classes.

[1] 80 Fed. Reg. 80884 (Dec. 28, 2015) (the "**Proposing Release**").

1. Executive Summary

We believe that the combination of the Mark-to-Market Coverage Amount and Risk-Based Coverage Amount (as defined below) requirements in the Proposed Rule, together with the impending initial and variation margin requirements for over-the-counter ("OTC") derivatives, exchange-mandated initial and variation margin requirements for futures and other exchange-traded contracts, and the increased derivatives reporting requirements for Funds, represents a robust, comprehensive regulatory framework wholly sufficient to protect investors and Funds from the risks attributed to the use of derivatives.

If the Commission does proceed with adopting some form of the proposed notional-based exposure limits, we believe these limits would unnecessarily restrict or eliminate investor choice and deprive retail investors of a valuable portfolio diversification tool. The scope of the Proposed Rule with these limits would be unnecessarily broad when a more tailored approach could achieve an equivalent purpose without adversely affecting investors and their portfolios. As we discuss more fully below, investors have been increasingly turning to managed futures and funds that offer these strategies. Managed Futures Funds offer a source of liquid return historically and typically not correlated to other investment classes. Not only would the notional-based limits harm investor choice, but they may actually serve to increase risk in fund portfolios. Once subject to these limits, funds will exchange investments in derivatives that have relatively low risk per dollar of notional value (e.g., bond futures) for derivatives that have relatively high risk per dollar of notional value (e.g. natural gas futures) to generate returns while complying with the notional limits.

We believe such notional-based limits are unnecessary and suggest and explain below our proposals for more risk-sensitive alternatives to limiting leverage. We offer a margin-based approach, in which a Managed Futures Fund – in addition to complying with the Proposed Rule's new asset segregation requirements – would segregate additional assets equal to the initial margin of the derivatives in its portfolio.

2. Background – Managed Futures Funds and Strategies

Managed Futures Funds are those funds that typically take long and short positions in futures, options, swaps and foreign exchange contracts, both listed and over-the-counter, based on market trends or momentum. A majority of Managed Futures Funds follow trend-following or, price-momentum strategies. Other Managed

Futures Funds follow strategies including systematic mean-reversion, discretionary global macro and commodity index tracking strategies, among others.[2]

Managed futures strategies have historically produced return streams that are lowly-correlated to traditional investments in stocks and bonds, which feature so prominently in most investor portfolios. Although it is important to note that **past performance is not indicative of future results,** an investment in managed futures has shown the potential to lower the risk profile of a portfolio containing traditional investments.[3]

Because of the low historical correlation to stocks and bonds, managed futures strategies have shown the potential to provide valuable diversification in times of market stress and financial crisis in the equities markets in particular. For example, in 2008, when U.S. and international equities dropped 38% and 45%, respectively, managed futures experienced 13% positive returns.[4] More recently, for the first two full months in 2016, managed futures, as measured by the SG CTA Index (formerly the Newedge CTA Index), returned 7.27%, while the S&P 500 Index generated a negative return of (5.46%). We do not assert that managed futures strategies will perform well in all periods of decline for equity or fixed-income markets. However, the statistics above are just two examples that demonstrate the value of managed futures strategies as a tool for investors to maintain a balanced and diversified portfolio, which can facilitate the ability of investors to diversify their portfolios, thus providing a measure of protection against losses during market downturns.[5]

The appeal of liquid, transparent and uncorrelated returns has been a significant factor in the tremendous growth of managed futures strategies, including offerings through Managed Futures Funds. Assets managed by the managed futures industry

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2 This description of Managed Futures Funds and their investment strategies is based on Morningstar's criteria for its "Managed Futures" fund category, *available at* http://www.morningstar.com/InvGlossary/managed-futures.aspx.

3 For an excellent discussion and supporting information on this point please see the Millburn Richfield Corporation comment letter on the Proposal submitted to the Commission on March 28, 2016 ("Millburn Letter").

4 Figures cited reflect the returns of the S&P 500 Total Return Index, MSCI EAFE Developed Markets Index and the SG CTA Index (formerly the Newedge CTA Index), respectively.

5 See also discussion and supporting information regarding the performance of managed futures strategies during the worst 5 drawdowns of the S&P 500 Index from January 1987 (inception of the BTOP 50 Index) through December 2015 contained in the Millburn Letter

increased from approximately $300 million in 1980 to more than $200 billon by the end of 2008.[6] This rapid pace of growth continued after the financial crisis in 2007 and 2008, as indicated by the surge in investment in alternative strategies mutual funds (many of which use futures and other derivatives) increasing from $58 billion to $170 billion between 2009 and 2014.[7]

3. Comments on the Proposed Rule

We are fundamentally concerned with the Proposed Rule's limits on a Fund's derivatives notional exposure. The Proposed Rule would require Funds to comply with either one of two portfolio limitations immediately after entering into each derivatives transaction.

A. Notional Portfolio Limits Should be Unnecessary Due to Proposed Rule's Asset Segregation Requirements

If the notional-based limits are adopted as proposed, certain funds, including many Managed Futures Funds, may not be able to continue operations as they exist today. As acknowledged by the Commission, these funds may need to liquidate or deregister as investment companies. Investors in such funds would no longer have the opportunity to obtain their desired investment exposure or portfolio diversification benefits through a registered investment vehicle that is subject to the robust regulatory oversight of the Commission, and may not be able to replace such exposure. In addition, notional-based limits would have the unintended effect of increasing risk in funds that use derivatives.

The Proposed Rule makes notional value a scarce resource, and funds would be incentivized to allocate this resource to its highest value use. Funds would shift their derivatives exposures away from low-risk asset classes (such as interest rate future contracts and foreign exchange forward contracts) resulting in more concentrated positions in higher risk asset classes (such as natural gas futures contracts) to deliver performance while remaining under the hard notional limits. The Proposed Rule, accordingly, will permit those Funds to operate as mutual funds and be sold to retail investors, with *less diversification* and a *potentially higher risk*

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6 *See* "Understanding Managed Futures", Man Investments, *available at* https://www.maninvestments.com.au/files/default/file/research/200902-understanding-managed-futures.pdf.

7 Investment Company Institute (ICI), "2015 Investment Company Fact Book", 55th ed., at p. 44.

profile, as the number of markets would be decreased and an allocation to higher-risk asset classes would be increased. One of the examples cited in the Rule Proposal was the Amaranth matter. In that situation, the fund was not well diversified and had a highly concentrated position in natural gas futures contracts. That lack of diversification, combined with other factors, contributed to significant losses by a privately offered fund. We are concerned that an unintended consequence of the Rule Proposal's limits on derivatives notional exposure could be to eliminate highly diversified Managed Futures Funds as options to retail investors, while permitting the registration and offering of Managed Futures Funds that are highly concentrated in higher risk contracts. Accordingly, we are concerned that an unintended consequence of the Proposed Rule is the potential to *increase* the risk to retail investors who seek the low-correlation benefits of adding a managed futures strategy to a portfolio of traditional investments.

We instead believe that the asset segregation requirements under the Proposed Rule, as augmented by the Mark-to-Market Coverage Amount and Risk-Based Coverage Amount, if adopted, would be entirely sufficient to address the Commission's concerns over derivatives transactions risks.

The Proposed Rule would require a Fund to segregate on its books each day "qualifying coverage assets" ("**Qualifying Coverage Assets**") equal to the sum of a "**Mark-to-Market Coverage Amount**", which reflects the Fund's net obligations if the Fund exited its derivatives positions on such day, plus a "**Risk-Based Coverage Amount**", which is designed to capture additional losses the Fund would suffer if it exited its derivatives transactions under stressed market conditions. These combined asset segregation requirements would be a significant enhancement in investor protection by requiring Funds to earmark a greater amount of assets than has been required by the Commission over the past 40 years.

In 1979, the Commission set forth in Investment Company Act Release No. 10666 ("**Release 10666**")[8] a segregated account approach to address certain types of transactions that raise "senior securities" issues under Section 18. As described in Release 10666, this approach requires a Fund to segregate liquid assets sufficient to meet potential obligations arising from the Fund's investment in reverse repurchase agreements, firm commitment agreements and standby commitment agreements. The Commission reiterated and refined this approach through a series of more than

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8 Investment Company Act Release No. 10666 (Apr. 18, 1979).

twenty subsequent no-action letters, in which the Commission addressed how Funds must segregate assets against, or enter into cover transactions to offset, obligations arising under a wide array of derivatives transactions.[9]

The SEC's segregated account approach has been in effect for nearly four decades, throughout extreme market conditions, including the 1994 Mexican Peso crisis, the 1997 Asian crisis, the 1998 Russian crisis, the September 11th attacks, the dot-com equity collapse and most recently the 2008-9 global financial crisis. We are unaware of any adverse impact on Managed Futures Funds during or due to the events of any such crises, and the Commission does not discuss or identify any concerns with respect to a single Managed Futures Fund over the past 40 years. We note that, while the Commission does cite extensive losses suffered by a private fund investing in futures contracts, private funds are not subject to the SEC's asset segregation requirements or other SEC derivatives regulations and, thus, this rule would provide no protection with respect to those types of funds. We are further unaware of any other material event or occurrence, or series of events or occurrences, related to the operation of Managed Futures Funds and their use of derivatives to justify why the SEC would abruptly cease relying on its successful, long-standing asset segregation policy.

We believe that the asset segregation requirements in the Proposed Rule would not only preserve the Commission's traditional segregated account approach but also improve it by requiring Funds to segregate the new Risk-Based Coverage Amount. In addition, the Proposed Rule's asset segregation requirements would be supplemented by margin requirements for OTC derivatives that have been adopted, or will soon be adopted, by the Comptroller of the Currency, the Federal Reserve Board and certain other prudential regulators (collectively, the "**Prudential Regulators**"), as well as the CFTC and the SEC itself (the "**OTC Margin Rules**"). Based on the foregoing, there appears to be no need or justification for the imposition of the notional exposure limits.

9 Use of Derivatives by Investment Companies under the Investment Company Act of 1940, Investment Company Act Release No. 29776 (Aug. 31, 2011) at 23.

We note finally that we share this view with Commissioner Piwowar and support his dissenting statement on the Proposed Rule.[10] Commissioner Piwowar stated that he believes the Mark-to-Market Coverage Amount and Risk-Based Coverage Amount that Funds would be required to segregate, together with the newly implemented regulatory oversight for derivatives, including the OTC Margin Rules, and the enhanced mutual fund reporting requirements, should be sufficient to address the investor protections as they relate to Funds' use of derivatives.

B. We Recommend Replacing the Notional Approach with a Margin-based Approach for Enhanced Risk Sensitivity and Ease of Implementation

Nevertheless, if the Commission does require additional investor protections beyond its asset segregation requirements (as enhanced by the proposed Mark-to-Market Amount and Risk-Based Coverage Amount, if adopted), we urge the Commission to consider replacing the notional-based portfolio limits with a much simpler margin-based approach that, in our view, better quantifies and addresses the specific risks posed by a wide array of derivatives contracts.

Under this approach, Managed Futures Funds that use derivatives would be required to segregate on their books and records cash, cash equivalents or other liquid assets in an amount equal to the exchange-required initial margin for each futures contract traded, or in the case of OTC derivatives, an amount equal to the initial margin required under the OTC Margin Rules. This proposal would effectively force Funds to over-collateralize by 100% the initial margin requirements of their futures and other derivatives positions. This approach would allow Managed Futures Funds to maintain significant cash or other liquid assets to meet this enhanced asset segregation requirement, while at the same time allowing Funds to engage in appropriate levels of derivatives activity.

This approach is built upon the well-established use of margin that has successfully governed risk on the exchange-traded derivatives markets for decades. We note first that futures exchanges determine and review margin requirements, and continuously adjust these requirements to reflect risk and current market

[10] Commissioner Michael S. Piwowar Dissenting Statement at Open Meeting on Use of Derivatives by Registered Investment Companies and Business Development Companies, issued December 11, 2015.

conditions. Exchanges increase margins during volatile, riskier time periods across a wide variety of futures contracts, including fixed income, stock index and energy contracts. These margin amounts already reflect, account for and protect against market risk and they are continuously monitored and adjusted by the exchanges.

We note that under our margin-based approach, Managed Futures Funds would segregate additional assets for OTC derivatives based on the collateral requirements required by multiple regulatory bodies, including the Commodity Futures Trading Commission and the Prudential Regulators in their respective final OTC margin rules, as well as the Commission itself in its proposed OTC margin rules. In response to OTC margin requirements under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, these regulatory bodies have conducted extensive reviews and analyses of the appropriate initial and variation margin levels for OTC derivatives. The margin-based approach builds upon these important risk-reducing regulations to provide an even greater degree of protection to investors in Managed Futures Funds.

In addition, risk limits based on margin amounts address the Commission's concerns about overstating risks of large dollar value notional fixed income contracts such as the CME Eurodollar contract. A margin-based approach also avoids the uncertainty and inconsistencies that may arise when different Funds use different methods of calculating VaR, and is more responsive to evolving market conditions than VaR, which is based on a look-back period that may not capture spikes in volatility.

We acknowledge that the Commission may have certain concerns over the margin-based approach. However, we believe that this approach is time-tested, monitored continuously, simple in application, enforcement and testing, and narrowly tailored so as to reduce undue speculative trading activity. Funds would have fewer complicated formulas to apply and less flexibility for interpretation, reducing possible market manipulation or abuse. This approach also addresses the Commission's concerns regarding investor protection, while preserving the ability of investors to allocate to Managed Futures Funds and other affected Funds.

4. Request for Re-proposal of the Proposed Rule Following Receipt of Comments and Recommendations

We support the Commission's efforts to protect investors in mutual funds and other retail products from excessive risks related to derivatives transactions. The Proposed Rule is an important first step in addressing the extended, regulatory patchwork of Commission policy and guidance on these issues for nearly forty years.

We expect that the Commission will receive numerous recommendations, proposals and other comments on the Proposed Rule. After the Commission has reviewed and taken into account these comments, given the profound and unprecedented impact a final rule will have on the U.S. mutual fund industry, including Managed Futures Funds, we urge the Commission to re-propose the Proposed Rule, along with an additional comment period after the rule proposal has been amended to reflect comments received.

Thank you for considering our views on this important topic. If you have any questions or if we can provide any additional information that may assist the Commission and its Staff, please contact me at ([redacted] or at tom.lloyd@campbell.com.

Respectfully submitted,

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Thomas P. Lloyd
General Counsel

cc: The Honorable Mary Jo White
The Honorable Kara M. Stein
The Honorable Michael S. Piwowar
Diane C. Blizzard, Associate Director
Division of Investment Management