Rafferty Asset Management, LLC

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March 28, 2016

Mr. Brent J. Fields, 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, File No. S7-24-15

Dear Mr. Fields:

Rafferty Asset Management, LLC ("Rafferty") appreciates the opportunity to comment on proposed Rule 18f-4 under the Investment Company Act of 1940, as amended ("1940 Act" or "Act"). Rafferty is the sponsor of and investment adviser to the Direxion Shares ETF Trust ("Trust") and each of its separate series ("Direxion ETFs"). Many of the Direxion ETFs seek to provide daily returns, before fees and expenses, that correspond to three times the daily performance of an underlying index or three times the inverse (opposite) of the daily performance of an underlying index (the "3X ETFs" or "Funds").

The Commission's release proposing Rule 18f-4 ("Release") acknowledges that leveraged exchange-traded funds ("ETFs"), including the Direxion ETFs, were repeatedly granted exemptive relief by the Commission between 2006 and 2009,[1] with full knowledge of the Funds' structure and their use of derivatives. Since that time, the Funds have consistently complied with the conditions in the exemptive orders, have had no regulatory issues, and have become an important part of the securities markets.

Rule 18f-4, if adopted as proposed, would have significant negative ramifications for the Funds. The Commission recognizes the unique position of the Funds and has sought comment on whether the Commission should continue to permit the Funds to operate as they have for nearly a decade "pursuant to the terms and conditions of exemptive orders granted by the Commission."[2] For the reasons explained below, Rafferty submits that the proposed rule would be arbitrary and capricious as applied to the Funds. Therefore, Rafferty strongly opposes the adoption of Rule 18f-4, as proposed, and respectfully submits that it should be revised to grandfather the Funds or otherwise modified to clearly permit them to continue to operate under the 1940 Act.

I. Background

As the Release suggests, the investment landscape and the registered fund landscape, in particular, have changed since 1940 when the Act was adopted. Access to information and the markets has improved significantly since 1940. Implicit and explicit transaction costs have fallen as the brokerage industry has evolved and investors have become more empowered and independent.

The advent of online investing platforms has contributed to increased independence among investors. They routinely direct their own investments and, as a result, frequently pay investment-related fees that are dramatically lower than they would be if they had to invest through a traditional broker or financial advisor. These lower fees are widely believed to inure to investors' benefit by minimizing the "bite" that such fees take out of investment performance and maximizing investor returns.[3]

With such investor independence has come a new breed of registered funds. Among other things, whereas traditionally funds had been designed primarily to provide passive investors with a buy-and-hold investment by giving them access to a professional portfolio manager to whom they could defer for investment advice, some funds are now designed to provide active investors with tools that they can use to implement their own investment strategies.

Leveraged ETFs, including the Direxion ETFs, are one such type of investment tool. Rafferty's first leveraged ETFs were launched in 2008. Rafferty focused then, as we do now, on traders and tactical investors who employ dynamic strategies and may seek amplified exposure to a particular asset class, or the inverse performance of an asset class, on a short-term basis. The Funds provide such exposure at a significantly lower cost than alternatives, such as margin accounts.[4]

The ETF structure is particularly well suited to the strategies pursued by the Funds because it provides an efficient vehicle for short-term trading due to the simple fact that secondary market transactions in ETF shares may take place intra-day and investors know the per share price of such transactions immediately. In addition, secondary market transactions do not have any impact on a fund portfolio, so they can be effectuated without any direct impact on other fund shareholders.[5] Thus, Rafferty believes, and the Commission has likewise concluded,[6] that the ETF structure, which moves frequent trading by investors away from a fund portfolio to an exchange, is appropriate for the 3X ETF strategies.

The Trust currently has over fifty 3X ETFs listed on NYSE Arca, Inc. ("NYSE"). Each 3X ETF seeks *daily* investment results, before fees and expenses, of 300% of the performance or the inverse performance of a benchmark index ("Underlying Index").[7] The ETFs utilize derivatives to achieve their limited investment objective of obtaining the stated multiple, or inverse multiple, of the Underlying Index's *daily* return.

II. The Commission Granted Exemptive Orders for the 3X ETFs with a Clear Understanding of Their Leveraged Strategies and the Funds Have Operated Successfully Since Obtaining the Orders

The Funds began operation only after the conclusion of a lengthy exemptive application process. During that process the nature of the Funds was considered at length by the Commission's Division of Investment Management ("Division"), and the exact amount of leverage to be obtained by the Funds was an important factor considered by the Division. In this regard, the Commission's notice of the Funds' initial application for exemptive relief stated:

> The Funds will seek daily investment results, before fees and expenses, that… (b) provide up to 400% of the return of their Underlying Indices ("Leveraged Funds"); or (c) provide up to 400% of the inverse performance of their Underlying Indices ("Inverse Funds").[8]

Pursuant to the exemptive order ultimately issued to Rafferty and the Funds ("First Order"), the Funds were allowed to obtain notional exposures of 400%. However, they were required to invest at least 80% of their total assets in the component securities of their Underlying Indices. Stated differently, they were allowed to obtain exposures of up to 400% of their assets but were only allowed to obtain exposures of approximately 320% of their assets from investments in derivatives. The Division, acting "for the Commission" pursuant to authority delegated to it by the Commission, granted the First Order, finding the relief requested to operate the Funds to be "necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act."

Almost one year later, the Commission granted a second exemptive order to Rafferty and the Funds ("Second Order," and together with the First Order, "Orders"),[9] which re-defined the terms "Leveraged Fund" and "Inverse Fund." Specifically, the Second Order defined Leveraged Funds to mean funds seeking up to 300% of the performance of an Underlying Index and defined Inverse Funds to mean funds seeking up to 300% of the inverse performance of an Underlying Index. Importantly, unlike the First Order, the Second Order did not require Leveraged or Inverse Funds to invest any particular percentage of total assets in the component securities of their Underlying Indices. Rather, the Second Order permitted both Leveraged and Inverse Funds to obtain all of their exposures from derivatives. Like the First Order, the Division, acting "for the Commission," granted the Second Order again on the grounds that it was "necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act."

Taken together, the Orders indicate that the Commission has *twice* examined the appropriate amount of derivative usage to permit for the Funds and *twice* concluded that it would be "necessary or appropriate in the public interest and consistent with the protection of investors" to permit the Funds to obtain at least 300% exposure from derivatives. Given the successful operation of the Funds since the Orders were issued, Rafferty does not believe that there is current justification for restricting the Funds' exposures from derivatives to 150%. To the contrary, Rafferty believes that the Funds' operations have further justified the Commission's issuance of the Orders and urges the Commission to reconsider whether its Section 6(c) findings in the Orders and the Funds' operations to date can be reconciled with the proposed 150% limit on the Funds' exposures from derivatives.

III. The Justifications Offered in the Release Do Not Support the Application of the Proposed Rule to 3X ETFs

Proposed Rule 18f-4(a)(1)(i) would impair the ability of the Funds to continue to operate under the 1940 Act. The proposed rule achieves this result by limiting the aggregate exposure that could be obtained by the Funds through investments in derivatives to "150% of the value of the fund's net assets."[10] The Release primarily offers one justification for the 150% cap -- "undue speculation."

Neither the statute nor any Commission release has ever defined "undue" speculation, but the Release implies that it includes an element of magnitude and an element of expectation. In other words, a certain *amount* of derivatives usage by a fund may constitute undue speculation and the *unexpected* usage of derivatives by a fund may constitute undue speculation.

For the reasons discussed below, Rafferty does not believe that the 3X ETFs obtain *so much* exposure from derivatives as to cause them to be unduly speculative. In fact, the amount of exposure obtained by the Funds from derivatives is exactly the same today as was specifically authorized by the Commission in the Orders. In addition, for the multitude of reasons detailed below, the Funds certainly do not engage in any *unexpected* usage of derivatives such that they could reasonably be deemed to be unduly speculative.

Further, Rafferty is concerned that Rule 18f-4 will lead to regulatory arbitrage that is harmful to investors inasmuch as Rule 18f-4, if adopted as proposed, may result in 3X strategies migrating to other exchange-traded structures that impose greater costs on investors and provide fewer protections for investors. Under such circumstances, investors could actually be harmed – rather than helped – as intended by the proposed rule.

A. "Undue Speculation" Concerns Do Not Justify the 150% Derivatives Cap for 3X ETFs

The Release states that a cap higher than 150% "could implicate the undue speculation concerns expressed in Sections 1(b)(7) and 1(b)(8) of the Act,"[11] and implies that the proposed 150% limit is a function of the 300% asset coverage requirement set forth in Section 18(f) of the 1940 Act. Rafferty does not believe that an across-the-board 150% limit is mandated by Section 18(f) or that such an across-the-board limit is appropriate. An exclusive focus on the magnitude of a fund's notional exposure from derivatives ignores other factors that impact the risk profile of a fund investing in derivatives. Such factors include the complexity of the derivatives, the volatility and liquidity of the derivatives' reference asset, and the liquidity of the derivatives themselves, including their term and termination provisions. Additionally, an across-the-board cap neither makes a distinction between derivatives or reference assets that can be liquidated in a matter of days and those that can only be liquidated over many months.

The derivatives employed by each Fund typically reference a single benchmark, which is typically the relevant Fund's Underlying Index. The Funds do not aggregate derivatives that can interact in unexpected ways.[12] Rather, they typically hold total return swaps that are terminable at any time by the Fund and the exposure in each Fund is rebalanced daily to provide the same ratio of exposure to net assets (*i.e.,* 3 to 1) each trading day. The derivatives are not opaque or hard-to-value, but rather are straightforward, liquid instruments that refer to liquid benchmarks. Each derivative provides for complete daily liquidity, meaning they can be terminated at any time by a Fund, without penalty. Additionally, the swap contracts utilized by each Fund contain loss limitations that would limit a Fund's losses if the underlying reference assets were to moves more than a certain percentage.[13] In short, the characteristics of the derivatives that the Funds employ expose investors to less risk than funds that use more exotic derivatives.

In addition, it is important to acknowledge that the Funds are entirely passive. Each tracks the performance of an Underlying Index, which is an index composed entirely of securities that meet certain liquidity requirements, as established by NYSE. These characteristics of the Funds expose investors to less risk than funds that employ more complicated, principally active strategies, where derivatives usage can "creep" up or affirmatively be ramped up without limit.

In sum, while Rafferty can agree that leverage is *one* factor that contributes to risk, we cannot agree that it is the *only* factor. Thus, if the Commission determines to move forward with a final version of Rule 18f-4, Rafferty urges the Commission to distinguish in the rule between funds that are passively managed and invest exclusively in derivatives that are reset to achieve the same notional exposure daily and can be liquidated daily and funds that employ very different, and potentially more complicated, derivatives strategies. Such a distinction would be fully justified given the distinctly different risk profiles of the Funds and other vehicles, respectively.

B. Unlike the Investment Companies in the Enforcement Actions Cited in the Release, the Funds Clearly Disclose Their Daily Leveraged Investment Strategies and Do Not Expose Investors to an Unexpected Use of Derivatives

The Funds employ several measures to seek to ensure that investors understand their investment objectives and the associated risks, and the Funds do not drift from the investment objectives and strategies disclosed to investors. In this regard, Rafferty notes that all of the enforcement cases in the Release involved actively managed funds. The 3X ETFs are not actively managed funds. To the contrary, each Fund is a passive investment vehicle. Its sole objective is to provide returns that correspond on a daily basis to a multiple, or an inverse multiple, of its Underlying Index. Thus, while the Funds do obtain levered exposure from investments in derivatives, the similarities between the Funds and those in the enforcement actions stop there.

Unlike the portfolio managers of actively managed funds, portfolio managers of index funds – even leveraged index funds – have little discretion. They are as constrained as the index-tracking strategy of the funds they manage. Accordingly, the portfolio managers do not have the same opportunity to inconsistently use derivatives and drift from the disclosed investment mandate that actively managed funds employing derivatives do.

In addition, each Fund employs a naming convention that is designed to tell an investor – even if s/he reads nothing but the name of the Fund – that the Fund is an index fund that seeks leveraged returns on a daily basis. The naming convention of the Funds is as follows:

Direxion + Daily + Underlying Index + Bull (Bear) + 3X + Shares

Thus, for example, our Leveraged Fund that tracks the S&P 500 Index is named the "Direxion Daily S&P 500 Bull 3X Shares," and our Inverse Fund tracking the same index is named the "Direxion Daily S&P 500 Bear 3X Shares." This naming convention conveys that: the Funds are short-term (*i.e.,* daily) investment vehicles; they are leveraged (*i.e.,* 3X); they track an index (*e.g.,* S&P 500); and they seek long (*i.e.,* Bull) or short (*i.e.,* Bear) exposure to the Underlying Index.

In addition to adhering to this descriptive naming convention, the Funds provide the following disclosure in boldface type on the first page of the summary prospectus immediate below each Fund's investment objective:

> **The Fund is designed to be utilized only by knowledgeable investors who understand the potential consequences of seeking daily leveraged investment results, understand the risks associated with the use of leverage, and are willing to monitor their portfolios frequently. The Funds seeks daily leverage investment results relative to the Index and is different and riskier than similar benchmarked exchange-traded funds that do not use leverage. Therefore, the Fund is not intended to be used by, and is not appropriate for, investors who do not intend to actively monitor and manage their portfolios.**

Additionally, the following disclosure appears in boldface type at the front of the statutory prospectus and Statement of Additional Information:

> **The Funds are not suitable for all investors. The Funds are designed to be utilized only by sophisticated investors, such as traders and active investors employing dynamic strategies.**

Furthermore:

Investors who do not understand the Funds or do not intend to actively manage their funds and monitor their investments should not buy the Funds.

If a Fund's underlying index moves more than 33% on a given trading day in a direction adverse to the Fund, the Fund's investors would lose all of their money.

The Release seeks to justify the proposed rule by citing several enforcement actions involving funds that had derivatives-related losses.[14] Those enforcement actions can be summarized as follows:

- In *In the Matter of Oppenheimer Funds, Inc.*, Investment Company Act Release No. 30099 (June 6, 2012), involving an open-end mutual fund that invested in junk bonds, the Commission found that the respondents failed to disclose "the fund's practice of assuming substantial leverage on top of those investments."

- In *In the Matter of Fiduciary Asset Management LLC,* Investment Company Act Release No. 30309 (Dec. 19, 2012), involving a closed-end investment company, the Commission found that the registration statement "made no mention of the downside risks the Fund could face by trading index put options and variance swaps, including leveraged exposure to market declines or exposure to spikes in market volatility."

- In *In the Matter of Claymore Advisors, LLC,* Investment Company Act Release No. 30308 (Dec. 19, 2012), involving a closed-end investment company, the Commission found that there was "no mention of the downside risks the Fund could face by trading index put options and variance swaps, including the Fund's leveraged exposure to market declines and to spikes in market volatility."

- In *In the Matter of UBS Willow Management LLC and UBS Fund Advisor LLC,* Investment Company Act Release No. 31869 (Oct. 16, 2015), also involving a closed-end fund, the Commission found that the adviser failed to disclose it had reversed the Fund's investment strategy from investing in distressed debt to investing in credit default swaps and, in that connection, failed to disclose that the credit default swaps had "synthetic leverage" that "amplified the Fund's profits and losses."

Given the above-recited disclosures made by 3X ETFs, however, the Commission cannot reasonably contend the 3X ETFs' disclosures suffer from similar defects. As noted above, the leveraged nature and use of derivatives by 3X ETFs is clearly disclosed. Further, in the case of 3X ETFs, they not only clearly state how they use derivatives, but they also fully and transparently disclose the actual derivatives that they hold in type and amount on a daily basis in each Fund's daily holdings file and on their website. These disclosures stand in stark contrast to the lack of disclosures at the heart of the enforcement actions cited in the Release and reinforce that the Funds do not present the concerns raised by these enforcement cases.

Further, in addition to the disclosure provided by the 3X ETFs themselves, there are substantial compliance processes at brokerage firms that pertain to purchases of 3X ETF shares. In June 2009, the Financial Industry Regulatory Authority ("FINRA") issued Regulatory Notice 09-31, entitled Non-Traditional ETFs, in which it "remind[ed] firms of sales practice obligations relating to leveraged and inverse exchange-traded funds." This included ensuring that its written supervisory procedures require that:

1) "the appropriate reasonable-basis suitability analysis is completed;"
2) "associated persons perform appropriate customer-specific suitability analysis;"
3) "all promotional materials are accurate and balanced;"
4) "all FINRA and SEC rules are followed;"
5) that firms "document the steps they have taken to ensure adherence to these procedures;" and
6) that firms "train registered persons about the terms, features and risks of all ETFs that they sell, as well as the factors that would make such products either suitable or unsuitable for certain investors."

Notice 09-31 further stated that the training "should emphasize the need to understand and consider the risks associated with such products, including the investor's time horizons, and the impact of time and volatility on the fund's performance."

Similarly, in January 2012, FINRA issued Regulatory Notice 12-03, establishing heightened supervision requirements involving the sale of certain products, including leveraged and inverse ETFs. More specifically, Notice 12-03 required a list of questions registered representatives must be able to answer before recommending the products, a post-approval review process, training of registered representatives, consideration of a customer's financial sophistication, required conversations with the customer, and other steps. Thus, in addition to the compliance procedures applied to the Funds under Notice 09-31, these heightened supervision requirements became applicable to the Funds.

Broker-dealers have responded to these requirements by taking steps, for example, to enhance investor education, limit who can purchase the products, and limit the amount of an account that can be invested in these products. In the same vein, fund supermarkets have developed and employ cautionary point-of-sale disclosure in connection with transactions.[15] Such disclosure appropriately echoes the disclosures the Funds provide in the 3X ETFs prospectuses, including that they are intended for individuals that actively monitor their investments.

As a result of the extensive disclosure provided by the Funds and broker-dealers, the products have become well understood, and available market data supports the contention that investors do, in fact, understand the products. Most importantly, as presented in detail in Appendix C and the related exhibits, based on publicly available market data information, Rafferty has been able to calculate the average holding period ("implied holding period") by investors of shares of each of the eight Direxion ETF that were operational between December

1, 2008 and April 30, 2009.[16] As presented in Appendix C, the implied holding period was less than one day for seven (of the eight) Direxion ETFs and slightly over one day for one of the Direxion ETFs.[17] Similarly, from May 1, 2009 through July 31, 2015, the implied holding period for the eight Direxion ETFs studied ranged only from 1.18 days to 4.03 days.[18] Based on the Release, it does not appear that the Commission's staff (the "Staff") has yet analyzed such data in connection with the proposed rule. Rafferty believes that such data analysis is critical to the Commission moving forward with the proposed rule as applied to the Funds, including because the implied holding period data in Appendix C strongly suggests that *investors understand and actively trade Fund shares*. The Commission should not adopt the proposed rule based on an unsubstantiated concern or fear, or isolated cases, to the contrary.

In summary, investors in 3X ETFs receive extensive and direct disclosure regarding the Funds' strategies, use of derivatives, leverage and related risks both from the Funds themselves and from their brokerage firm as well. As a result, they understand the products, and their understanding of the products is evidenced by their active trading of them, which is reflected in the short implied holding periods of their shares. Thus, Rafferty does not believe that the use of derivatives by the Funds is, or can reasonably be deemed to be, unexpected by an investor. Therefore, to the extent that a fund's speculation may be characterized as "undue" speculation within the meaning of the Act because its investors did not anticipate such leverage from its offering documents, the Funds cannot reasonably be viewed as engaging in undue speculation and should be carved out of any rule based on such undue speculation concerns.

C. The Loss of 1940 Act Protections for Investors Undermines the Investor Protection Rationale for the Rule

The Release recognizes that the proposed rule may have negative implications for certain funds under the 1940 Act and suggests that such funds "may wish to consider deregistering under the 1940 Act, with the fund's sponsor offering the fund's strategy as a private fund or as a public (or private) commodity pool, which do not have statutory limitations on the use of leverage."[19] The Release states that these alternatives could be "marketed to a more targeted investor base (*i.e.,* those with higher incomes or net worth, in the case of private funds, and those familiar with commodity pool investment partnerships, in the case of public commodity pools) and would not be expected by their investors to have the protections provided by the Investment Company Act."[20] While this suggestion may be appropriately directed to funds that pursue managed futures and other complex derivatives-based strategies typically associated with "hedge funds" and commodity pools that originated in the private markets, it is not appropriately directed toward 3X ETFs and other index-based products. Such funds and strategies are trading vehicles created in response to market demand, and have historically been available to the public and belong on exchanges.

For that reason, should the 3X ETFs lose the ability to operate as investment companies under the 1940 Act, they would not retreat to the private markets. Rather, they would likely continue to operate as exchange-traded products ("ETPs") or exchange-traded notes ("ETNs") both of which are registered only under the Securities Act of 1933, as amended ("1933 Act").[21] Both of these products trade on an exchange. Neither, however, has the protection of the 1940 Act. Thus, the paradoxical impact of the proposed rule would be to migrate 3X ETFs from a more-regulated environment (covered by the 1933 and 1940 Acts) to a less-regulated environment (covered only by the 1933 Act).

In connection with such a migration, investors would lose important protections. To give but one example of the protections investors would lose, the 1940 Act requires ETFs to have a board of directors that exercises oversight over the investment adviser and protects shareholders. The Staff has described the board as "the shareholders' watchdog," particularly with respect to its review of the adviser's contract and related fees.[22] The Commission's Director of Enforcement has stated that the board is "the first line of defense in protecting mutual fund shareholders."[23] Additionally, independent directors oversee policies and procedures and monitor the use of derivatives and the liquidity of portfolio securities. However, no board oversees or monitors the operations of ETPs. Accordingly, any migration of these strategies to an ETP structure would result in the loss of important investor protections.

Instead of reorganizing as ETPs, the 3X ETFs could pursue operation as ETNs. Similar to ETPs, ETNs do not provide investors with the protections of the 1940 Act, including a board of directors. In addition, investors in ETNs, unlike investors in ETFs and ETPs, do not directly or indirectly own any underlying assets — they simply have an unsecured promise by the ETN sponsor to pay a return, and they have the same risk that any unsecured creditor of the ETP sponsor has. This increases the risks for investors because it exposes them to credit and issuer risk from a single issuer. Indeed, when Lehman Brothers filed for bankruptcy, investors in Lehman exchange-traded notes were reported to have lost billions of dollars because they had assumed the credit risk on Lehman Brothers.[24]

Because ETPs and ETNs are traded on the same public securities markets and platforms as a 1940 Act-registered ETF, investors would have the same access to invest in the strategies. They may not, however, understand or fully appreciate the fewer investor protections applicable to them. Yet they would almost surely incur the higher costs normally entailed by them. The Release nowhere explicitly considers the downside of removing the Funds from the 1940 Act – particularly in light of the Orders that they received and the Section 6(c) determinations made with respect to the Funds -- and contains no analysis of whether the costs of alternative structures would make them more expensive for investors.

IV. The Proposed Rule Is Arbitrary and Capricious in Selecting a Cap that Impairs the Ability to Offer Leveraged ETFs Under the 1940 Act Even Though the Commission Previously Approved Them and They Have Performed as Represented

The Act mandates that when the Commission engages in rulemaking, it consider whether the rule "will promote efficiency, competition, and capital formation." 15 U.S.C. §80a-2(c). The

Administrative Procedure Act condemns any rule that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. §706(2)(A). It requires that the Commission "examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made." *Chamber of Commerce v. SEC,* 412 F.3d 133, 140 (D.C. Cir. 2005), quoting *Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Auto. Ins. Co.,* 463 U.S. 29, 43 (1983).

- For example, in the *Chamber of Commerce* case, the D.C. Circuit held that in adopting a rule requiring 75% independent directors and an independent chairman, the Commission violated the APA because it failed to adequately analyze the costs of the rule and gave inadequate consideration to an alternative that two dissenting Commissioners had proposed.

- In *American Equity Investment Life Ins. Co. v. SEC,* 613 F.3d 166 (D.C. Cir. 2010), the D.C. Circuit vacated a rule stating that fixed indexed annuities are not annuity contracts on grounds that its analysis of the impact of the rule on efficiency, competition, and capital formation was arbitrary and capricious.

- In *Business Roundtable v. SEC,* 647 F.3d 1144 (D.C. Cir. 2011), the D.C. Circuit vacated Rule 14a-11, requiring public companies to provide shareholders with information about shareholder-nominated candidates for the board of directors, because, again, the Commission's analysis of the effect of the rule on efficiency, competition and capital formation was flawed. Now Justice Ginsburg, writing for the D.C. Circuit, stated that the Commission "inconsistently and opportunistically framed the costs and benefits of the rule; failed adequately to quantify certain costs or to explain why those costs could not be quantified; neglected to support its predictive judgments; contradicted itself; and failed to respond to substantial problems raised by commenters." Given that, the court stated, it wasn't even necessary to determine whether the rule should also be vacated because the Commission arbitrarily rejected alternatives.

Accordingly, we respectfully submit that careful consideration should be given to the following:

1. There is no finding that the extensive disclosures that the Funds make do not fully apprise investors of the precise risks of the funds, nor has the Commission ever charged or found that the disclosures regarding leveraged and inverse funds are inadequate.

2. There is no finding that the investors who currently purchase these Funds do not understand those risks and do not actively trade the Funds. In fact, the implied holding period calculations show that shareholder do actively trade the Funds, which indicates they understand the Funds and therefore the risks.

3. There is no finding that the Funds have not worked as represented both to the Commission at the time it approved them and to investors.

4. There is no finding with regard to why 300% exposure from derivatives was deemed acceptable by the Commission in 2009, but without any showing of any abuse by the Funds or failure to meet their regulatory obligations or failure of the Funds to perform as described, the 300% should now be reduced to a number that impairs the ability of the Funds to operate under the 1940 Act.

5. There is no finding that the use of derivatives is inconsistent with the purposes of the 1940 Act — rather, there is merely an arbitrary determination that a 150% across-the-board limit on derivatives applicable to every fund in every circumstance is appropriate no matter how the fund is used by investors, marketed, and disclosed. The Release cites no statutory language or legislative history in support of its selection of 150% as an appropriate across-the-board derivatives cap for the entire fund industry.

6. There is no connection drawn between the enforcement cases referenced in the Release and the operation of the Funds.

7. There is no finding in the Release that the Funds cause systemic risk. Indeed, the Release does not cite a single example where leveraged or inverse funds failed to sufficiently manage the risks resulting from the use of derivatives.

Finally, the Release provides insufficient analysis of the impact on efficiency, competition, and capital formation of these Funds potentially being unable to operate under the 1940 Act — precisely what the 1940 Act and the D.C. Circuit require of the Commission for it to adopt the rule. Yet, it is clear that these Funds provide a highly efficient means for effectuating certain short-term trading strategies; and investors who wish to employ such strategies would be harmed as the Funds may not be able to operate under the 1940 Act and may be forced to transact in an unregulated or less-regulated environment. Under such circumstances, capital formation would arguably be disserved rather than promoted by the proposed rule.

V. The Final Rule Should Be Modified to Grandfather or Otherwise Accommodate the Funds

A. The Final Rule Should be Modified to Permit the Funds to Continue to Operate Under the 1940 Act

As noted above, the Release proposes 150% cap on derivatives for registered funds; except funds that use derivatives to limit their value at risk ("VaR Funds") are permitted to utilize derivatives equivalent to as much as 300% of their net assets. Rafferty believes that 3X ETFs also should be permitted to utilize derivatives equal to as much as 300% of their net assets due to the straightforward manner in which they use derivatives to pursue passive investment strategies that are clearly and prominently disclosed to investors. In particular, Rafferty notes the following risk-limiting features of 3X ETFs and their usage of derivatives.

- The Funds are passively managed, meaning, their sole investment objective is to provide returns that correspond on a daily basis to a multiple, or an inverse multiple, of a benchmark index.

- Each benchmark index is (a) wholly comprised of securities, which in the aggregate meet liquidity requirements established by national securities exchanges in consultation with the Commission,[25] and (b) created, compiled, sponsored, and maintained by an unaffiliated third party.

- Each Fund's investment objective is to pursue leveraged returns on a benchmark index *on a daily basis.* Thus, each Fund seeks and obtains only daily leveraged exposure, and its exposure is rebalanced on a daily basis. As a result, every trading day, the ratio between each Fund's notional market exposure and net assets is the same (3:1). There is no incentive or opportunity for a Fund to have different exposures over time (*i.e.,* no leverage creep) or to assume additional exposures to "make up" for lagging performance.

- The Funds normally invest in derivatives contracts with one, and only one, reference asset (*i.e.,* the relevant benchmark index). Thus, the Funds' returns are linear. They align with three times the return of the relevant Fund's benchmark index on a daily basis, and the returns on the Funds' derivatives are not materially affected by the performance of any other instrument in which the Funds invest.

- The derivatives in which the Funds invest are completely liquid. They can be closed out at any time without a penalty. In addition, they can be valued based on market quotations for the component securities in the underlying benchmark index and do not require fair valuation.

- The Funds' full portfolio holdings, including of derivatives contracts, are completely transparent. They are published to the market and disclosed on the Funds' website each day before the commencement of trading on the Funds' listing exchange.

- Each Fund employs a naming convention, which is described in detail above and which clearly and concisely signals the daily leveraged or inverse nature of its investment objective.

- The Funds provide explicit and expansive warnings, including on their prospectus cover page, that they are only appropriate for sophisticated investors who understand the daily leveraged nature of their strategies and the concept of compounding and who intend to monitor their portfolio frequently.

- Brokers have no financial incentive to sell the Funds' shares to investors. The Funds do not charge a sales load. The Funds do not charge Rule 12b-1 fees, and Rafferty has not entered into any revenue sharing arrangements with brokers for the distribution of Fund shares. In fact, many brokerage firms provide cautionary point-of-sale disclosures to investors purchasing shares of leveraged ETFs.[26]

Under the above-described circumstances where the Funds are using derivatives in a simplified manner in pursuit of a passive investment strategy and prominently disclosing their leveraged natures, both through a naming convention and risk disclosure, the Commission should permit them in Rule 18f-4 to obtain exposures of up to at least 300% of their net assets from derivatives. As discussed above: The Commission has *twice* previously approved at least 300% exposures from derivatives for the Funds; there has been no showing that the Funds have not worked as designed; the Funds now have approximately $9 billion in assets as a result of the Commission's prior actions; and the Release provides no compelling justification for moving them into a less-regulated environment that promises fewer investor protections and higher costs. Accordingly, Rafferty strongly urges the Commission to grandfather the Funds in connection with any adoption of the proposed rule or to include a carve out in the final rule, similar to that for VaR Funds, on which the Funds and other market participants could rely to offer up to 3X leveraged index ETFs.

Rafferty appreciates that the Commission may be concerned, on one hand, about the competitive effect of grandfathering the Funds and, on the other hand, the market effect of adopting a carve out that could be used by new market entrants to offer 3X leveraged index strategies. Rafferty is indifferent between these options.[27] In our view, the market for leveraged index-based strategies is inherently limited. In fact, Rafferty provides data in Appendix C, Exhibit 4, which shows that the level of total assets in leveraged ETFs has generally remained flat since 2011 while over the same period total assets in other registered ETFs have increased from approximately $1 trillion to approximately $2 trillion. Therefore, Rafferty does not believe that a carve out would attract a significant number of additional providers or assets to the leveraged index ETF business.

B. Absent Additional Data on Registered Funds' Usage of Derivatives and an Opportunity to Consider the Effect of the Final Liquidity Rule on Fund Portfolios, the Proposed 150% Limit Is Premature

Rafferty agrees with Commissioner Michael S. Piwowar's December 11, 2015 Dissenting Statement, in which he identified reasons that the Commission's proposal to impose a derivatives limit on registered funds under proposed Rule 18f-4 is, at best, premature. Most importantly, as he stated, other current rulemaking proposals "will either have a direct impact on the risks of derivatives positions held by funds, or will provide [the Commission] with data that could be used to better understand how we should regulate this market."[28]

For example, proposed new Form N-PORT will provide the Commission far more extensive information on funds' derivatives holdings to better enable the Commission to assess the exposures they create. As Commissioner Piwowar stated, “The data collected under that proposal would bear directly on issues of leverage and risk that are at the heart of [the Commission’s] recommendation,” and would inform the judgment on whether “there is any need to further limit funds’ use of derivatives.”

In addition, the proposed Liquidity Risk Management Program Proposal will require funds to classify their derivatives investments based on the number of days within which a fund’s position would be convertible to cash and to their liquidity risk. As Commissioner Piwowar observed, this could eliminate any reason for a 150% limit on derivatives as it “could reduce the risks associated with a fund’s use of derivatives by ensuring that funds account for their derivatives exposures in formulating and implementing their liquidity risk management programs.”

The Commission should also consider the impact of eliminating the 3X ETFs on the overall market, including the public securities market, options markets and market makers. Since the 3X ETFs’ inception in 2008, the Funds have had total historical trading volumes of over $5 trillion. In addition, options on leveraged ETFs which change investment objectives may be impaired if the referenced 3X ETFs are required to materially change their investment objectives. Rafferty encourages the Commission and its Division of Economic and Risk Analysis (“DERA”) to analyze the markets further before finalizing the proposed Rule.

In summary, the Release provides no justification for the 150% cap that is being proposed. Further, the Commission will obtain more information – and relevant information – from its recent N-PORT and pending rulemakings. Thus, if the Commission opts not to modify the proposed rule as suggested above, we urge the Commission to delay adopting a final rule in this area until its Staff and commenters can review and consider the data generated by the Commission’s N-PORT and liquidity rulemaking efforts.

VI. Conclusion

For the reasons described above, we respectfully submit that Rule 18f-4, as proposed, would be arbitrary and capricious as applied to the Funds and, therefore, if the Commission moves forward with a final rule, it should grandfather the Funds or otherwise permit them to continue to operate under the 1940 Act.

Respectfully submitted,

/s/ Angela Brickl

Angela Brickl
General Counsel
Rafferty Asset Management, LLC

APPENDIX A

The Funds

Direxion Daily S&P 500 Bull 3X Shares
Direxion Daily S&P 500 Bear 3X Shares
Direxion Daily Mid Cap Bull 3X Shares
Direxion Daily Mid Cap Bear 3X Shares
Direxion Daily Small Cap Bull 3X Shares
Direxion Daily Small Cap Bear 3X Shares
Direxion Daily Brazil Bull 3X Shares
Direxion Daily Developed Markets Bull 3X Shares
Direxion Daily Developed Markets Bear 3X Shares
Direxion Daily Emerging Markets Bull 3X Shares
Direxion Daily Emerging Markets Bear 3X Shares
Direxion Daily FTSE China Bull 3X Shares
Direxion Daily FTSE China Bear 3X Shares
Direxion Daily FTSE Europe Bull 3X Shares
Direxion Daily India Bull 3X Shares
Direxion Daily Japan Bull 3X Shares
Direxion Daily Latin America Bull 3X Shares
Direxion Daily Russia Bull 3X Shares
Direxion Daily Russia Bear 3X Shares
Direxion Daily South Korea Bull 3X Shares
Direxion Daily Gold Miners Index Bull 3X Shares
Direxion Daily Gold Miners Index Bear 3X Shares
Direxion Daily Healthcare Bull 3X Shares
Direxion Daily Healthcare Bear 3X Shares
Direxion Daily Junior Gold Miners Index Bull 3X Shares
Direxion Daily Junior Gold Miners Index Bear 3X Shares
Direxion Daily Natural Gas Related Bull 3X Shares
Direxion Daily Natural Gas Related Bear 3X Shares
Direxion Daily Retail Bull 3X Shares
Direxion Daily Semiconductor Bull 3X Shares
Direxion Daily Semiconductor Bear 3X Shares
Direxion Daily Energy Bull 3X Shares
Direxion Daily Energy Bear 3X Shares
Direxion Daily Financial Bull 3X Shares
Direxion Daily Financial Bear 3X Shares
Direxion Daily Real Estate Bull 3X Shares
Direxion Daily Real Estate Bear 3X Shares
Direxion Daily Technology Bull 3X Shares
Direxion Daily Technology Bear 3X Shares

Direxion Daily 7-10 Year Treasury Bull 3X Shares
Direxion Daily 7-10 Year Treasury Bear 3X Shares
Direxion Daily 20+ Year Treasury Bull 3X Shares
Direxion Daily 20+ Year Treasury Bear 3X Shares
Direxion Daily Oil & Gas Exp. & Prod. Bull 3X Shares
Direxion Daily Oil & Gas Exp. & Prod. Bear 3X Shares
Direxion Daily S&P Biotech Bull 3X Shares
Direxion Daily S&P Biotech Bear 3X Shares
Direxion Daily Homebuilders & Supplies Bull 3X Shares
Direxion Daily Homebuilders & Supplies Bear 3X Shares
Direxion Daily Regional Banks Bull 3X Shares
Direxion Daily Regional Bank Bear 3X Shares

APPENDIX B

Example of Broker-Dealer Point-of-Sale Disclosure for Purchases of Shares of Leveraged and Inverse ETFs

As discussed in in the body of the letter (at Section III.B), various broker/dealers and other brokerage platforms on which the Funds may be purchased or sold by investors provide additional information to shareholder prior to the purchase of leveraged or inverse ETFs shares. When an investor seeks to purchase shares of a leveraged ETF through an on-line transaction with a broker platform, specific information regarding leveraged ETFs appears. Below is an example from a major brokerage firm of the language provided to investors prior to the purchase of shares of a leveraged ETF. Most brokerage firms provide similar language prior to the purchase of leveraged/inverse ETF shares.

Example of Additional Information Provided to Purchasers of Leveraged and Inverse ETFs

> Leveraged and Inverse ETPs entail unique risks and are intended for sophisticated investors. They are not designed for investors who seek to track an index over a long period of time. An inverse ETP attempts to mimic the opposite of the performance of its stated benchmark. A leveraged ETP seeks to generate a return that is a multiple of its benchmark index's performance. Both seek results over a pre-set time period indicated in the prospectus or offering circular. That time period is often one day. As a result, their returns can differ significantly, both positively and negatively, from that of their benchmark index, especially over investment periods lasting longer than one day. Investors should, therefore, monitor their holdings consistent with their strategies, as frequently as daily.
> Exchange traded products (ETPs) are subject to market volatility and the risks of their underlying securities which may include the risks associated with investing in smaller companies, foreign securities, commodities and fixed income investments. Foreign securities are subject to interest-rate, currency-exchange-rate, economic, and political risks, all of which are magnified in emerging markets. ETPs that target a small universe of securities, such as a specific region or market sector are generally subject to greater market volatility as well as the specific risks associated with that sector, region or other focus. ETPs which use derivatives, leverage, or complex investment strategies are subject to additional risks. The return of an index ETP is usually different from that of the index it tracks because of fees, expenses and tracking error. An ETP may trade at a premium or discount to its Net Asset Value ("NAV") (or Indicative Value in the case of ETNs). Each ETP has a unique risk profile which is detailed in its prospectus, offering circular or similar material, which should be considered carefully when making investment decisions.

Then via hyperlinks, this additional information is available for potential investors:

Leveraged (ETF): A type of Exchange Traded Product (ETP) that seeks to amplify the potential returns and/or potential losses of a benchmark index. Leveraged ETPs seek results over a pre-set time period indicated in the prospectus or offering circular. That time period is often one day. As a result, their returns can differ significantly, both positively and negatively, from that of their benchmark index, especially over investment periods lasting longer than one day. These ETPs use a variety of derivatives such as futures, options and swaps. They aim to keep a constant amount of leverage during the investment time frame, (often one day) such as a 2:1 or 3:1 ratio. Leveraged ETPs can either amplify returns and losses on the long side of the market or the inverse side of the market.

Inverse: A type of Exchange Traded Product (ETP) that seeks to profit from a negative move in its stated benchmark index. Inverse ETPs generally seek results over a pre-set time period indicated in the prospectus or offering circular. That time period is often one day. As a result, their returns can differ significantly, both positively and negatively, from that of their benchmark, especially over investment periods lasting longer than one day. These ETPs use a variety of derivatives such as futures, options and swaps. These ETPs may give an investor single or multiple (leveraged) inverse exposure, such as double or triple inverse exposure. These ETPs are also known as "Short" or "Bear" ETPs.

Leveraged/Inverse: Factor – A multiplier that identifies the leverage exposure. A leveraged fund provides the investor with exposure greater than 100% as compared to the underlying index. It can also be negative to provide inverse exposure. It is updated as by Marco Polo XTF as necessary and as stated in the prospectus.

Leveraged/Inverse: Rebalance Frequency - How often the fund or index rebalances its constituents. Leveraged ETPs typically rebalance daily. The data is updated as necessary to what is stated in the prospectus.

APPENDIX C

Data Analysis

The attached exhibits provides additional information regarding investors' use of Direxion ETFs by calculating the implied holding period (as defined above) during two periods and providing information regarding the growth of assets for the ETFs.

Exhibit 2 provides the implied holding period calculation for December 1, 2008 to April 30, 2009, for the eight Direxion ETFs that were operational during this period. This was a period of high volatility for the markets and is utilized by the SEC on its website as a cautionary example for investors of leveraged ETFs. During this period because of compounding and volatility, each Underlying Index's returns were positive, but the returns for all but one of the Direxion ETFs presented were negative. The SEC example assumes that investors held their shares for the entire period; however, the implied holding period of each ETF's shares ranged from less than half a day to slightly longer than one day (*i.e.,* 0.44 to 1.14 days). This data indicates that shareholders held their shares for a significantly shorter period of time than the entire period. In other words, based on the implied holding period, it is unlikely that an individual shareholder had the experience depicted in the SEC's example.

Exhibit 3 provides the implied holding period calculation for May 1, 2009 to July 31, 2015, for the same eight Direxion ETFs that were utilized in the first example. For this period, the cumulative returns for each underlying index were positive and the returns for three of the four long 3X ETFs exceeded 300% of the cumulative index return. Thus, if a shareholder had held during the entirety of this period, they would have experienced a spectacular return on their purchase. However, again as indicated by the implied holding period for each Fund, it is unlikely that a shareholder held shares for the entire period. The implied holding periods for the ETFs presented ranged from approximately four days to slightly over one day (*i.e.,* 1.18 to 4.03 days).

This data indicates that investors in the 3X ETFs understand these products and are using the products as intended, namely for short-term tactical trading. In fact, because the implied holding period was less during a period when the securities markets were highly volatile, the data also indicates that investors have an awareness of the volatility of the markets and decrease their holding period based on such volatility. Yet as shown by the returns of certain of these Funds for May 1, 2009 to July 31, 2015, it would not be unreasonable for a shareholder to hold shares in these Funds for longer than one day as long as the shareholder actively monitors their investment.

Finally, for the period January 1, 2011 through December 31, 2015, Exhibit 4 provides information regarding the growth of all 1940 Act-registered ETFs and, comparatively, the growth of 1940 Act-registered leveraged ETFs. During the period, total assets in 1940 Act registered ETFs grew from approximately $1 trillion to approximately $2 trillion during the period. In contrast, during the same period, total assets in all 1940 Act-registered leveraged ETFs grew from only approximately $21 billion to approximately $24 billion. This data supports the view that the overall market for leveraged ETF is inherently limited. Therefore, even if the Commission provides a carve out in the proposed rule to permit such strategies by registered funds, the number of new entrants that are likely to offer leveraged ETFs and the number of new assets that are likely to flow into leveraged ETFs will likely be limited.

Information regarding the data and methodology utilized in the analysis described above is attached hereto in the Report of S.P. Kothari, Ph.D, the Gordon Y. Billard Professor of Accounting and Finance at the Sloan School of Management of the Massachusetts Institute of Technology. *See* Exhibit 1 to this Appendix C. Rafferty invites the DERA to review the Report and examine the data, then conduct its own analysis and calculation of the asset growth of leveraged ETFs and the implied holding period of the 3X ETFs as compared to other investment vehicles, including unleveraged ETFs.

[1] Release at 103 and 103 n.229.

[2] Release at 110.

[3] *See e.g.*, James J. Angel et al*., Equity Trading in the 21st Century,* 1 QUART. J. OF FIN. 1 (Mar. 2011)*; and* Yannis Bakos, et. al, *The Impact of E-Commerce on Competition in the Retail Brokerage Industry*, 16 INFORMATION SYSTEMS RESEARCH 4 (Dec. 2005).

[4] As of the date of this letter, many investors have written comment letters that oppose this effort to eliminate or restrict the leveraged ETFs that currently exist. *E.g.,* Mar. 10, 2016 comment letter of Fei Li; Feb. 22, 2016 comment letter of Shreeniwas V. Iyer; Feb. 18, 2016 comment letter of Cavell Harris-Brandts; Feb. 12, 2016 comment letter of Al Smart; Jan. 27, 2016 comment letter of Mark Gorman; Jan. 27, 2016 comment letter of Jeff McG; Jan. 21, 2016 comment letter of Amod P. Lokre; Jan. 20, 2016 comment letter of Robert Croce; Jan. 12, 2016 comment letter of Nate Jones; Jan. 7, 2016 comment letter of John LaFave; Jan. 4, 2016 comment letter of Charles Royce; Dec. 13, 2015 comment letter of Saumil Patel; and Dec. 12, 2015 comment letter of Hussein Abdulrasool.

[5] *See* Actively-Managed ETF Concept Release, Investment Company Act Rel. No. 25258 at 7 (Nov. 8, 2001).

[6] *See* Orders *infra* at notes 8 and 9.

[7] *See* Appendix A (attached hereto).

[8] *In the Matter of Rafferty Asset Management, LLC*, Investment Company Act Release Nos. 28379 (Sept. 12, 2008) (notice) and 28434 (Oct. 6, 2008) (order).

[9] *In the Matter of Rafferty Asset Management, LLC*, Investment Company Act Release Nos. 28889 (Aug. 27, 2009) (notice) and 28905 (Sept. 22, 2009) (order). The relief was granted under Section 6(c) of the 1940 Act, which empowers the SEC to grant exemptions from the Act, or any rule or regulation adopted under the Act, "if and to the extent such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions" of the Act. As the D.C. Circuit has recognized, the SEC has generally exercised its authority under Section 6(c) "to adjust its provisions to take account of special situations not foreseen when the [Act] was drafted." *NASD v. SEC*, 420 F.2d 83, 92 (D.C. Cir. 1969), *vacated on other grounds, Investment Co. Inst. v. Campo*, 401 U.S. 617 (1971).

[10] Rafferty acknowledges that the proposed rule would allow certain funds to obtain exposures of as much as 300% of the value of their net assets. In order to rely on this provision of the rule, however, a fund's "full portfolio VaR" would need to be "less than the fund's securities VaR." The Funds could not satisfy this requirement. Therefore, this provision of the proposed rule would be inapplicable to them.

[11] Release at 95.

[12] *Compare U.S. Commodity Futures Trading Commission v. Amaranth Advisors LLC, et al.*, 07 Civ. 6682 (DC) August 10, 2009.

[13] The Funds take other measures that are designed to address the Commission's other historical concerns under Section 18(f) related to asset sufficiency. For example, as historically required under Investment Company Act Release No. 10666, 44 FR 25128 (Apr. 27, 1979), the Funds segregate the amount due to each swap counterparty on a daily basis. Each Fund's swap contracts require bi-lateral collateralization, meaning swap counterparties are required to post collateral to each Fund for amounts due to them under the swap contract due to changes in the value of the underlying reference assets. Each Fund also utilizes tri-party collateral arrangements to protect the Fund's interests. Pursuant to such arrangements, the collateral pledged by a Fund under a swap contract is held by the Fund's custodian in a segregated account rather than directly with a counterparty. Further, when using swap contracts, each Fund also utilizes several counterparties to limit its counterparty and credit risks.

[14] Release at 96.

15 *See* Appendix B (attached hereto) (for an example of such disclosure).

16 Rafferty used the December 1, 2008 through April 30, 2009 time period as a basis for its calculations due to the usage by the SEC of the same time period to develop a cautionary tale for investors about buying and holding shares of Leveraged and Inverse Funds. "Leveraged and Inverse ETFs: Specialized Products with Extra Risks for Buy-and-Hold Investors," Securities and Exchange Commission, (Aug. 18, 2009), available at https://www.sec.gov/investor/pubs/leveragedetfs-alert.htm. Rafferty supports the publication of such cautionary tales as a way to ward off investors who do not understand the Funds. However, Rafferty does not believe that such cautionary tales should be the basis for rulemakings, particularly when – as here – based on the implied holding period data provided in Appendix C (attached hereto), the cautionary tale does not appear to accurately describe the actual experience of Fund investors.

17 Four of these Direxion ETFs are Leveraged Funds and, therefore, attempt to provide returns that are 300% of the daily performance of an Underlying Index. The other four Direxion ETFs are Inverse Funds and, therefore, attempt to provide returns that are 300% the inverse of the daily performance of an Underlying Index.

18 Appendix C also provides an analysis of the performance of the same eight Direxion ETFs from May 1, 2009 through July 31, 2015. During this longer period, three of the four Leveraged Funds provided significant positive returns which were in excess of three times the performance of their respective Underlying Indices. Thus, contrary to the narrative spun by the Commission in its Investor Alert (that investors will invariably get "burned" if they buy and hold 3X ETFs), investors who held these Funds for the over 300 weeks studied would have achieved spectacular returns. Based on the data provided in Appendix C, Rafferty does not believe any investor actually did hold throughout the period or achieve such returns. As discussed in the body of the letter, the implied holding period for each 3X ETF during this period ranged from 1.18 to 4.03 days. Nevertheless, Rafferty believes it is important for the Commission to understand that holding leveraged ETFs for more than one day is not intrinsically irrational or necessarily financially catastrophic. As shown by these statistics, holding leveraged ETFs longer term may be both rational and profitable.

19 Release at 105.

20 Release at 105.

21 The term "ETP" is a broad term typically used to describe any and all products that trade on an exchange. *See* Gordon Rose, "What's the Difference between an ETF and an ETP?" (Mar. 21, 2011), available at http://www.morningstar.co.uk/uk/news/67711/what-is-the-difference-between-an-etf-and-an-etp.aspx. ETNs and ETFs are each a different type of ETP.

22 Statement of Julie M. Riewe, in "SEC Charges Investment Adviser and Mutual Fund Board Members with Failures in Advisory Contract Approval Process," (June 17, 2015), available at https://www.sec.gov/news/pressrelease/2015-124.html. Section 15(c) of the 1940 Act requires the independent directors of the board to evaluate all such information as may reasonably be necessary to evaluate the terms of any contract whereby a person undertakes to serve as an investment adviser of the fund.

23 Statement of Andrew Ceresney, in "SEC Charges Investment Adviser and Mutual Fund Board Members with Failures in Advisory Contract Approval Process," (June 17, 2015), available at https://www.sec.gov/news/pressrelease/2015-124.html.

24 *See* "ETN Credit Risk Rears its Ugly Head," Morningstar, (Sept. 18, 2008), available at http://investors.morningstar.com/news/cmsAcontent.html?t=OAKIX&src=Morningstar&date=04-08-2015&nav=no&region=USA&culture=en-US&ProductCode=mle&resourceId=253614.

25 With respect to benchmark indexes of domestic equity securities: 90% of the weight of the index must have a minimum market value of $75 million; 70% of the weight of the index must have a minimum monthly trading volume of 250,000 shares or minimum monthly notional volume of $25,000,000 for the last six months; no one security in the index can exceed 30% of its weight and the five largest positions in the index cannot exceed 65% of the weight of the index; the index must include at least 13 securities (with certain exceptions); and all

securities in the index must be NMS Stocks, as defined in Rule 600 of Regulation NMS under the 1934 Act. Similarly, with respect to benchmark indexes of foreign equity securities: 90% of the weight of the index must have a minimum market value of $100 million; 70% of the weight of the index must have a minimum global monthly trading volume of 250,000 shares or minimum global monthly notional volume of $25,000,000 for the last six months; no one security in the index can exceed 25% of its weight and the five largest positions in the index cannot exceed 60% of the weight of the index; the index must include at least 20 securities (with certain exceptions); and all securities in the index must be listed and traded on an exchange with last-sale reporting. With respect to fixed income benchmark indexes: 75% of the weight of the index must have a minimum original principal amount outstanding of $100 million or more; except for U.S. Treasury and agency securities, no one security in the index can exceed 30% of its weight and the five largest positions in the index cannot exceed 65% of the weight of the index; the index must include at least 13 unaffiliated securities (with certain exceptions); and at least 90% of the weight of the index must be securities a) from issuers that are required to file reports pursuant to Sections 13 and 15(d) of the Securities Exchange Act of 1934; b) from issuers that have a worldwide market value of its outstanding common equity held by non-affiliates of $700 million or more; c) from issuers that have outstanding securities that are notes, bonds debentures, or evidence of indebtedness having a total remaining principal amount of at least $1 billion; d) exempted securities as defined in Section 3(a)(12) of the Securities Exchange Act of 1934; or e) from issuers that are a government of a foreign country or a political subdivision of a foreign country. *E.g.,* NYSE Arca Equities Rule 5.2(j)(3) (generic listing standards for index-based ETFs).

[26] *See, e.g.,* Appendix B (attached hereto).

[27] Further, Rafferty supports the provisions of the proposed rule that require the adoption and implementation of a written derivatives risk management program, including the requirements that a fund board approve and oversee it and that an individual be designated to oversee it.

[28] Statement of Commissioner Michael S. Piwowar, in "Dissenting Statement at Open Meeting on Use of Derivatives by Registered Investment Companies and Business Development Companies," (Dec. 11, 2015), available at https://www.sec.gov/news/statement/piwowar-dissenting-statement-use-of-derivatives-funds.html.

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Exhibit 1

Report of S.P. Kothari, Ph.D.

1. I am the Gordon Y Billard Professor of Accounting & Finance at the Sloan School of Management of the Massachusetts Institute of Technology ("MIT"). I have published numerous academic articles in the areas of accounting, finance, and economics and have co-edited two books titled Financial Statement Analysis, published by McGraw-Hill, and Contemporary Accounting Research, published by North-Holland Publishing.

2. I have been retained by Rafferty Asset Management, LLC, and have been asked to compute implied holding periods for select pairs of the company's leveraged and inverse leveraged ETFs during the periods from December 1, 2008 to April 30, 2009 and May 1, 2009 to July 31, 2015. Exhibits 2 and 3 contain this analysis. In addition, I have been asked to examine the growth in leveraged and inverse leveraged ETFs during the past five years in comparison to growth in the ETF market generally. Exhibit 4 contains this analysis.

3. Using data from Bloomberg, I calculate the implied holding period as daily shares outstanding divided by daily share trading volume. This ratio provides an estimate of the number of days it would take for all of an ETF's shares to be turned over (i.e., bought and sold). For example, if an ETF had 10 million shares outstanding and trading volume on a particular day were 2 million shares, its implied holding period would be five days, meaning that it would take an estimated five days of 2 million shares being traded per day for the 10 million shares outstanding to be turned over. No claim is made that on each of these five days a distinct set of 2 million shares is traded. That is,

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it is possible that some shares are traded in less than five days and others in more than five days, but on average, a share is held for five days before being traded.

4. As seen in Exhibit 2, the cumulative buy-and-hold returns for both Direxion's leveraged and inverse leveraged ETFs during the period December 1, 2008 to April 30, 2009 differed from their respective benchmark indices. This pattern reflects not only the design of these products to produce a given leveraged return versus a benchmark index on a daily basis but also the volatile conditions in the financial markets at this time. As also seen in Exhibit 2, the average implied holding periods for these ETFs during this period are extremely short, ranging from 0.44 to 1.14 days. Collectively, these statistics indicate that investors in these ETFs, on average, hold their shares for a day (or under in most cases).

5. The analysis in Exhibit 3 is identical to Exhibit 2, except it covers a later and more extensive time period - May 1, 2009 to July 31, 2015. Exhibit 3 shows, as in Exhibit 2, that the cumulative buy-and-hold returns for both Direxion's leveraged and inverse leveraged ETFs during this period differed from their respective benchmark indices. However, unlike in Exhibit 2, the data from Exhibit 3 reveal that it is possible for Direxion's leveraged and inverse leveraged ETFs to exceed the cumulative buy-and-hold returns on their underlying benchmark indices by more than their leverage factors. For example, the company's S&P 500 Bull 3X ETF delivered over five times the performance of the S&P 500 Index during this period (1005.56% versus 174.85%). As also seen in Exhibit 3, the average implied holding periods for these ETFs during this period continue to be extremely short, ranging from 1.18 to 4.03 days. Lastly, Exhibit 3

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shows that changes in shares outstanding for these ETFs during this period are inversely correlated with cumulative buy-and-hold returns.

6. Exhibit 4 provides information on the growth in net assets during the last five years in all ETFs registered under the Investment Company Act of 1940 and all such leveraged and inverse leveraged ETFs. This exhibit highlights the recent significant growth in the ETF market, with net assets doubling from a little under $1 trillion in 2011 to approximately $2 trillion in 2015. This exhibit also shows that leveraged and inverse leveraged ETFs, with net assets averaging around $23 billion during this period, make up a small portion of the overall ETF market. Despite the fact leveraged and inverse leveraged ETFs experienced growth in net assets during the last five years, it was not sufficient to keep pace with growth in the ETF market generally. Collectively, these statistics suggest that leveraged and inverse leveraged ETFs are a niche product with modest growth prospects within the much broader ETF market.

S.P. Kothari March 28, 2016

Exhibit 2

Total Return and Implied Holding Period for Select Direxion Leveraged ETFs - December 1, 2008 to April 30, 2009

Name	Ticker	Cumulative ETF Return	Cumulative Index Return	Average Implied Holding Period (# days)
Direxion Daily S&P 500 Bull 3X	SPXL	7.72%	8.19%	0.78
Direxion Daily S&P 500 Bear 3X	SPXS	-48.58%	8.19%	0.44
Direxion Daily Small Cap Bull 3X	TNA	13.75%	17.81%	0.79
Direxion Daily Small Cap Bear 3X	TZA	-68.30%	17.81%	0.44
Direxion Daily Financial Bull 3X	FAS	-53.34%	8.36%	0.65
Direxion Daily Financial Bear 3X	FAZ	-89.61%	8.36%	0.44
Direxion Daily Energy Bull 3X	ERX	-22.55%	3.03%	1.14
Direxion Daily Energy Bear 3X	ERY	-39.85%	3.03%	0.58

Notes and Sources:

Data from Bloomberg. Variable names in brackets.

ETF and index returns are calculated by cumulating daily total return [DAY_TO_DAY_TOT_RETURN_GROSS_DVDS].

Implied holding period is calculated as daily shares outstanding [EQY_SH_OUT] divided by daily share trading volume [PX_VOLUME].

Exhibit 3

Total Return, Implied Holding Period, and Change in Shares Outstanding for Select Direxion Leveraged ETFs - May 1, 2009 to July 31, 2015

Name	Ticker	Cumulative ETF Return	Cumulative Index Return	Average Implied Holding Period (# days)	Percentage Change in Shares Outstanding
Direxion Daily S&P 500 Bull 3X	SPXL	1005.56%	174.85%	3.16	-81%
Direxion Daily S&P 500 Bear 3X	SPXS	-98.42%	174.85%	4.03	4603%
Direxion Daily Small Cap Bull 3X	TNA	683.70%	176.04%	1.18	-41%
Direxion Daily Small Cap Bear 3X	TZA	-99.45%	176.04%	2.48	45213%
Direxion Daily Financial Bull 3X	FAS	515.44%	165.25%	3.73	-80%
Direxion Daily Financial Bear 3X	FAZ	-99.38%	165.25%	3.74	2859%
Direxion Daily Energy Bull 3X	ERX	66.38%	72.27%	3.99	144%
Direxion Daily Energy Bear 3X	ERY	-97.09%	72.27%	3.89	5269%

Notes and Sources:
Data from Bloomberg. Variable names in brackets.
ETF and index returns are calculated by cumulating daily total return [DAY_TO_DAY_TOT_RETURN_GROSS_DVDS].
Implied holding period is calculated as daily shares outstanding [EQY_SH_OUT] divided by daily share trading volume [PX_VOLUME] and is averaged across all days between May 1, 2009 and July 31, 2015.
Percentage change in shares outstanding is calculated as (shares outstanding on July 31, 2015 - shares outstanding on May 1, 2009) / shares outstanding on May 1, 2009, using daily shares outstanding [SO Index for relevant ETF].

Exhibit 4
Total Year-End Net Assets ($ Billions)

	2011	2012	2013	2014	2015
All 1940 Act ETFs	939	1,217	1,611	1,918	2,052
All 1940 Act Leveraged ETFs	21	19	26	24	24

<u>Notes and Sources:</u>
1940 Act ETFs are registered under the Investment Company Act of 1940.
Data on all ETFs from Investment Company Institute.
Data on all leveraged ETFs from Morningstar.
Leveraged includes both leveraged and inverse leveraged ETFs.