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March 28, 2016

Mr. Brent J. Fields
Secretary U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Use of Derivatives by Registered Investment Companies and Business Development Companies
File No. S7-24-15

Dear Mr. Fields:

Brandywine Global Investment Management, LLC ("Brandywine Global") appreciates the opportunity to provide comment to the U.S. Securities and Exchange Commission (the "SEC" or "Commission") on the SEC's proposed rule 18f-4 (the "Proposed Rule")[1] under Section 18 of the Investment Company Act of 1940, as amended, governing the use of derivatives by registered investment companies and business development companies.

Brandywine Global was founded in 1986 and provides a broad array of fixed income, equity, and alternative strategies that seek value across global markets. Brandywine Global advises separate accounts and pooled investment vehicles, including registered investment companies, UCITS and hedge funds. Brandywine Global had approximately $69 billion in assets under management as of December 31, 2015. The firm is a wholly owned, independently operated subsidiary of Legg Mason, Inc.

Although the Proposed Rule solicits feedback in a number of areas, Brandywine Global seeks to reply specifically to the following:

Question: *Are there other adjustments pertaining to the use of notional amounts for purposes of determining a fund's exposure appropriate that we should consider, either with respect to certain types of derivatives transactions or in general? Should the proposed rule permit or require this practice? Why or why*

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[1] *See Use of Derivatives by Registered Investment Companies and Business Development Companies*, 80 Fed. Reg. 80883 (Dec. 28, 2015).

not? Would a derivative's notional amount adjusted in this way serve as a better measure of the fund's exposure than the derivative's unadjusted notional amount?

As a top-down, value-driven global fixed income manager, Brandywine Global's bond strategies seek to benefit from mean-reversion in global bond and currency markets. The strategies broadly seek long-term total returns by targeting elevated real yields globally and limiting investment to only countries and currencies expected to outperform given the macroeconomic outlook. The strategies seek to control risks related to fluctuations in foreign currencies, interest rates, and bonds by using a variety of exchange-traded and over-the-counter derivatives. These derivatives provide Brandywine Global with an efficient means of implementing macro level economic investment decisions as well as tools to control risk.

While Brandywine Global supports the Commission's aim of bringing simplicity and clarity to the calculation of portfolio leverage limitations, it also agrees with the Commission's recognition that an exposure-based test based on notional amounts could be viewed as a relatively blunt measure in that different derivatives transactions having the same notional may expose a fund to very different potential risks.[2] Brandywine Global believes that treating notional values from all sources as equivalent regardless of their tenor or contribution to risk does not achieve the Commission's desired balance between flexibility and leverage risk limitation. Brandywine Global believes that the use of notional amounts---exclusively and without adjustment---is not appropriate. By doing so, the Proposed Rule would unnecessarily impede funds that employ instruments with high notional amounts but low risk, such as short-term interest rate derivatives (e.g., Fed funds, Eurodollar, and Euribor futures), to the ultimate detriment of investors.

A fund may use such interest rate futures to express its view on, or hedge the risk of, short-term interest rate movement. For instance, if a fund sought to decrease the fund's duration by one year using 3-month Eurodollar futures, a notional exposure of 400% would result from just this position (i.e., notional exposure equals the fund value multiplied by four given the short duration of the Eurodollar contract at ¼ year). The large notional exposure is more a reflection of the short duration and high notional value of the contract than a comparable risk measure.

Brandywine Global believes it reasonable and appropriate that any rule that the Commission seeks to adopt that would limit a fund's exposure based upon notional amount provide for adjustments to be made to the notional amount of interest rate derivatives with a duration of less than two years for the purpose of determining a fund's exposure. Specifically, Brandywine Global believes that the notional amount of these instruments should be divided by an appropriate divisor to reflect that the instrument's duration is less than two years. As the Commission noted in the

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[2] *See Use of Derivatives by Registered Investment Companies and Business Development Companies*, 80 Fed. Reg. 80903 (Dec. 28, 2015).

Proposed Rule, it is industry convention to divide the notional amount of an interest rate future with a duration of less than two years by the appropriate divisor so as to not overstate the magnitude of the investment exposure.[3]

Additionally, once the notional amount of a short-term interest rate derivative has been adjusted for tenor, Brandywine Global believes that subsequent adjustments should be permitted to further account for risk. In order to achieve this, Brandywine Global supports the use of uniform risk-adjusted multipliers (as proposed by other industry participants and commenters). Under this approach, a risk-adjusted notional amount that is more representative of the actual risk to which a fund is exposed would be used in lieu of the unadjusted notional amount to determine a fund's compliance with the portfolio limit tests.

Without these adjustments, a fund's portfolio limit would be consumed by these short-term interest rate derivatives in an amount that is wholly disproportionate to the overall risk of the portfolio. If no adjustment were made to the notional amount of these short-term interest rate derivatives, their use would be severely restricted thereby effectively limiting the industry's ability to utilize a valuable, widely-used, cost-effective tool.[4] Brandywine Global respectfully urges the Commission to modify its proposed approach for the use of notional amount for all derivatives transactions and instead adjust the notional amount for short-term interest rate derivatives as suggested.

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[3] The Commission noted that its staff, when evaluating funds' notional exposures for the DERA White Paper, followed industry convention of dividing the notional amount of short-term interest rate futures by the appropriate divisor to adjust any interest rate future having a term shorter than one year. *See* Proposed Rule, *supra* note 1, at 80908. *See also* Daniel Deli, Paul Hanouna, Christof Stahel, Yue Tang & William Yost, *Use of Derivatives by Registered Investment Companies* Division of Economic and Risk Analysis (2015) ("DERA White Paper"), *available at* http://www.sec.gov/dera/staff-papers/white-papers/derivatives12-2015.pdf.

[4] DERA staff indicated that their study showed that interest rate futures are the third most commonly used derivative. *See* DERA White Paper, *supra* note 2, at 11.

We appreciate the opportunity to respond to the Commission's request for comment and we hope that our comments above are helpful and contribute to the important work of the Commission. If you would like to discuss any aspect of the letter, please do not hesitate to contact me.

BRANDYWINE GLOBAL INVESTMENT
MANAGEMENT, LLC

By: Christopher D. Marzullo
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