To Whom It May Concern:

I'm writing in response to the proposed rule by the SEC regarding Use of Derivatives by Registered Investment Companies and Business Development Companies; Required Due Diligence by Broker-Dealers and Registered Investment Advisers Regarding Retail Customers' Transactions in Certain Leveraged/Inverse Investment Vehicles.

I will start by simply saying there are many aspects of the proposed rule that I feel attack freedom, free agency, and personal choice and responsibility. Other aspects I feel are unnecessary.

- <u>Investors should have the ability to assume risk</u>, participate in risky activities, etc. at their discretion, with their own capital. The United States was built by people taking risks; sometimes very large risks. This is an economic right and privilege that ensures individual freedom. It should not be the responsibility or prerogative of the SEC to protect investors from themselves, but rather to protect investors from predatory and/or fraudulent practices and from individuals, firms and schemes established, meant or designed to purposefully take advantage of or defraud investors.
- <u>The proposed rule seems to put government regulation over personal freedoms and choice, and disregard investors' ability to understand and assume risk</u>. In effect, it feels like the SEC believes that investors are unable to understand the risks of geared and inverse products, so they are proposing rules that may limit investors' abilities to invest in these products and/or limit the ability of providers of these products to take on risk. Or in the extreme, these proposed rules may limit the willingness of providers to supply these products to investors. I think fundamentally this goes against the basic freedoms of our country and several of my arguments in the prior paragraph around freedom of choice and personal responsibility.
    - <u>It should be noted</u> that I do firmly believe that the SEC and other regulatory agencies should intervene when the aggregate risk of a subset of financial products pose a foreseeable and likely catastrophic risk to financial systems and markets. The SEC and other regulatory agencies are in better position than the average investor to assess and monitor these sorts of dire aggregate risks, and as a result should do so.
- <u>The proposed rule change seems to completely ignore one of the basic components of investment management, which is the concept of an investment portfolio and diversification</u>. It is entirely possible that an investor holds incredibly risky investments. However, if their portfolio is correctly built around their risk tolerance, objectives and needs, then the risk of a single investment shouldn't be the focus. The ability of an investor to bear the risks of a geared or inverse product is directly affected by the other holdings in their portfolio.
- <u>The rule seems to be a case of over-regulation for Investment Advisers.</u> Any prequalification or added regulatory burden seems unnecessary. Investment advisers already are required to build "suitable" investment portfolios based on investor risk tolerance and needs as part of the fiduciary rule. Building portfolios takes into account risk tolerance and other investments held by an investor to build a holistic portfolio based on their needs, objectives and risk tolerance.
    - <u>Pre-Qualifying Investors:</u> It should not be the responsibility of an investment adviser or broker to qualify an investor as to whether they are capable of evaluating the risks of buying and selling leveraged or inverse funds. For investors managing their own assets, that should be their own responsibility. For those using an investment adviser, it is

already the responsibility of advisers to choose suitable investments within the context of building a portfolio based on needs, objectives and risk-tolerance.

Getting into some other specifics:

Limiting Leverage. While I do take issue with limiting an investors ability to take risk. I don't take serious issue with limiting leverage to say 300% of the underlying index. Frankly, few people need more leverage than that and those seeking more leverage than 300% are typically the types of investors that can effectively achieve significantly larger amounts of leverage (significantly above and beyond 300%) through direct purchases of futures and or options. One might further argue that 300% leverage on a fund meant to track the VIX is much more extreme than a fund with 300% leverage on the S&P 500. That said, it is the responsibility of investment advisers and investors, who manage their own investments, to determine the suitability of the investment in the context of their overall portfolio. A leveraged VIX exposure might make sense in a portfolio as a supplemental exposure held to hedge against market volatility. This ability and reasonable use shouldn't be taken away from investors or impeded with regulatory hurdles because some people may choose to misuse the particular financial instrument by over allocating to such an instrument or not fully understanding the risks.

> *I have read a comment by one commenter about some leveraged funds losing their entire NAV (ie. Investors losing all of their capital held in that particular security). My rebuttal to that is that like options, some leveraged positions bear a lot of risk, including the potential for the full loss of capital. There is precedent with respect to allowing securities that bear the risk of complete loss of capital in a very short period of time.*
>
> *I have also read comments by another commenter about the fact that there are many companies with such high operating leverage, that they are effectively leveraged higher than some leveraged index products. I agree with his perspective. To me it seems disingenuous to not take issue with high operating leverage, but determine that the leverage taken by leveraged index products should not be allowed.*

Again, I don't believe that the SEC should be in the business of protecting investors from themselves, but rather it should be focused on protecting investors from predatory and/or fraudulent practices and from individuals, firms and schemes established, meant or designed to purposefully take advantage of or defraud investors. Freedom, choice and responsibility are fundamental and I feel like these would be limited by several aspects of the proposed rule.

Role of Speculation: I largely agree with the Statement on the Re-Proposal to Regulate Funds' Use of Derivatives as Well as Certain Sales Practices by Commissioner Pierce and Commissioner Roisman. They commented on using derivatives for non-speculative purposes. There are very legitimate non-speculative uses for many of these instruments. That said, I don't think these instruments should be limited to non-speculative uses. Equity investing is speculative. Geared and inverse products are speculative. Trading bonds, rather than holding to maturity, is speculative. Anything in which the outcome is unknown is speculative. We shouldn't be regulating away or proposing rules that limit the ability to speculate because it deprives investors of their economic freedom.

Duplication of Regulation: Investment Advisers already have the responsibility to determine suitability of an investment for a client. Suitability is a better standard, because it also allows an investment advisor to determine the suitability of an investment in the context of a portfolio. The proposed rule however seems to remove the concept of an investment portfolio and focuses instead on the specific investment product. Any investment product in isolation would likely not be suitable based on the overall needs, objectives and risk tolerance of a specific investor. For instance, it could be argued that a young professional early in their career with moderate to high risk tolerance who is invested entirely in TIPS would have a portfolio ill suited for their overall needs, objectives and risk tolerance, despite TIPS generally being considered a low risk investment because they are bonds (generally considered lower risk) with inflation protection.

> *As an aside, it is all together possible that an investor doesn't understand the potential risks of TIPS: including deflation, duration (which I feel most average investors really don't understand) and the nuances of CPI as a measure of inflation. It would seem silly to have brokers and advisers pre-qualify investors based on their understanding of bond risks, including price fluctuations with respect to duration, which is a more mathematically complex calculation than those typically associated with geared and inverse products: i.e. (i) inverse performance relative to a benchmark and (ii) long-term performance variations with respect to the underlying index due to daily compounding of leveraged returns.*

On the other hand, the same young professional could use leveraged products and rebalancing to get larger exposure to equities at a point in life when they are able to bear the risk. Furthermore, because they lock up less capital to get the same exposure, they could invest their remaining capital in dividend/interest producing instruments, covered calls or protective puts, which would significantly increase the defensive and overall risk parameters of the portfolio and their overall risk-adjusted returns.

<u>Other Instances of Difficulty Assessing and Understanding Risk</u>: It seems that if risk and an investor's ability to understand risk is a primary objective of the proposed rule, then the SEC should also implement similar rules to highly risky securities. For instance, one could argue that pharmaceutical and medical device companies and their related securities contain much larger and more complex risks than geared and inverse instruments. I believe it is much easier to understand the dynamics of geared and inverse funds than it is to understand the complexities surrounding the risks associated with pharmaceutical and medical device companies. That said, I am not making the argument that the SEC should make rules around those companies, or any other risky and potentially difficult to understand security (including other examples I've used throughout this comment). Rather I am trying to demonstrate that precedent exists for investors to be allowed to take significant, potentially difficult to understand risks without regulatory interference and without being pre-qualified by a broker or investment adviser, etc.

<u>Orderly Rebalancing of Market and Overall Market Risk</u>: The argument can be made that the rebalancing of index funds generally creates price distortions in the underlying securities (and as a result in the market overall). Unless it is felt that current regulations with respect to derivatives and counterparty stress tests are insufficient, I do not support implementing limits based on these concerns. However, <u>I fully support regulations to ensure protections to the underlying market that may be created because of excessive risk taking by those issuing derivatives.</u>

<u>Conclusion:</u> In conclusion, I disagree largely with the proposed rules, because they limit individual freedom and responsibility. Economic freedom, including the freedom for individuals to assume risk and

responsibility with their own capital, even risk that others may consider excessive, is paramount to individual freedom. Investors should be able to assume risk without regulatory intervention and without added paperwork or barriers. I also feel that the proposed rules are regulating (at least for investment advisors) things that are already regulated with respect to the fiduciary rule and client suitability. However, I do feel that to the extent geared and inverse funds are creating systematic and aggregate risks, for which the typical investor is at a significant disadvantage compared to the SEC or other regulators to understand and assess, that rules should be in place to protect investors from such risks. I'd like to reiterate that I don't believe that proposed rules should be established to protect investors from themselves. Investors should be free to choose for themselves what to do with their own capital without additional paperwork or hurdles. Again, this is a fundamental freedom that we enjoy that is threatened with any such proposed regulation. Rather, rules, if and when necessary, should be implemented to protect investors from individuals, firms, schemes and practices that are created or meant to take advantage of investors and to protect investors from systematic and aggregate risks, for which the SEC and other regulatory bodies are in a much better position to assess and manage such risks.

Sincerely,

Michael J. Thornton
David T. Holley