GATEWAY
INVESTMENT ADVISERS, LLC

March 24, 2020

Electronically submitted to: rule-comments@sec.gov

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: Use of Derivatives by Registered Investment Companies and Business Development Companies (**File No. S7-24-15**) (the "Release")

Dear Ms. Countryman:

On behalf of Gateway Investment Advisers, LLC (hereinafter "Gateway"), we are writing to comment on the Securities and Exchange Commission's (the Commission) re-proposed Rule 18f-4 under the Investment Company Act of 1940 regarding the use of derivatives (the "Proposed Rule"). Gateway applauds the Commission for thoughtfully hearing industry concerns regarding the 2015 Rule 18f-4 proposal, primarily because the 2019 Proposed Rule is less rigid and prescriptive and more principles-based in addressing investor protections and concerns underlying Section 18 of the Act.

Gateway is confining its comments to the Proposed Rule's exceptions for funds that limit their use of derivatives. Gateway is requesting the Commission to allow funds that limit their use of derivative transactions to U.S. exchange-traded index options that lower and hedge the funds' equity market risk and volatility, as described in this letter, to rely on the proposed limited derivatives user exception.

Gateway, a registered investment adviser founded in 1977, has lengthy experience with index option-based strategies and is one of the largest low volatility option-overlay managers in the U.S. For over 40 years, Gateway has endeavored to deliver low volatility equity strategies to risk-conscious investors. As of December 31, 2019, Gateway had approximately $10.95 billion in assets under management. The majority of such assets are held in U.S. registered investment companies which are available to the retail sector with low investment minimums. Gateway-managed funds provide a low-cost means for consumers to invest in the equities market but with markedly less volatility due to the firm's use of index option derivatives. At no time does Gateway use leverage as part of its investment strategies.

We read with interest section 18f-4(c)(3)(i)-(ii) that includes an exception from the Proposed Rule's derivatives risk management program requirement and limit on fund leverage risk for "limited derivatives users." The proposed exception would be available

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to a fund that either: (1) limits its derivatives exposure to 10% of its net assets (exposure exception); or (2) uses derivative transactions solely to hedge certain currency risks (hedging exception).

We believe that the limited derivatives user exception makes complete sense. We ask that the Commission take the next logical step to this limited use exception: broadening the hedging exception to include a fund that uses **exchange-traded written index call options** solely to hedge **equity market risks**, where the options have a tight correlation to underlying equities held by the fund. For the reasons discussed in this letter, we believe that, for funds that limit use of derivatives solely to hedge such risks, the Commission's overall objective of investor protection has not only been addressed but enhanced.

It is widely accepted that selling covered options is a mainstream form of hedging. To quote Sheldon Natenberg's <u>Option Volatility and Pricing:</u> "The purchase of a protective option and the sale of a covered option are the two most common hedging strategies involving options"[1]. The author refers to both (1) covered call selling where the written call is secured by underlying equity and (2) covered put selling where the written put's maximum loss is fully secured by cash or equivalents.

For the remainder of this letter we focus on written call options, which Gateway uses for certain funds that it manages and would be the subject of the proposed broadened hedging exception.

For example, the Gateway Equity Call Premium Fund (the "Fund"), which is a member of the Natixis Funds family and advised by Gateway, has been in existence since September 2014. The Fund has the stated objective that: "seeks [the] total return with less risk than U.S equity markets."[2] The Fund invests in a broadly diversified portfolio of common stocks, while also selling U.S. exchange-traded index call options. Writing index call options reduces the Fund's volatility, provides cash flow and is an important source of the Fund's return. More specifically, the Fund generates returns by writing at- and near-the-money index call options against the full value of its underlying equity portfolio. This cash flow from option call writing mitigates the downside of the unhedged equity market and provides the Fund with a significantly and consistent lower standard deviation than the equity market.

As seen in the Fund's long-term performance and standard deviation record in <u>Appendix A</u>, the Fund has consistently exposed investors to significantly less volatility as compared to an unhedged broadly diversified market index. There are other U.S. registered management investment companies that achieve low volatility via the use of

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[1] Sheldon Natenberg's <u>Option Volatility and Pricing</u> –1994 McGraw-Hill

[2] See Gateway Equity Call Premium Fund Prospectus dated May 1, 2019, available at www.ngam.natixis.com.

U.S. exchange-traded index options and, as a result, the exception we are requesting could well serve other funds - and ultimately their shareholders.

Below we cite sections of the Proposing Release that supports the hedging exception as applied to currency hedging activities (as seen in bold). We added commentary as to why the same/similar arguments support an exception for fully secured exchange-traded written index call options used solely to hedge equity market risks.

P 4485 **"The proposed currency hedging exception reflects our view that using currency derivatives solely to hedge currency risk does not raise the policy concerns underlying section 18.**
This statement is true. Just as the Commission describes using currency derivatives solely to hedge currency risk, a primary function of writing listed index call options is to hedge equity risk.

P 4488 **"We believe that the currency hedging described... is definable because it involves a single risk factor (currency risk) and requires that the derivatives instrument must be tied to specific hedged investments."**
This statement is absolutely true with written index call options, tied to underlying equity, if one replaces "currency hedging" and "currency risk" with "equity hedging" and equity risk". Just as the Commission describes using currency derivatives as being used solely to hedge currency risk, a primary function of writing listed index call options is to hedge equity risk. Like currency derivatives, these call options are not complex derivatives. The logic makes sense and the conclusion is sound.

P 4488 **"Although we recognize that most funds that use derivatives do not use them solely to hedge currency risks, these currency hedges are not intended to leverage the fund's portfolio, and conversely could mitigate potential losses."**
Again, the Commission's statement holds true for exchange-traded written index call options tied to reference asset: (1) they are not intended to leverage fund's portfolio as described above; and (2) conversely, they could mitigate potential losses. In writing call options, where the fund has underlying stock with tight correlation to the relevant index, fund management endeavors to earn time premium as the written option approaches its expiration date. This phenomenon of time erosion acts as a buffer against some downside in the underling equity. Perhaps more importantly, no leverage is introduced as a result. The only leverage risk would be if the Fund sold "naked" or insufficiently covered options. That leverage risk is not present where fund's equities behave like the relevant index. Further, underlying equities are sufficiently liquid to "buy back" the written options at any time, including at exercise or expiration.

P 4486 **"A fund relying on the limited derivatives user exception would be required to manage the risks associated with its derivatives transactions by adopting and implementing policies and procedures that are reasonably designed to manage the fund's derivative risks."**

Gateway agrees wholeheartedly with this statement. Certain components of these policies and procedures for a fund relying on the hedging exception as we have proposed would be to ensure, on a daily basis, that (1) all of the fund's written call options are fully "covered" by corresponding securities held by the fund, (2) leverage is avoided, and (3) risk is controlled. In this case, holding written call options with a notional value equal to 99% of the value of the reference asset dedicated to such options would be permissible; 101% would not.

P. 4488 **"Are there other types of derivatives that funds use that are less likely to raise the policy concerns underlying section 18?"**
Yes. As described above, exchange traded written index call options are the type of derivatives less likely to raise policy concerns for identical reasons as the Commission lays out for the proposed Rule's currency hedging exception.

P. 4489 **"Is it appropriate to require funds relying on the limited derivatives user exception to adopt policies and procedures that are reasonably designed to manage their derivatives risk, in lieu of requiring such a fund to adopt a derivatives risk management program that includes all of the proposed program elements and comply with the proposed VaR-based limited on fund leverage risk?"**
Yes, absolutely. Such policies and procedures would be required to be well thought-out, thorough, and subject to a backward-looking review to ensure they work as intended. The specific elements required under the full derivatives risk management program would not be necessary to manage the derivatives risks created by the written covered call strategy.

With regard to other statements made by the Commission in the Proposing Release, Gateway asserts that the statement, "the risks and potential impact of derivative transactions on a fund's portfolio generally increase as the fund's level of derivatives usage increases"[3], is not necessarily always true. One could easily argue that a fund that limits its use of derivatives solely to those intended to hedge such market risk with index options is less problematic as they do not create the same types of risks that could be created by the non-hedging transactions of a fund that limits its derivative exposure to less than 10%. Similar to the Commission's reasoning in the Proposing Release when addressing the limited derivatives users exception, "[r]equiring a derivatives risk management program that includes all of the program elements specified in the rule for funds that use derivatives only in a limited way could potentially require these funds to incur costs and bear compliance burdens that are disproportionate to the resulting benefits."[4] More specifically, components of the Proposed Rule's risk management program, including: risk identification and assessment, risk guidelines, weekly stress testing, daily backtesting, internal reporting

[3] See Proposing Release at 4844

[4] See Proposing Release at 4844

and escalation would be unduly burdensome for asset managers who effectively limit funds' risk in the first place. Shareholders of these funds have already chosen, and are receiving, the benefits of a low volatility, risk averse investment when compared to an investment in unhedged equities.

We understand the Commission's concerns that investments in derivative transactions can pose a variety of risks such as market, counterparty, leverage, liquidity and operational risks.[5] Gateway asserts that transactions in U.S. exchange-traded index options for the purpose of lowering portfolio risk are not subject to the aforementioned risks. More specifically:

a) Market risk of the fund's securities portfolio is consistently and reliably lowered with the use of index options intended to mitigate volatility as noted in Appendix A;
b) Counterparty risk is virtually eliminated as the Options Clearing Corporation (OCC) issues and stands behind each transaction of a U.S. exchange-traded index option;
c) Leverage risk is non-existent for funds that use index options to lower risk as compared to the unhedged market. This is easily and measurably achieved, when assessing these options and the fund's underlying equity portfolio holistically, where written index call options cover no more than 100% of the underlying portfolio on a daily basis;
d) Liquidity risk is extremely low with the use of the more widely established U.S. exchange-traded index options as they are considered among the largest options markets in the world. In addition, U.S. registered open-end funds currently have in place a comprehensive liquidity risk program that addresses the liquidity risk of these derivatives under normal and stressed conditions as provided in Rule 22e-4 under the Investment Company Act of 1940; and
e) Operational and legal risks for these instruments are non-existent as these derivatives are standardized, cash-settled contracts that have been utilized world-wide for decades.

Moreover, to the extent any of these derivatives risks are raised by the use of exchange traded equity index call options with a sole purpose of hedging, the risks are the type that can be managed using principles-based policies and procedures as offered in the Proposed Rule.

In conclusion, Gateway understands and agrees with the Commission's objective to address an investor's risks with regard to a fund's use of derivatives. We believe the type of low volatility funds managed by Gateway and other management firms are not the type of funds the Commission envisioned as a potential risk to investors when proposing a comprehensive derivatives risk management program as proposed in Rule

[5] See Proposing Release at 4860

18f-4. We ask the Commission to consider the undue burdens faced by mutual fund asset managers that strive to lower market risks for investors through the use of U.S. exchange-traded index options as a hedging strategy when finalizing this Proposed Rule.

We hope our comments are helpful to the Commission and staff, and we would be pleased to discuss them in more detail. Questions about this letter may be directed to either of us at [redacted]

Respectfully,

/s/Paul R. Stewart	/s/Donna M. Brown
Paul R. Stewart	Donna M. Brown
President and CEO	General Counsel and CCO

Enclosure: Appendix A – Performance and Standard Deviation of the Gateway Equity Call Premium Fund

cc: The Honorable Jay Clayton
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman
The Honorable Allison Herren Lee

Dalia O. Blass, Director
Division of Investment Management, U.S. Securities and Exchange Commission

Kirk Johnson,
Chief Compliance Officer, Natixis Funds

Gateway Equity Call Premium Fund – Y shares

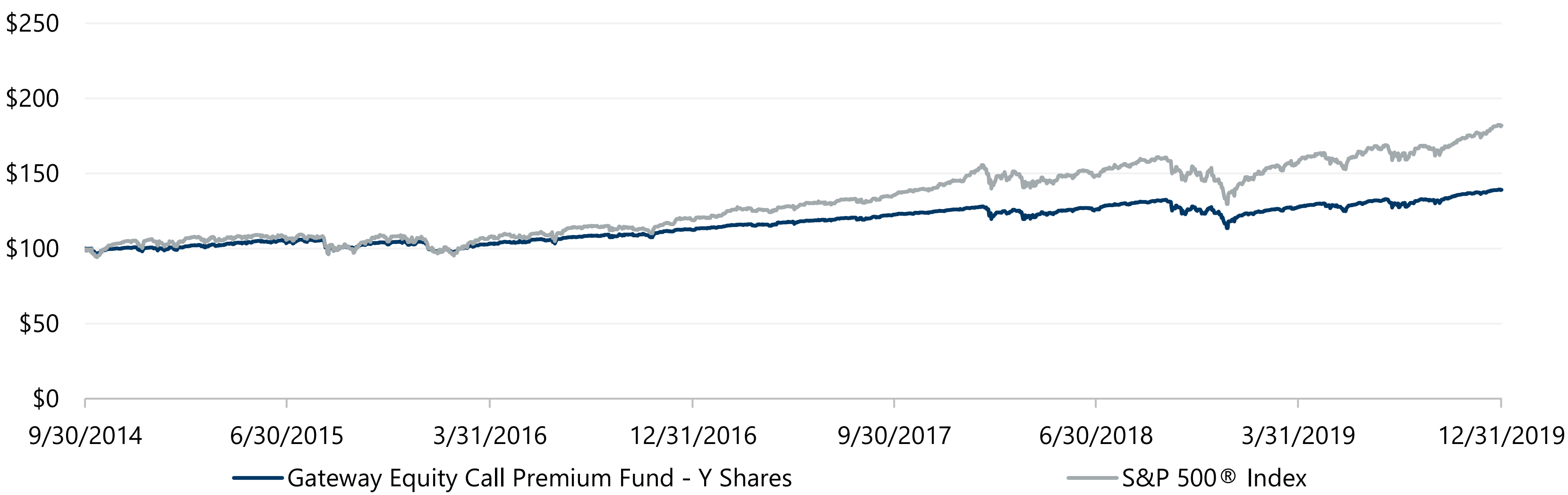
Performance & Risk

	Average annual returns for the period ended December 31, 2019			
	1 Year	3 Years	5 Years	Since 9/30/14*
Gateway Equity Call Premium Fund – Y shares	16.67%	7.40%	6.81%	6.50%
S&P 500® Index	31.49%	15.27%	11.70%	12.13%

	*Standard deviation** for the period ended December 31, 2019*			
	1 Year	3 Years	5 Years	Since 9/30/14*
Gateway Equity Call Premium Fund – Y shares	7.21%	7.36%	7.07%	6.92%
S&P 500® Index	12.89%	12.10%	11.98%	11.74%

Cumulative Return Since Inception - Growth of $100

September 30, 2014 through December 31, 2019



*Inception date is September 30, 2014. Periods greater than one-year are annualized. Past performance is no guarantee of future results. *Standard deviation based on monthly performance. Data source: Morningstar Direct^SM.

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