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March 24, 2020

VIA ELECTRONIC UPLOAD at www.sec.gov

Ms. Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

RE: Comment on File Number S7-24-15

Dear Ms. Countryman:

This letter responds to the Securities and Exchange Commission ("**Commission**") request for comment on a package of proposed rules relating to derivative and leverage risk in investment funds (the "**November Release**").[1] My comments focus in particular on the proposed sales practices rules for investment advisers with discretionary authority.

Written for Brokers, the Proposed Sales Practice Rules Are Ill-Suited to Discretionary Investment Advisers

The November Release says the proposed sales practices rules are modeled on FINRA's options account approval rules for broker-dealers. This is the wrong approach to apply to investment advisers.

The options rules were designed to confirm customers had the basic knowledge to be able to understand the decision they were making when trading in options. The Commission's proposed sales practices rules would similarly require a broker to confirm the customer is "capable of evaluating the risks" of leveraged/inverse investment vehicles. Leveraged exchange traded funds ("**ETFs**") are an example of why this approach may be appropriate for brokers. Leveraged ETFs are widely available to retail investors, and a broker's customers are ultimately responsible for the investment decision. Brokers also often have a strong financial incentive to recommend certain products. With these factors, a retail investor very well may end up inappropriately concentrated in one or more leveraged ETFs without understanding the potential impact.

Investment advisers with discretionary authority are entirely different. The adviser is hired to use professional judgment to make investment decisions on behalf of the client—the client is not making individual investment decisions—and each of those individual investment decisions must be made consistent with the adviser's fiduciary duty. Requiring the decision maker to assess someone else's ability to make the decision confuses this responsibility. By way of analogy, it is like prohibiting surgeons from using a certain instrument unless they first determine that the

[1] 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, Nov. 25, 2019, 85 Fed. Reg. 4446 (Jan. 24, 2020).

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patient is capable of using the instrument. I expect my doctor to consult with me and help me understand the procedure and its risks, but ultimately the doctor is responsible for deciding how each instrument is used. Similarly, an investment adviser with discretion is responsible for selecting individual instruments. The proposed sales practices rules undermine this, pushing responsibility for individual investment decisions to clients.

If the Commission is concerned about how investment advisers are using certain investment products, the Commission's focus is better directed at the advisers' investment decision making processes. Taking a rule designed to protect clients from the practices of brokers and misapplying it to investment advisers is not the answer.

Prescriptive Due Diligence Procedures for Certain Products Can Undermine an Adviser's Principles-Based Fiduciary Duty

Just last June, the Commission restated the contours of an investment adviser's fiduciary duty to clients (the "**June Release**").[2] The June Release articulates long-established and well-understood principles that go beyond what the proposed sales practices rules would require. Advisers have a duty to inquire into an individual client's financial situation, level of financial sophistication, investment experience, and financial goals.[3] For an in-depth financial plan, this involves learning about income, investments, assets, debt, marital status, tax status, insurance policies, and financial goals.[4] The adviser has to also thoroughly investigate the investment to understand its characteristics, liquidity, risks, benefits, volatility, performance, time horizon, and cost.[5] In addition, the adviser must determine the advice given is in the client's best interests, within the context of the entire portfolio and the client's objectives, risk tolerance, and financial sophistication.[6] With higher risk products, the adviser should apply heightened scrutiny.[7]

This analytical framework tied to an adviser's fiduciary duty has worked for many years, and it continues to work. Requiring an investment adviser to take additional due diligence steps for a leveraged ETF adds nothing, other than paperwork.

Prescriptive due diligence requirements for certain products also raises questions about what other products should be included. For example, the Commission asks if the sales practices rules should be expanded in scope to apply to exchange-traded notes ("**ETNs**").[8] In my view, no. Despite the somewhat similar sounding names, an ETN and a leveraged ETF are entirely

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[2] Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Jun. 5, 2019, 84 Fed. Reg. 33669 (Jul. 12, 2019).

[3] *Id.* at 33673.

[4] *Id.*

[5] *Id.* at 33674.

[6] *Id.* at 33673.

[7] *Id.* at 33673-4.

[8] November Release at 4494.

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different. ETNs, which are essentially contracts between parties, are largely unknown to the retail market and are not commonly accessible to individual investors. The notion that investors unable to access leveraged ETFs will move their capital to ETNs is quite unlikely, in my opinion.[9] In my experience, advisers are not putting their retail clients in ETN-only or ETN-majority portfolios. ETNs, if used by advisers at all, are a small percentage of a portfolio, used by an adviser as one component of a diversified portfolio. Used in this way, ETNs can offer a unique and valuable investment option for clients, where appropriate in an adviser's professional judgment and consistent with the client's overall risk tolerance and investment objectives.

Investment advisers are correctly subject to the principles-based requirements of their fiduciary duty to their clients. Advisers' existing processes work well to evaluate each investment in the context of the client's unique circumstances. The proposed sales practices rules, if applied to investment advisers, will create process with little meaningful substance and potentially undermine the fiduciary framework applicable to advisers the Commission correctly set out in the June Release.

Thank you for taking the time to consider my comments.

Sincerely,

Ken Fisher

[9] *See* November Release at 4528 n.597.

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