GUGGENHEIM

April 27, 2020

VIA ELECTRONIC DELIVERY

Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: 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 (File No. S7-24-15).[1]

Dear Ms. Countryman:

Guggenheim Investments[2] ("Guggenheim" or "we") appreciates the opportunity to respond to the request by the U.S. Securities and Exchange Commission (the "SEC" or "Commission") for comments regarding the above-referenced release (the "Proposing Release"). Preliminarily, we commend the Commission on the Proposing Release, which represents, in our view, a major improvement over the original proposing release from 2015 (the "2015 Proposing Release") and promises to stem the proliferation of "inconsistent industry practices."[3] However, while the Proposing Release is a substantial step in the right direction, we believe further surgical tweaks are necessary to avoid unduly stifling the use of derivatives and other forms of non-traditional leverage (e.g., reverse repurchase agreements, "Reverse Repo").

Fundamentally, we would like to reiterate our stance in both our comment letter on the Concept Release in 2011 and our comment letter on the 2015 Proposing Release that the use of derivatives, Reverse Repo and similar instruments and techniques by responsible portfolio managers can be a highly effective investment tool.[4] Specifically, derivatives can increase shareholder investment options, reduce trading costs and provide for effective risk management. Other forms of non-traditional leverage (e.g., Reverse Repo) provide funds and therefore the investing public with cost-effective alternatives to clunkier, more costly borrowing

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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. 85 Fed. Reg. 4446 (Jan. 24, 2020).

2 Guggenheim Investments represents the investment management business of Guggenheim Partners, LLC, which includes Guggenheim Partners Investment Management, LLC, Security Investors, LLC ("SI") and Guggenheim Funds Investment Advisors, LLC. We refer to the funds under Guggenheim's management as "Guggenheim Funds" or "Funds."

3 Use of Derivatives by Registered Investment Companies and Business Development Companies, 80 Fed. Reg. 80884 (Dec. 28, 2015). Proposing Release at 4448.

4 Letter from Amy J. Lee, Senior Vice President, Security Investors, LLC, to Elizabeth M. Murphy, Secretary, SEC, dated November 7, 2011 (responding to the SEC's 2011 Concept Release soliciting comments on a variety of matters relating to mutual funds' use of derivatives); Letter from Donald C. Cacciapaglia, Vice Chairman, Guggenheim Investments, to Brent J. Fields, Secretary, SEC, dated March 28, 2016 ("2016 Guggenheim Comment Letter") (responding to the 2015 Proposing Release).

devices such as traditional credit agreements. While it is imperative to ensure that these instruments are used properly, under the auspices of a prudent risk management program and with due consideration to their risks, it is equally important to avoid unduly disincentivizing funds from using them.

As the initial provider of leveraged/inverse mutual funds, we have more than twenty-five years of experience utilizing a wide array of derivatives products that provide targeted exposure to shareholders. We offer a variety of Funds that invest in various asset classes that provide tools for shareholders to gain leveraged exposure (long and short) to various benchmarks or to hedge risks in their investment portfolios in daily liquid funds. We have also been an innovator of Funds that employ alternative investment strategies such as managed futures, which may provide a means of diversification for shareholders' portfolios. Further, our fixed income Funds rely on derivatives to manage risk in connection with their portfolios and also regularly employ Reverse Repo as an efficient leverage strategy.

In developing these comments, we have drawn on our extensive experience in managing such Funds and our resulting appreciation for the benefits and risks of the relevant products. Cognizant of the need to implement the proposed rules expeditiously, we have kept our comments limited to the following items which are most crucial in our view, particularly with an eye to minimizing regulatory burden for small and midsize market participants: (1) the proposed definition of "Limited Derivatives User"; (2) the proposed treatment of Reverse Repo; (3) the proposed definition of "Leveraged/Inverse Funds"; and (4) the proposed sales practices rules. We note that there are other items that warrant discussion, but we believe many of these issues will be adequately and thoroughly covered by comment letters issued by various trade organizations.

I. Background – Guggenheim Funds' Beneficial Use of Derivatives and Reverse Repo

A. Derivatives

As the Commission acknowledges in the Proposing Release, funds employ derivatives for a variety of beneficial purposes, including to: seek higher returns through increased investment exposures; hedge interest rate, credit, and other risks in their investment portfolios; gain access to certain markets; and achieve greater transaction efficiency.[5] The use of derivatives is important to many Guggenheim Funds to obtain the investment exposure required by their strategies and selected by Fund shareholders, and to implement hedging programs that help shield such shareholders from various risks. We refer the Commission to the 2016 Guggenheim Comment Letter, in which we describe in detail our Funds' use of derivatives.[6] For those Funds that use derivatives to hedge, derivatives quite simply offer a risk-mitigating tool that is not equally achievable in the cash market (or achievable only at a much higher cost). For those Funds that take a position using derivatives, derivatives offer a cost-efficient and highly-liquid method for achieving the goals communicated to shareholders.

B. Reverse Repo

Many Funds also rely on Reverse Repo to prudently and effectively manage their balance sheet. As compared to secured lending, Reverse Repo can be implemented more easily, at a lower implementation cost and at a reduced price. Unlike traditional secured lending arrangements, which require voluminous

5 Proposing Release at 4448.

6 2016 Guggenheim Comment Letter at 2.

documentation (including formal opinions) and significant lead-time to put in place, Reverse Repo leverages industry-standard master netting agreements to facilitate speedy entry and exit of positions, all at a comparatively lower spread over the risk-free rate.

II. Comments on Proposed Rule 18f-4

A. The "Limited Derivatives User" Definition Should be Expanded

We are encouraged that the Commission explicitly "recognize[s] the valuable role derivatives can play in helping funds to achieve their objectives efficiently or manage their investment risk"[7] and that "[r]equiring funds that use derivatives only in a limited way to adopt a derivatives risk management program that includes all of the proposed program elements could potentially require funds (and therefore their shareholders) to incur costs and bear compliance burdens that may be disproportionate to the resulting benefits."[8] That said, the proposed "Limited Derivatives User" exception is still unnecessarily narrow in scope. As a result, several market participants who may use derivatives only in a straightforward and commoditized manner may be burdened with maintaining a sophisticated derivatives risk management program that is unnecessary in light of the transactions being entered into.

Several types of derivatives pose neither undue speculation and excessive leverage concerns nor asset sufficiency concerns and should therefore be specially recognized in the definition of "Limited Derivatives User." Accordingly, we propose that a category of "exempted derivatives" be added to the rule and that the definition of "Limited Derivatives User" be amended as follows:

> "Limited derivatives users. A fund is not required to adopt a program as prescribed in paragraph (c)(1) of this section, or comply with the limit on fund leverage risk in paragraph (c)(2) of this section, if the fund adopts and implements policies and procedures reasonably designed to manage the fund's derivatives risks and: (i) The fund's derivatives exposure (excluding exposure resulting from Exempted derivatives) does not exceed 10 percent of the fund's net assets; or (ii) The fund limits its use of derivatives transactions to Exempted derivatives".

Additionally, we propose that the following definition of "exempted derivatives" be added to the rule:

> "Exempted derivatives. The following derivatives shall be deemed "Exempted derivatives" in addition to any others that the Commission determines should also be so deemed: (i) currency derivatives that hedge the currency risks associated with specific foreign-currency-denominated equity or fixed-income investments held by the fund, provided that the currency derivatives are entered into and maintained by the fund for hedging purposes and that the notional amounts of such derivatives do not exceed the value of the hedged instruments denominated in the foreign currency (or the par value thereof, in the case of fixed-income investments) by more than a negligible amount; (ii) interest rate derivatives that hedge the interest rate risks associated with specific equity or fixed-income investments held by the fund, provided that the interest rate derivatives are entered into and maintained by the fund for hedging purposes and that the notional amounts of such derivatives match the principal amount based upon which interest payments are calculated and made under the hedged instruments (or do not differ by a material amount); (iii) duration hedging; and (iv) commodity derivatives that hedge the commodity risks associated with specific commodities (or securities referencing such commodities) held by the fund, provided that the commodity derivatives are

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7 Proposing Release at 4453.

8 *Id*.

entered into and maintained by the fund for hedging purposes and that the notional amounts of such derivatives do not exceed the value of the hedged instruments by more than a negligible amount. For the purposes of the foregoing calculations, notional shall be determined according to the methodology set forth in the definition of Net Notional Amount."

Additionally, in order to accurately reflect the risk profile of derivatives instruments (and therefore the scope of the Section 18 of the Investment Company Act of 1940 (the "Investment Company Act" and "Section 18" thereunder) speculation concern), we propose the following revised definition of "Derivatives exposure" and the additional defined term "Net Notional Amount":

> "Derivatives exposure means the sum of the Net Notional Amounts of the fund's derivatives instruments and, in the case of short sale borrowings, the then-applicable value of the asset sold short. In determining derivatives exposure a fund may convert the notional amount of interest rate derivatives to 10-year bond equivalents and delta adjust the notional amounts of options contracts."
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> "Net Notional Amount means, for each set of derivatives instruments transacted under a single enforceable[9] master netting agreement (such as an ISDA Master Agreement or Futures and Options on Futures Agreement (and Cleared Swaps Addendum in the case of cleared over-the-counter derivatives), the sum of the notional amounts of the fund's derivatives instruments after giving effect to netting of offsetting derivatives instruments of the same type, tenor and reference asset(s) and/or underlier(s)"[10]

The following sections describe in more detail our rationale for suggesting these changes, which we believe are consistent with the investor protection concerns underlying Section 18. The final section also proposes particular treatment for certain fully-paid transactions, which do not pose a comparatively meaningful risk profile to funds.

i. The "Limited Derivatives User" Definition Should be Expanded to Carve Out Rate Hedging, Commodity Hedging and other Hedges to the Extent they are "Matched" in Notional

First, the proposed rule's definition of "Limited Derivatives User" excludes from the program and limit on fund leverage risk requirements funds that only use derivatives transactions as certain hedges entered into to mitigate risk in connection with foreign currency investments. This makes sense, as currency hedges tied to specific cash investments clearly do not raise the undue speculation and excessive leverage concerns underlying Section 18. However, currency hedges are by no means unique in this regard. As the

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9 *See Ibid*

10 By means of example, if a fund sells $100,000,000 notional of credit protection referencing Company X and then buys $50,000,000 notional of credit protection referencing Company X, for the period during which the two transactions overlap, so long as they have the same terms (e.g., reference entity, credit events, etc.) and are executed under and governed by a single ISDA Master Agreement for which close-out netting is enforceable, the fund would have a Net Notional Amount of $50,000,000. Similarly, and particularly relevant for the proposed exemption of bought credit protection discussed above, giving effect to this netting is important – if a fund buys $100,000,000 notional of credit protection referencing Company X and then sells $50,000,000 notional of credit protection referencing Company X, for the period during which the two transactions overlap, so long as such transactions have the same terms (e.g., reference entity, credit events, etc.) and are executed under and governed by a single ISDA Master Agreement for which close-out netting is enforceable, because the fund would *not* have any derivatives exposure for the purposes of the "Limited Derivatives User" test.

Commission notes in Request for Comment 161, certain interest rate derivatives correspond directly to, and are used to hedge interest rate risk arising from, specific cash instruments being hedged.[11] For example, a fund may enter into a fixed-to-floating interest rate swap to convert a floating rate asset to a fixed rate cash flow. Such a transaction would be easy to identify as a "true" hedge if the notional thereof (as well as any amortization schedule) is sized in an amount not to exceed by more than a negligible amount the face amount and payoff schedule, respectively, of the cash instrument. As with a currency hedge, such a matched-notional interest rate hedge "is definable because it involves a single risk factor (interest rate risk) and requires that the derivatives instrument must be tied to specified hedged investments".[12] Other categories of derivatives (e.g., commodity hedges) may have similar profiles and should similarly be excluded from the types of derivatives that would disqualify funds from availing themselves of the "Limited Derivatives User" definition.[13]

ii. The "Limited Derivatives User" Definition Should be Expanded to Carve Out Duration Hedging

While other interest rate hedges may be less immediately obvious, funds engage in a wide variety of interest rate derivatives in order to mitigate risk in connection with portfolios. Fixed income funds in particular rely on interest rate derivatives to manage duration, which is a measure of the sensitivity of the value of a fixed income instrument (or portfolio thereof) to changes in interest rates. Interest rate derivatives are able to alter this sensitivity to protect investors in fixed income vehicles against the price-depressing effects of increasing interest rates. For example, if a portfolio has a duration of five (meaning that for every 1% increase in interest rates, the value of the portfolio will decline by 5%), interest rate derivatives could be used to reduce that sensitivity to a lower rate (for example, 2% or 3%). This type of hedging has a clearly demonstrable intent and effect. Like the hedges noted above, these hedges present only one type of risk – interest rate risk. A board-approved policy regarding duration management should suffice to carve such trades out of the scope of derivatives instruments subject to the current proposed rule's de minimis test. This could be required to be reviewed as frequently as quarterly to ensure no speculative use. It could also be subject to outward reporting and disclosure to ensure that a consistent standard evolves across mangers.

iii. The "Limited Derivatives User" Definition Should be Expanded to Carve Out Fully-Paid Options and Swaptions and Purchased Credit Protection

The Commission properly confines "derivatives transactions" to instruments "under which a fund is or may be required to make any payment or delivery of cash or other assets during the life of the instrument or at maturity or early termination."[14] Accordingly, we would read the proposed rule to exclude from the scope of "derivatives transactions" a purchased cash-settled option or swaption[15] for which a fund has fully paid

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11 *Id.* at 4488.

12 *Id.*

13 Consider as an example a fund that has exposure to $10,000,000 of debt issued by a gold mining outfit. A fund could use $10,000,000 notional of gold futures to tightly and effectively mitigate its risk in connection with risk that the gold mining company fails to repay. Consider as another example a fund that holds $10,000,000 of market value in Gold exchange-traded funds. Such a fund could use $10,000,000 notional of gold futures to tightly and effectively mitigate its risk in connection with the exchange-traded fund.

14 *Id.* at 4558.

15 A swaption is an option transaction giving one party the right (but not the obligation) to enter into a swap transaction on particular terms. In the case of a cash-settled swaption, if exercised, the option buyer will receive a cash payment equal to the difference (if greater than zero) between the mark-to-market value of the referenced swap transaction at the exercise date and the strike price.

a premium (a "fully-paid option"). Under such a transaction, the purchasing fund would have no future payment or delivery obligations. It would be helpful if the Commission specifically provides in the final rule or confirms in adopting the final rule that such fully-paid options are not "derivatives transactions" and therefore are excluded from the types of derivatives that would disqualify funds from availing themselves of the "Limited Derivatives User" definition.

Additionally, the Commission correctly notes in the Proposing Release that "unfunded commitment agreements generally raise the Investment Company Act's concerns regarding the risks of undue speculation."[16] The Commission describes such agreements as a contract "under which a firm commits, conditionally or unconditionally, to make a loan to a company."[17] According to the Proposing Release, an unfunded commitment agreement that is not a derivatives transaction is not "undertaken to leverage a fund's portfolio" and would not "generally raise the Investment Company Act's concerns regarding the risks of undue speculation," but, depending on the facts and circumstances, "could raise the asset sufficiency concerns underlying the Investment Company Act."[18] Therefore, a fund could enter into an unfunded agreement "if the fund reasonably believes, at the time it enters into such agreement, that it will have sufficient cash and cash equivalents to meet its obligations with respect to all of its unfunded commitment agreements, in each case as they come due."[19] This makes perfect sense: a fund's obligations under a loan of which it is a lender are prescribed at a fixed upper boundary; a fund can easily manage its book to ensure that it maintains sufficient liquidity to meet its obligations.

There are several classes of derivatives that are identical in their risk profile and shouldn't be considered "derivatives transactions" for the purposes of the proposed rule (or at a minimum the "Limited Derivatives User" definition). For example, consider a straightforward credit default swap ("CDS") purchased by a fund. When a fund purchases a CDS, it is effectively protecting itself from a scenario in which a reference issuer (such as a corporation) fails (e.g., by neglecting to perform on material indebtedness or filing for bankruptcy). The value of the CDS fluctuates based on the perceived credit risk of the reference issuer. For most standard CDS, a purchaser will pay (or receive) an upfront premium based on the difference between (a) the net present value of a series of regular standard coupon payments for the life of the trade (e.g., 100 basis points for investment grade reference issuers) and the (b) net present value of coupon payments at a level above the risk-free rate that reflects the then-perceived credit risk of the reference issuer. If (a) is higher than (b), the fund will receive a premium to buy protection. If (b) is higher than (a), the fund will pay a premium to buy protection.

Once the fund pays the upfront premium, its only obligation for the remainder of the transaction is to pay regularly scheduled coupons at a rate fixed at the outset of the trade (e.g., 100 basis points for investment grade reference issuers). If the reference issuer has not failed prior to the maturity of the CDS, the fund will have no further obligations thereunder and the fund's counterparty (or clearinghouse, if the trade is centrally cleared) will have no further obligations thereunder. If, however, the reference issuer fails during the term of the trade, an auction settlement process will unfold pursuant to which the fund will receive a cash payment equal to the difference (if greater than zero) between the par value of the reference issuer's debt and the auction-determined price of such debt.[20] The purchaser will not be obligated to make any other

16 Proposing Release at 4506.
17 *Id*. at 4505.
18 *Id*. at 4506.
19 Proposed Rule 18f-4(e)(1).
20 This explanation is meant to demonstrate the typical mechanics of straightforward CDS. These are the types of CDS that would be used by most funds in their hedging programs.

payment or delivery to the counterparty (or clearinghouse, if the trade is centrally cleared).[21] Accordingly, a fund that purchased the CDS would be in the same position as a fund that entered into an unfunded commitment agreement. Just as in the case of an unfunded commitment agreement, a fund can easily manage its book to ensure that it maintains sufficient liquidity to meet its fixed coupon obligations under a purchased CDS.

The benefits to funds of CDS as hedging instruments are significant. Index CDS enable funds to insulate investors from macroeconomic credit shocks in a cost-effective manner, and single-name CDS provide a uniquely efficient tool for incrementally de-risking specific assets or asset classes without having to make a final decision to offload a particular asset or set thereof. As a result, funds should be encouraged to, not discouraged from, using CDS in a prudent manner. Accordingly, we strongly recommend that such purchased CDS be excluded from the types of derivatives that would disqualify funds from availing themselves of the "Limited Derivatives User" definition. That said, it would not be unreasonable, in our view, to require funds using such CDS to segregate liquid assets sufficient to meet anticipated premium payments in order to obtain such relief.

iv. The "Limited Derivatives User" Definition Should Test Notional on a Net Basis

We recognize that the "Limited Derivatives User" exception is "not designed to provide a precise measure of a fund's market exposure or to serve as a risk measure"[22] but rather to "identify funds that use derivatives in a limited way."[23] However, contrary to the view expressed in the Proposing Release, we suggest that permitting funds to give effect to netting in calculating their derivatives notional is essential to accurately identifying limited users of derivatives. For example, in certain circumstances, the only – or most practical – way to unwind a derivatives position or set thereof might be to enter into an offsetting position. If the goal of the "Limited Derivatives User" exception is to capture funds that exceed a specified notional amount as a percentage of its net assets that is viewed as material, then it makes sense to treat all methods of unwinding and neutralizing existing positions equally.

For example, and as described in Footnote 10, imagine a fund that sells $100,000,000 notional of credit protection referencing Company X and then buys $50,000,000 notional of credit protection referencing Company X. For the period during which the two transactions overlap, so long as they have the same terms (e.g., reference entity, credit events, etc.) and are executed under and governed by a single ISDA Master Agreement for which close-out netting is enforceable, the fund would be in the same position as if it had only sold $50,000,000 notional of protection. In the converse, if a fund buys $100,000,000 notional of credit protection referencing Company X and then sells $50,000,000 notional of credit protection referencing Company X, for the period during which the two transactions overlap, so long as such transactions have the same terms (e.g., reference entity, credit events, etc.) and are executed under and governed by a single

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21 A significant volume of CDS are subject to auction settlement, which was formally "hardwired" into the definitional booklets governing the CDS market after the 2008 financial crisis. Many CDS fall back to "physical settlement" in a scenario where auction settlement fails. In physical settlement, the fund that purchased the CDS would need to deliver a specified quantity of the reference issuer's debt in exchange for the par value of such debt. However, the fund could opt to walk away from the CDS contract (and not trigger the settlement mechanics) or alternatively allow the protection seller to simply "buy in" the debt. In such case, the fund could end up receiving nothing (e.g., in a circumstance where the debt was "bought in" at par), but it would *not* be responsible for paying or delivering any asset upon settlement.

22 Proposing Release at 4484.

23 *Id.*

ISDA Master Agreement for which close-out netting is enforceable, the fund would be in the same position as if it had only bought $50,000,000 notional of protection.

Crucial to this analysis is the concept of close-out netting and the enforceability thereof. As the Commission is well aware, most derivatives transactions in the G20 are governed by master agreements that prohibit cherry-picking of transactions in a default scenario and rather require the non-defaulting party to terminate all *but not fewer than all* transactions under a single master agreement in a default scenario. These master agreements (e.g., ISDA Master Agreement for uncleared bilateral derivatives and a standard Futures & Options on Futures Agreement and Cleared Swaps Addendum, where applicable, for cleared trades such as futures and cleared swaps) all incorporate close-out netting mechanics that prohibit a non-defaulting party from walking away from obligations and instead require the parties to settle obligations based on net calculations of risk.[24] The enforceability of these provisions upon the insolvency and/or bankruptcy of a trading counterparty entails complex legal analysis, but fortunately (and critically for the market) this analysis is set forth in regularly updated legal opinions commissioned by ISDA.[25] Generally speaking, the derivatives market in the G20 operates on the basis that close-out netting is generally enforceable. Indeed, certain market participants – such as insurance companies and pension plans – that may not be as clearly covered by these standard opinions generally need to seek bespoke opinions in order to access the over-the-counter derivatives marketplace. These concerns are generally not applicable to registered investment companies transacting in the G20.

Taking a broad and commercially accurate view of netting, derivatives exposure should be based on net payables or receivables under all master netting agreements. However, we acknowledge that the goal of the Limited Derivatives User exception is not to measure risk but to measure trading activity. Accordingly, we would propose that a middle ground be implemented whereby funds transacting offsetting transactions with the same counterparty under the same enforceable master netting agreement be permitted to acknowledge the reality of the de facto unwind effectuated by such offsetting transactions. We believe our proposed definition of "Net Notional Amount" facilitates this clearly.

B. Reverse Repo Transactions Should Not Constitute Leverage if Covered

We are concerned that requiring funds to add leverage incurred via Reverse Repo to the 300% leverage test will place an unnecessary obstacle in the way of funds' use of a valuable financing tool, and we strongly suggest that the 10666 coverage regime be preserved for such transactions for those funds that so elect.[26]

We agree with the Commission that because Reverse Repo "have the economic effect of a secured borrowing," they "more closely resemble bank borrowings with a known repayment obligation rather than the more-uncertain payment obligations of many derivatives", and we agree that the repayment obligation at the maturity of a Reverse Repo raises Section 18 asset sufficiency concerns. However, bank borrowings and Reverse Repo are far from identical. Some salient differences are set forth in the chart below.

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24 *See, e.g.,* Section 6(e) of the ISDA 2002 Master Agreement.

25 These opinions are generally available to ISDA members at https://www.isda.org/opinions-overview/.

26 Securities Trading Practices of Registered Investment Companies, Investment Company Act Release No. 10666 (Apr. 18, 1979) 44 Fed. Reg. 25128 (Apr. 27, 1979) ("10666").

Attribute	Bank Borrowing	Reverse Repo
Documentation	Requires bespoke negotiation of full credit facility (often hundreds of pages) for each lending commitment from each lender	Requires negotiation of straightforward master repurchase agreement on industry-standard form; one per counterparty
Cost of Documentation	Requires engagement of outside counsel and obtaining opinions; often involves compensating lender for counsel's fees	Negotiation of master agreement can often be handled by in-house counsel; negotiation more straightforward and efficient due to standard terms
Best Execution	Because of the set-up time (can be months from negotiation to actual borrowing), difficult to pivot from one agreement to another	Relatively easy to establish Reverse Repo agreement trading lines with multiple counterparties; can "pick and choose" best deals easily and in real time
Pricing	Traditional leverage does not offer the regulatory capital benefits of repo-based lending or the collateral rehypothecation benefits of repo-based lending	Because Reverse Repo agreements generally benefit from unique treatment under bankruptcy and insolvency laws (including SIPA, the Bankruptcy Code and the FDIA), they provide regulatory capital benefits to dealers, which result in more efficient pricing; pricing benefits also result from the fact that counterparties are permitted (and even expected to) rehypothecate collateral
Insulation from Default	Credit agreements concentrate borrowing from one counterparty (the lending bank); if a default event occurs to the fund, the lending bank can generally accelerate the full amount of the loan	Each Reverse Repo facility will be its own separate item; to the extent there are defaults under one, they are unlikely to translate to defaults under other Reverse Repo agreements (and so if leverage is spread across these agreements, one would not expect all financing to be susceptible to a single default)

These (and other) benefits of Reverse Repo make them important tools for funds. It is important to facilitate access to such agreements consistent with past practice under 10666 to avoid unduly constraining funds' ability to take advantage of the benefits of the same. Were funds forced to treat Reverse Repo similarly to secured borrowing for Section 18 purposes, many – particularly fixed income funds – would find their use of leverage hampered by unnecessary operational restraints. Unlike secured borrowings, which as noted above tend to require significant negotiations and a lengthy setup runway, the Reverse Repo market can be quickly entered and exited. This can make the 300% calculation unwieldy and costly – whereas in the context of a single credit agreement, the leverage numerator doesn't change frequently (and likely requires only calculating payables to one lending counterparty), in the context of Reverse Repo, the leverage

numerator could change dramatically on regular basis (even daily) and would require evaluation of multiple counterparties. This is not to say that a fund shouldn't be able to take on this burden should it deem fit. Rather, funds that already have established systems and procedures to adequately cover Reverse Repo leverage should be permitted to continue to rely on them. Generally speaking, funds are accustomed to – and well able to – address the asset sufficiency concerns of Section 18 by covering the "repurchase price" (i.e., the loan repayment amount plus accrued interest) obligations under Reverse Repo consistent with current practice under 10666.

We understand why the proposal "does not treat a fund's obligation to return securities lending collateral as a financing transaction similar to a reverse repurchase agreement" and acknowledge that whereas securities lending arrangements are generally covered by cash and cash equivalents, Reverse Repo are unlikely to be covered by cash and cash equivalents.[27] However, the fact that collateral underpinning Reverse Repo will be liquid in nature should not be ignored. A fund that sets aside liquid assets to cover its repayment obligations under a Reverse Repo should not be treated similarly as a fund that does not set aside liquid assets (or any assets) to cover its repayment obligations. From an asset sufficiency perspective, a fund that adequately covers its repayment obligations will be poised to avoid a circumstance in which shareholders are disadvantaged to Reverse Repo lenders, and from an undue speculation perspective, a fund that adequately covers its repayment obligations will be effectively limited to 200% leverage. In conclusion, we would note that given the advantages of Reverse Repo, should a fund prefer Reverse Repo to secured borrowings, if there is no cover opportunity, a fund could find itself in a worse position than if it merely borrowed via secured borrowings. This is because of the unique bankruptcy treatment of Reverse Repo. More specifically, where as a fund's lender in the credit agreement context would be stayed from accessing and liquidating collateral upon a fund bankruptcy, a fund's lender in the Reverse Repo context could immediately liquidate collateral notwithstanding the bankruptcy. From a shareholder perspective, this point militates in favor of preserving a cover regime for Reverse Repo transactions. Accordingly, funds should be given the option of either treating their Reverse Repo activity as leverage for the 300% test or covering their Reverse Repo activity.

C. The Definition of "Leveraged/Inverse Investment Vehicles" Should be Expanded to Include All Relevant Entities

We welcome and support the specific treatment afforded to "leveraged/inverse investment vehicles". However, we note that the definition of these vehicles should be expanded to avoid inadvertently excluding entities that might not track a specific index but rather track another salient (and disclosed) measure.[28] For example, while it is clear from the proposed rule that a fund that tracks a multiple of a specific index (e.g., a 2x S&P 500 fund) would qualify as a "leveraged/inverse investment vehicle," it is less clear that a fund that tracks 1x the "high yield bond market" or 1.2x the current long Treasury Bond fits squarely within the definition. Such vehicles, despite not actually referencing an index, only differ from funds referencing an index insofar as to the measurement they are targeting – they nonetheless are "designed to hedge against or profit from short-term market movements" and are "generally intended as short-term trading tools."

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27 Proposing Release at 4504.

28 Due to timing differences between the pricing time of a given index and the pricing time of the vehicle referencing that index (or multiple thereof), there may from time to time be slight tracking errors. We would imagine – but appreciate confirmation – that such errors would not pull a vehicle that otherwise meets the definition of "leveraged/inverse investment vehicles" from satisfying such definition's requirements.

III. Comments on Proposed New Exchange Act Rule 15*l*-2 and Advisers Act Rule 211(h)-1 ("Sales Practices Rules")

We would also suggest the proposed sales practices rules are unnecessary in light of existing regulation. The sales practices rules as proposed would establish a new set of due diligence and account approval requirements for SEC-registered broker-dealers and investment advisers and their respective personnel (each, a "firm" and collectively, "firms") that offer shares of certain leveraged/inverse investment vehicles. These same firms and their relationships with investors are already regulated, as investment advisers have an obligation to act in their client's best interest under the adviser's standard of conduct ("Standard of Conduct") and broker-dealers will be subject to a best interest obligation beginning June 30, 2020 under regulation best interest ("Regulation BI").

Under the proposed sales practices rules, a firm offering shares of such funds would have to exercise enhanced due diligence in determining whether to approve a retail customer's or client's account to buy or sell leveraged/inverse investment vehicles and could only approve the account if, based on the retail investor's information, the firm has a reasonable basis to believe that the customer or client could be "reasonably expected to be capable of evaluating the risks" associated with such vehicles.[29] The proposed due diligence requirements are modeled after current FINRA options account approval requirements.[30]

Guggenheim manages a suite of leveraged/inverse mutual Funds consisting of 42 such Funds with a range of leveraged exposure from -2x to 2x that track both indexes and other market segments, including emerging market bond, high yield market and the 30-year Treasury bond,[31] some of which are leveraged/inverse investment vehicles as defined in the proposed sales practices rules (the "Guggenheim Leveraged/Inverse Funds").

The Guggenheim Leveraged/Inverse Funds are primarily distributed through a sophisticated team of third-party financial advisors that are subject to the Standard of Conduct and/or Regulation BI. In this capacity, the financial advisors must act in their advisory clients' best interest when advice or a recommendation is given, including in the selection of Guggenheim Leveraged/Inverse Funds. Accordingly, our comments are limited to the perspective of leveraged/inverse funds selected by firms on behalf of their clients or customers.

A. The Proposed Sales Practices Rules are Unnecessary and Premature in Light of the Standard of Conduct and Regulation BI

We note that investors who have engaged investment advisers to manage their investments generally rely on the expertise of the adviser in trading leveraged/inverse funds. Investment advisers are bound by their fiduciary duty to their advisory clients to act in the clients' best interest. Similarly, Regulation BI imposes on broker-dealers a duty to act in their customer's best interest when making a securities recommendation. While we recognize that leveraged/inverse mutual funds have unique features, we have found that the

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29 Proposing Release at 4494.

30 Proposing Release at 4493.

31 SI serves as the adviser to these Funds, which include: Dow 2x Strategy; Emerging Markets 2x Strategy; Europe 1.25x Strategy; Government Long Bond 1.2x Strategy; Inverse Dow 2X Strategy; Inverse Emerging Markets 2x Strategy; Inverse Government Long Bond Strategy; Inverse High Yield Strategy; Inverse Mid-Cap Strategy; Inverse NASDAQ-100® Strategy; Inverse NASDAQ-100® 2x Strategy; Inverse Russell 2000® Strategy; Inverse Russell 2000® 2x Strategy; Inverse S&P 500® Strategy; Inverse S&P 500® 2x Strategy; Japan 2x Strategy; Mid-Cap 1.5x Strategy; Monthly Rebalance NASDAQ-100® 2x Strategy; NASDAQ-100® 2x Strategy; Nova; Russell 2000® 1.5x Strategy; Russell 2000® 2x Strategy; S&P 500® 2x Strategy; Strengthening Dollar 2x Strategy; Weakening Dollar 2x Strategy.

Guggenheim Leveraged/Inverse Funds are well understood by these financial advisors, many of which have a long-standing relationship with Guggenheim, and such Funds are appropriately used on behalf of their clients (and customers).

In this regard, these financial advisors are hired by investors to manage a portfolio of their assets. Such investors share information about themselves with the financial advisors and select a management style(s) and account guidelines for their accounts. On behalf of these investors, the financial advisors will actively manage and trade their accounts in accordance with such selected management style, including by potentially investing in the Guggenheim Leveraged/Inverse Funds. The financial advisors tend to choose a Guggenheim Leveraged/Inverse Fund as a temporary position for a client for the targeted return period as disclosed in the applicable Fund's prospectus to, for example, obtain leveraged investment exposure for the applicable period or hedge against an existing position or perceived overexposure to a certain asset class. The financial advisors are well-positioned to select investments that are in the best interest of these investors and typically have significant years of experience in the industry as well as with the Guggenheim Leveraged/Inverse Funds. Additionally, Guggenheim hosts, and our key financial advisors attend, conferences on the various investment products available on their respective platforms, including Guggenheim Leveraged/Inverse Funds, and in our experience have a deep understanding of such Funds. The financial advisors also have access to specialized literature on such Funds.

The financial advisors have duties to act in the investor's best interest. Based on our knowledge of these financial advisors, we do not believe that the sales practices rules provide an additional benefit to investors.

We are also concerned that implementation of the proposed sales practices rules potentially introduces inconsistencies with the Standard of Conduct and Regulation BI and will be costly for firms to implement. The proposing release notes that the FINRA options account approval requirements currently applicable to broker-dealers represents a current framework that can be used in connection with complex financial products generally. However, investment advisers, which have a more overarching fiduciary duty to their advisory clients where advice is given, are not subject to this type of specific account-level regulation currently. We are concerned that imposing prescriptive due diligence requirements on investment advisers, including the financial advisors, that are akin to the FINRA options account approval requirements for broker-dealers, is inconsistent and unnecessary in light of the Standard of Conduct and Regulation BI, and would add incremental regulatory costs without adding to investor protection in light of the existing duty to act in the investor's best interest when advice or a recommendation is given.

As an investment adviser without an existing options account approval process and based on our internal estimates, we believe that implementing the proposed new sales practices rules would be much higher than the cost-benefit analysis of the proposing release, which estimated total one-time costs for an investment adviser (or broker-dealer) under these proposed requirements "would range from $9,116 to $15,193," with estimated total ongoing costs ranging "from $2,271 to $3,915 per year."[32] We also note that this system build-out would be additional to the processes and recordkeeping obligations under the Standard of Conduct and Regulation BI.

As discussed herein, investment advisers have fiduciary duties to their advisory clients, and the standard of conduct explains the SEC's view that an adviser is already required to apply heightened scrutiny to certain products for retail clients, including complex investments or products, such as inverse and leverage exchange-traded products. Advisers are continuing to implement the standard of conduct. Similarly, the adopting release for Regulation BI explains that a broker-dealer's "Care Obligation" requires such broker-dealer recommending a leveraged/inverse investment vehicle to understand the terms, features and risks before recommending such product to a retail customer. Broker-dealers are implementing regulation best interest as the compliance date approaches this summer.

[32] Proposing Release at 4523.

In light of the foregoing, we believe it is premature to propose and potentially adopt sales practices rules before an assessment can be made of the impact of the Standard of Conduct and Regulation BI, and we believe that the SEC's cost/benefit analysis may underestimate implementation cost.

B. The Proposed Sales Practices Rules Depart from Disclosure-Based Regulation of Investment Companies

By imposing new due diligence requirements, the proposed sales practices rules deviate from the disclosure-based role of the SEC and would impose due diligence requirements that, at least initially, would be applicable only to leveraged/inverse investment vehicles, including the Guggenheim Leveraged/Inverse Funds.

The proposed sales practices rules represent a marked departure from the SEC's role as a disclosure-based agency that seeks to ensure that "all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it."[33] In particular, regulation of investment companies has focused on disclosure of principal risks so that investors can make informed decisions about whether an investment and its accompanying risks are appropriate for such investor. For example, the Guggenheim Leveraged/Inverse Fund prospectuses state the "Fund is very different from most mutual funds" and further states in bold font that "[t]he Fund is not suitable for all investors and is designed to be utilized only by sophisticated investors who (a) understand the risks associated with the use of leverage, (b) understand the consequences of seeking daily leveraged investment results, (c) understand the risks of shorting, and (d) intend to actively monitor and manage their investments. Investors who do not understand the Fund or do not intend to actively manage and monitor their investments should not buy shares of the Fund." We believe this plain English disclosure, especially when paired with the advice of a registered investment adviser, is effective. We do not believe that departing from a disclosure-based regime is appropriate as leveraged/inverse funds, while more volatile than many other investment companies when held for longer than the targeted return period as disclosed in the applicable Fund's prospectus, are still investment company products and do not rise to the complexity or risk of loss levels of options trading.

Additionally, investors in registered funds, including the Guggenheim Leveraged/Inverse Funds, benefit from the strength of regulatory protections and restrictions under the Investment Company Act, the adviser's and fund's existing policies and procedures and robust oversight provided through the governance of an independent fund board, unlike options or other types of securities. These protections work together with the other federal securities laws to ensure that the investment company shares are appropriate for investors.

We are concerned that treating an investment in leveraged/inverse mutual funds (including when relying upon the advice of a registered investment adviser) as analogous to a retail investor trading options is inappropriate in light of the existing framework under the Investment Company Act for registering investment company shares, and would be concerned that other types of funds could be subject to similar regulation going forward, thus moving further away from the SEC's role as a disclosure-based agency.

C. Recommendations

In summary, the proposed sales practices rules have slender benefits in light of the fiduciary duties owed by investment advisers to their clients and the best interest obligation owed by broker-dealers to their

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[33] *About the SEC: What We Do*, SEC, *available at* http://www.sec.gov/about/whatwedo.shtml (last modified June 10, 2013).

customers when making a recommendation, which already govern firms' interactions with clients, and are costly. We further believe that investments in, and the risks presented by, mutual funds are fundamentally different than options trading, and that such differences are material in consideration of the proposed sales practices rules.

Accordingly, we would recommend that the SEC allow the Standard of Conduct to continue to be implemented by investment advisers and Regulation BI to be fully implemented by broker-dealers, and further consider the appropriateness of imposing the proposed sales practices rules. In light of existing regulation governing investment advisers and broker-dealers, and the long history of the SEC's role as a disclosure-based agency, we believe that, if it is determined that further regulation or guidance is needed, the proposed sales practices rules should be replaced by a straightforward and thorough disclosure requirement whereby any investor in a leveraged/inverse investment vehicle would be explicitly put on notice of the unique nature of such vehicle and its particular exemptions with respect to derivative use.

IV. Conclusion

We wish to reiterate our appreciation for the SEC's diligent and thoughtful approach to the proposed rule. We believe that the changes discussed herein would improve upon the proposal and mitigate the issues that we have discussed above. In particular, we believe it is important to accommodate current and future investing practices that benefit investors and do not pose the asset sufficiency and speculation concerns the proposed rule seeks to address. Thank you again for taking the time to consider this letter and please feel free to contact me, Amy J. Lee, at amy.lee@guggenheimpartners.com or Jaime Madell at jaime.madell@guggenheimpartners.com with any questions.

Sincerely,

/s/ Amy J. Lee
Amy J. Lee
Guggenheim Investments