

**May 4, 2020**

**Via Electronic Mail ([rule-comments@sec.gov](mailto:rule-comments@sec.gov))**

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

**Re: *File No. S7-24-15; Release No. 34-87607*  
*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***

Dear Ms. Countryman:

TD Ameritrade, Inc.<sup>1</sup> (“TD Ameritrade” or “the Firm”) appreciates the opportunity to comment on the U.S. Securities and Exchange Commission’s (“SEC” or the “Commission”) above referenced Rule Proposal<sup>2</sup> which describes sales practices rules<sup>3</sup> requiring broker-dealers and investment advisers to engage in due diligence before permitting retail investors<sup>4</sup> to invest in certain leveraged/inverse investment vehicles.<sup>5</sup> As a broker providing brokerage services to predominantly a self-directed account base, TD Ameritrade believes it is uniquely qualified to comment on this proposal.

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<sup>1</sup> TD Ameritrade is a wholly owned broker subsidiary of TD Ameritrade Holding Corporation (Nasdaq: AMTD). AMTD has a 44-year history of providing financial services to self-directed investors. TD Ameritrade provides investing services and education to over 12 million client accounts totaling approximately \$1.2 trillion in assets, and custodial services for more than 7,000 independent registered investment advisors. As a leader in U.S. retail trading, TD Ameritrade handles millions of trades per day for our clients.

<sup>2</sup> *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*, Rel. No. 34-87607 (Nov. 25, 2019), 85 FR 4446 (Jan. 24, 2020) (the “Rule Proposal”).

<sup>3</sup> As defined in the Rule Proposal at 1 and 176.

<sup>4</sup> As defined in the Rule Proposal at 176.

<sup>5</sup> As defined in the Rule Proposal at 176.

## **I. INTRODUCTION**

TD Ameritrade supports the SEC's ongoing commitment to protecting investors, as well its consideration of the compliance burdens associated with any new regulation. While the Firm agrees with the underlying intent of the Rule Proposal, of ensuring that retail investors understand the risks and characteristics of leveraged/inverse investment vehicles, we do not support the sales practices rules in their current form. As proposed, the sales practices rules would unduly restrict investors' access to public markets and result in costs disproportionate to the problem they are aimed to address. In fact, we agree wholeheartedly with the SEC when it states "information enables investors, not the government, to make informed judgments about whether to purchase a company's securities."<sup>6</sup> That is why TD Ameritrade offers its clients a free comprehensive education to ensure that our clients are well informed and understand the risks of investing.

As detailed below, TD Ameritrade proposes that the sales practice rules be changed to require brokers to provide retail investors with a short, plain-English disclosure alert concerning the associated holding-period and volatility risks of leveraged/inverse ETFs, and a separate notice to clients when their holding period exceeds a certain period. The Firm believes this disclosure regime would enhance investor protection while lowering compliance costs compared to the proposed sales practices rules, which we expect will not achieve the desired results.

## **II. OVERVIEW, ANALYSIS AND A PROPOSED SOLUTION**

Leveraged/inverse investment vehicles are complex financial instruments in design, but simple in concept. Basically, depending on the exchange traded fund or trust ("ETF"), the goal is to have an investment vehicle that either increases/decreases in value at multiples of the indices they track, either the same way the market is moving, or its inverse. TD Ameritrade believes it is important for retail investors to possess the basic understanding that:

- (1) as leveraged products, the risks of investing are greatly amplified — investing in an ETF seeking to replicate three times the movement of an index, can result in three times the losses if the market moves in the opposite directions an investor believes it will move; and
- (2) leveraged/inverse investment vehicles are intended for short term trading and, unlike many non-leveraged/inverse ETFs, they should not be used as "buy and hold" investments.

TD Ameritrade believes the goal should be to inform retail investors about the risks of the products through education that clearly outlines the structure and risks of the product. This educational opportunity would be squandered on a diligence process that fails to empower clients with information so they better understand the products and their intended uses. If firms can instead call attention to potential pitfalls and direct investor attention to the most important information—especially around the point of sale when investor interest is heightened—then there should be fewer instances of retail investors not understanding the investment vehicles they are trading. In fact, we worry the proposed diligence and approval process could potentially worsen the situation by instilling a sense of

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<sup>6</sup> "The Laws that Govern the Securities Industry" at <https://www.sec.gov/Article/whatwedo.html>.

overconfidence in investors who are approved to invest in these products while still not understanding them.

We believe the most effective method would be to provide investors with a short, plain-English description of the primary risks and unintuitive behavior these products, *i.e.* they are intended as short-term investments, they are susceptible to losses due to volatility, and losses are magnified in proportion to the product's multiple. The disclosure could be displayed or provided before finalizing the purchase of leveraged/inverse investment vehicles. In addition, brokers would be required to send investors who hold the product for a specific period (*e.g.*, a week) a notice alerting them of such and reiterating the short-term nature of these products. Reasonable investors would likely pay extra attention to these disclosures and notice because of the unexpected delivery compared to other products. And given the proposed brevity and clarity of the information, simply reading through it should suffice to educate prospective investors.

### **III. THE SALES PRACTICES RULE AND DUE DILIGENCE REQUIREMENTS DO NOT ACHIEVE THEIR STATED PURPOSE AND PROVIDE LESS PROTECTION THAN OTHER AVAILABLE OPTIONS**

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TD Ameritrade believes the Rule Proposal's due diligence requirements fail to achieve the Commission's stated purpose of ensuring "that investors in these funds are limited to those who are capable of evaluating their characteristics."<sup>7</sup> We further believe that, even if due diligence inquiries were an effective way to determine investor capability, a lack of capability is generally not what causes investors to make uninformed investments in these products. We believe it is more likely that investors sometimes fail to realize these products carry special considerations and targeted disclosures educating clients would offer them better protection.

Having firms conduct due diligence of individuals' financial and trading capability will not help retail investors understand the risks of leveraged/inverse investment vehicles because it fails to provide a process whereby the investor is informed of the risks of the product and instead puts the responsibility on investors to direct information to financial firms. Given that this is an educational opportunity, we believe the informational flow should go the other way: from financial firms to investors. Doing so would more effectively protect investors and would minimize the burdens placed on investors and the industry. While the Rule Proposal and our suggested alternative are not mutually exclusive, TD Ameritrade believes due diligence inquiries would not add significant protections for retail investors. We believe an educated investor will make better informed decisions.

The proposed sales practices rules include a list of minimum diligence questions for firms to ask before deciding whether to approve a client for purchasing leveraged/inverse investment vehicles. Firms can choose to ask more questions if they want, but given these are the stated minimums one would expect them to cover the most essential topics. That does not appear to be the case, though. The questions address topics like employment status, income, net worth, and liquid net worth,<sup>8</sup> none of

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<sup>7</sup> Rule Proposal at 182.

<sup>8</sup> See Rule Proposal's minimum information requirements at 187.

which seem helpful for determining an investor's ability to understand these products.<sup>9</sup> Even the questions relating to investment objectives, time horizons, and percentage of liquid net worth allocated to these products<sup>10</sup> are only indirectly useful because they might indicate a conflict with an investor's risk profile or otherwise suggest an underlying misunderstanding.

The only directly relevant question is about how much investment experience and knowledge an investor has with these products and other financial instruments.<sup>11</sup> Unfortunately, even this line of inquiry will not determine whether retail investors understand the basic goals of leveraged/inverse investment vehicles. There is no proactive gauging of what the investor knows about the particular product, and no indication as to whether they understand the investment. So it remains unclear how firms are supposed to use these diligence questions since the information they produce does not align with their stated purpose. In fact, they only seem useful for obtaining information necessary for a suitability or best interest analysis. If that is the intention, it would clearly be unacceptable given the Rule Proposal's application to even unsolicited purchases. We worry this indicates the Commission intends to apply a commensurate level of scrutiny when reviewing broker-dealer's decisions to approve clients for trading these products.

TD Ameritrade strongly opposes the use of a suitability or best interest standard for permitting self-directed retail investors to purchase leveraged/inverse investment vehicles. We also oppose the application of the sales practices rules to registered investment advisers ("RIAs") making recommendations or transacting in client accounts. First, insofar as the Rules Proposal applies to recommendations or transactions in discretionary accounts, they would effectively be subsumed under the already robust requirements of Regulation Best Interest<sup>12</sup> and applicable fiduciary standards,<sup>13</sup> adding only a superfluous regulatory layer to the mix. Second, to the extent the rules apply to unsolicited client requests, that would all but eliminate the distinction between recommended and unsolicited transactions because what are effectively the same requirements would apply to both. For that reason, we assume the Commission does not intend to extend the rules in that manner and so request any final rule include clarifying language. We appreciate and agree with the Commission's decision to limit the sales practices rules for broker-dealers to only retail clients and further request that the rules continue to apply only with respect to retail clients and not those represented by RIAs.

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<sup>9</sup> See Commissioner Hester M. Peirce and Commissioner Elad L. Roisman, "Statement on the Re-Proposal to Regulate Funds' Use of Derivatives as Well as Certain Sales Practices" (Nov. 26, 2019) in II.B. where Commissioners Peirce and Roisman express a similar sentiment, available at <https://www.sec.gov/news/public-statement/roisman-peirce-statement-funds-derivatives-sales-practices>.

<sup>10</sup> See Rule Proposal's minimum information requirements at 187.

<sup>11</sup> *Id.*

<sup>12</sup> 17 CFR 240.15l-1; *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, Rel. No. 34-86031 (June 5, 2019).

<sup>13</sup> See *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Investment Advisers Act Release No. 5248 (June 5, 2019).

Additionally, TD Ameritrade requests that the Commission add an exemption to the sales practices rules for broker-dealers who accept or allow un-solicited transactions in leveraged/inverse investment vehicles where the product's issuer failed to properly indicate that it qualifies as a leveraged/inverse investment vehicle (under any final definition or standard). To facilitate this, the Commission should require issuers to include a checkbox or legend in their prospectus that would allow persons to easily determine whether a product requires compliance with the sales practices rules.

#### **IV. THE ESTIMATED COSTS FAR OUTWEIGH THE INTENDED BENEFITS**

TD Ameritrade appreciates the SEC's consideration of compliance costs and its attempt to create efficiencies by modeling the sales practices rules after FINRA's existing options approval rules. However, we expect the cost of implementing the required systems, policies, and procedures would far exceed any reasonably expected benefit to retail investors. The SEC estimates the industry's total cost of compliance will be nearly \$2.38 billion.<sup>14</sup> It is difficult to imagine how such a narrow subset of available products<sup>15</sup> would justify this cost. In fact, as of September 2019, the total net assets of all inverse/leveraged investment vehicles combined equaled only \$40 billion.<sup>16</sup> Extrapolating from that, the SEC expects the industry's costs to comply with the proposed sales practices rules would equal nearly 6% of the total net assets of the products they relate to.

TD Ameritrade believes such costs are disproportionate to the problem and any potential benefit the rules might be expected to produce,<sup>17</sup> and the SEC does not make clear to what degree compliance will improve things. The likely outcome is that many firms will simply stop selling leveraged/inverse investment vehicles to avoid the associated costs and potential liabilities. Our confusion with the lack of a reasonable cost benefit analysis grows when we consider that the scope of the sales practices rules only extends to retail investors. The result is that the already outsized compliance costs are to be distributed among only the subset of products held by retail investors—not

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<sup>14</sup> Rule Proposal at 292.

<sup>15</sup> See "Statement on the Re-Proposal to Regulate Funds' Use of Derivatives as Well as Certain Sales Practices" in II.B. where Commissioner's Peirce and Roisman say "Why would we introduce such a thing now, with respect to such a narrow subset of products?" <https://www.sec.gov/news/public-statement/roisman-peirce-statement-funds-derivatives-sales-practices>.

<sup>16</sup> Rule Proposal at 257.

<sup>17</sup> See NASAA's July 2019 "Report on Broker-Dealer Policies & Procedures for Leveraged and/or Inverse Exchange-Traded Funds" at 16 where they report that of the firms surveyed and which allow customers to purchase leveraged/inverse funds, 72% of them said they have not received a single customer complaint in the past three years. The report also provides that "[b]ased on the responses to additional questions, the number of customer complaints, regulatory actions and arbitration awards or civil judgments regarding leveraged and/or inverse ETFs in recent years at the surveyed broker-dealers was low." This is especially telling since potential actions or complaints would include those relating to solicited transactions, which are already subject to suitability requirements and will later fall under best interest standards.

institutional investors or anyone else.<sup>18</sup> No data is provided on what proportion of the products that might be, though.

In fact, the SEC does not even supply data on how many retail accounts are invested in leveraged/inverse investment vehicles. Instead, they provide estimates “based on staff experience.”<sup>19</sup> We understand the need to sometimes extrapolate or estimate, especially for forward-looking information. But we believe it is inappropriate for the SEC to restrict investor access to public markets, diminish the efficiency of those markets, and burden the industry with inflated compliance costs without first obtaining more information.

**V. CONCLUSION**

TD Ameritrade appreciates the opportunity to comment on the SEC’s Rule Proposal. The Firm supports taking measures to improve investor protection relating to leveraged/inverse investment vehicles but we believe the Commission could significantly improve its proposed sales practices rules by limiting them to a requirement of providing targeted disclosures.

TD Ameritrade greatly appreciates the Commission’s consideration of the above comments and concerns. Please feel free to contact me at [REDACTED] with any questions regarding our comments.

Respectfully submitted,



John S. Markle  
Interim General Counsel

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<sup>18</sup> This disparity continues to grow if one rejects the position that these rules should also apply to recommendations that would fall under Regulation Best Interest, which has its own separate compliance costs.

<sup>19</sup> Rule Proposal at 291.