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Congress of the United States
House of Representatives
Washington, DC 20515

May 5, 2020

The Honorable Walter J. Clayton, III
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Dear Chairman Clayton,

The past month has borne witness to unprecedented upheaval in the United States economy, including in the capital markets that the Securities and Exchange Commission (SEC) oversees. COVID-19 has given rise to unimaginable challenges for the investing public and for the U.S. securities industry that serves them. You and your fellow Commissioners are to be commended for your swift, comprehensive, and rationally focused response to those challenges. The nature and scope of conditional relief that the agency has extended, as well as the guidance you have provided to help market participants continue to support investors while satisfying their obligations under the law, are to be applauded.

On a number of occasions since this crisis began, you and your staff have highlighted the importance of robust, high quality disclosure as the bedrock of our securities laws and the capital markets. Just last month, you issued a comprehensive statement on this topic, observing: "Disclosure—providing the public with the information necessary to make informed investment decisions—is fundamental to furthering each aspect of" the SEC's tripartite mission of maintaining market integrity, facilitating capital formation, and protecting investors.[1]

We agree wholeheartedly with your views on the importance of disclosure. Indeed, since 1933, disclosure has served as the cornerstone of federal securities regulation. The law requires market participants to provide truthful information about securities and the risks associated with investing in them. Armed with this information, investors are then free to make their own decisions about whether to buy or sell a security.

We write today with respect to what appears to be an unprecedented departure from this foundational tenet of the securities laws. Specifically, we are very concerned about an SEC rule

[1] Jay Clayton, Chairman, and William Hinman, Director of Division of Corporation Finance, U.S. Securities and Exchange Commission, *The Importance of Disclosure – For Investors, Markets and Our Fight Against COVID-19* (Apr. 8, 2020), *available at* https://www.sec.gov/news/public-statement/statement-clayton-hinman.

proposal concerning the use of derivatives by registered investment companies.[2] Issued in November 2019, the proposal's overall objective of establishing guidelines for the use of derivatives in investment funds is laudable. However, the Commission appears to be have embarked on a highly unusual detour into merit-based regulation that takes the form of purported "sales practice rules" applicable to a single asset class – leveraged and inverse funds.

Under the proposal, investors who want to exercise their right to purchase such products would be required to be "precleared" by their broker or investment adviser. Investors would be forced to provide an array of sensitive and arbitrary information and undergo a subjective qualification test to prove they are capable of understanding the risks associated with the products – registered products that the SEC itself approved years ago and that play a crucial role in the investment strategies of thousands of investors.

For a host of reasons – many of which two of your fellow Commissioners articulated in a statement that was issued along with the proposal[3] – we are deeply concerned about the wide-ranging impact this foray into merit-based regulation would have on our capital markets, and in particular on investors' freedom to choose the best way to save for college, plan for their retirement, and otherwise achieve their financial goals.

First, we are deeply worried about the precedent such a requirement would establish. To the best of our knowledge, this would mark the first time the SEC has ever required investors to pass a test in order to qualify to purchase equity securities in the public markets. Instead of mandating high-quality disclosure and allowing investors to make their own decisions, the SEC for the first time in its history would be in the position of picking and choosing which products are safe for investors to buy, and which are not. This is a deeply concerning approach that, if adopted, could easily be expanded to include additional products in the future. We are highly skeptical of the justification for such a drastic departure from nearly ninety years of disclosure-based regulation, and indeed question whether the Commission has authority to impose such an obligation.

Second, we are not convinced that any requirements beyond the existing disclosure regime are necessary. The proposal is premised on the notion that investors are incapable of understanding the risks of leveraged and inverse products. However, the Commission has failed to make the case that traditional disclosure is inadequate to meet the needs of investors in these products. This is borne out in the thousands of letters that have been submitted to the comment file in opposition to the proposal, many penned by actual shareholders in these products who affirm that they understand their risks. Coupled with existing regulatory safeguards such as the Commission's recently adopted Regulation Best Interest and applicable fiduciary standards, the existing disclosure regime should be more than adequate to protect investors.

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[2] 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 (Release No. 34-87607; IA-5413; IC-33704; File No. S7-24-15).
[3] Hester M. Peirce and Elad L. Roisman, Commissioners, U.S. Securities and Exchange Commission, *Statement on the Re-Proposal to Regulate Funds' Use of Derivatives as Well as Certain Sales Practices* (Nov. 26, 2019), *available at* https://www.sec.gov/news/public-statement/roisman-peirce-statement-funds-derivatives-sales-practices.

Finally, we are concerned that the proposed requirements would actually harm, rather than protect, investors. As the comment file readily reflects, the proposed rules would deprive investors of a valuable, well-established tool for seeking enhanced returns in their portfolios or managing risk. Further limiting investor choice, the compliance burdens and attendant liability associated with the proposed qualification test would likely drive financial institutions to stop offering these products altogether, and could drive investors to take on riskier and more complex investment strategies such as shorting, transacting in options or futures, or seeking leverage through margin accounts – alternatives that can entail greater complexity and substantially greater economic risk than investing in leveraged and inverse funds, including losses that exceed invested principal.

We firmly believe that the U.S. capital markets that you oversee are the most robust, transparent, and fair markets in the world. They have functioned, and continue to function, remarkably well under the existing, disclosure-based regulatory construct of the federal securities laws. Any concerns about investor understanding of leveraged and inverse products should be addressed through disclosure – not through a merit-based rule that has the SEC picking and choosing what securities individual investors can buy and sell. We strongly urge you to eliminate the investor qualification test altogether from any final rule.

Sincerely,

Bryan Steil

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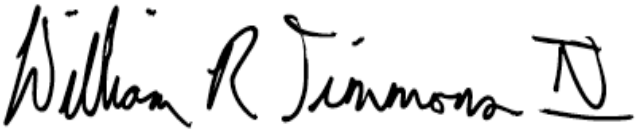

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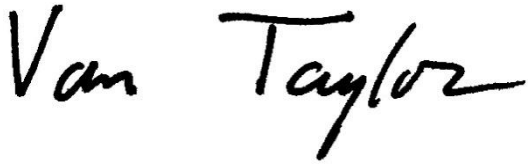

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