25 March 2016

Mr. Brent J. Fields  
Secretary  
Securities and Exchange Commission  
100 F Street NW  
Washington, DC 20549-1090  

Attn: File Number S7-24-15

Dear Mr. Fields:

The American Action Forum ("AAF") appreciates the opportunity to submit comments on the Securities and Exchange Commission's ("SEC") proposed rule 18f-4 ("proposed rule") to regulate certain types of financial commitments made by investment companies.

AAF is an independent, nonprofit 501(c)(3) organization that is not affiliated with or controlled by any political group. Its focus is to educate the public about the complex policy choices now facing the country and explain as cogently and forcefully as possible why solutions grounded in the center-right values that have guided the country thus far still represent the best way forward for America's future.

The proposed rule would severely restrict investment companies' use of derivatives and thereby limit investors' investment opportunities while imposing significant new compliance and other obligations on the directors and risk managers of such funds. Because of these reasons AAF opposes the proposed rule in its current form.

Additionally, AAF questions the SEC's authority to adopt such a rule and has concerns about the legitimacy of the SEC's cost-benefit analysis performed before and referenced throughout the proposal.

We address these concerns in the remainder.

1. Does the SEC have the authority to adopt the proposed rule?

AAF's concern over the SEC's authority to adopt the proposed rule is twofold. First, the proposed rule is in direct conflict with over 30 years of SEC guidance\(^1\) that investment companies have relied on.

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on to avoid implicating certain restrictions on senior securities laid out in the Investment Company Act ("ICA"), which the proposed rule seeks to amend. The proposed rule is significantly more restrictive and burdensome on these companies than previous guidance has dictated.

Second, AAF is aware of at least three decisions by the U.S. Court of Appeals for the D.C. Circuit that questioned the SEC’s authority to limit or otherwise regulate investment companies’ participation in derivatives. In each of these cases the Court held that the SEC’s proposed rules were either “impermissible,” “completely arbitrary,” or “exceed[ing] authority,” for various conflicts with then-existing precedent. In the current proposed rule, the SEC goes to great lengths to reference the ICA’s preamble (instead of Section 18 of the ICA, which the proposed rule seeks to amend) which neither mandates nor prohibits any particular activity of investment companies. That said, Section 18 does not, in fact, authorize the SEC to restrict investment company behavior, and therefore potentially impermissibly exceed its authority as it has proposed to do.

2. Did the SEC conduct a thorough and legitimate cost-benefit analysis of the proposed rule?

AAF believes that the cost-benefit analysis conducted by SEC in preparation for this rule proposal was insufficient. In fact, in the language of the proposed rule itself, the SEC admits that

"[b]ecause we do not know to what extent the current regulatory framework for derivatives may have been influencing funds’ use of derivatives…we do not know to what extent funds would change existing positions, or would enter into different positions going forward, under the proposed rule. Accordingly, we cannot quantify this potential effect." [Emphasis added.]

In conjunction with the release of the proposed rule, the SEC released a white paper entitled “Use of Derivatives by Registered Companies” in which it sought to analyze data on the companies’ use of derivatives products. For its research, the SEC randomly selected 10 percent of all registered investment companies and found that, in its opinion, relatively few of those funds would be affected by the proposed rule should it be adopted. While it is desirable for the SEC to include the paper in order to comply with section 553(c) of the Administrative Procedure Act, the paper cites “anecdotal evidence,” fails to explore the potential effects if and when the broader sampling of funds is forced to comply by the rules limitations and compliance requirements and is therefore an insufficient analysis of the costs and benefits of the proposed rule.

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3 See, Business Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990); Goldstein v. SEC, 451 F.3d 873 (D.C. Cir. 2006); and Financial Planning Association v. SEC, 482 F.3d 481 (D.C. Cir. 2007).

3. What would be the potential costs to investment companies and their consumers?

AAF agrees with the SEC\(^5\) that the proposed rule is a “blunt measurement” that lacks any differentiation as to an investment company’s nuanced purpose for using derivatives and does not precisely set a measure of risk. If the rule is finalized in its current form, it would force many funds to either liquidate certain holdings or deregister as a registered investment company under the ICA if their current investment strategies cannot be altered to come into compliance with the rule. This strips investors of the opportunity to benefit from the use of derivatives and ultimately forces many into investments that they otherwise would not have selected.

As to the compliance portions of the proposed rule, the asset segregation requirements are so convoluted that a fund likely would be required to expend a great deal of time and money just monitoring the fund’s activity in order to stay in compliance. Further, by requiring a fund’s directors and/or trustees to approve the derivatives transactions covered by the proposed rule, a fund’s board is pressed not only to devote the time and effort to comprehend and interpret the new rules and their impact, but the day to day employees of the fund are also pressed to create new risk policies required by the proposed rule, not to mention the hiring of a new risk manager required by the proposed rule.

To that end, AAF agrees with Commissioner Luis Aguilar who said in the SEC’s open meeting on December 11, 2015, when the proposed rule was announced, “Every time the [SEC] votes to add responsibilities to fund directors, I consider whether board are prepared and equipped to take on those added responsibilities, which seem only to increase in number and complexity over time.”\(^6\) The SEC should consider this concern and avoid setting the bar too high, even for fund boards that are the most well-versed in derivatives transactions and SEC regulation.

It is for the aforementioned reasons that AAF opposes the proposed rule as it is currently written and encourages the SEC to take into consideration the comments received throughout the duration of this comment period.

Sincerely,

Meghan Milloy
Director, Financial Services Policy
American Action Forum

Doug Holtz-Eakin
President
American Action Forum

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\(^5\) As it states on pages 21 and 27 of the proposed rule (or 80903 and 80909 of 80 Fed. Reg. 248 (2015)).