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VIA WEBSITE SUBMISSION

November 7, 2011

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Use of Derivatives by Investment Companies under the Investment
Company Act of 1940 (the "1940 Act") (File No. S7-33-11)

Dear Ms. Murphy:

Stradley Ronon Stevens & Young, LLP ("Stradley Ronon"), appreciates the opportunity to provide our views in response to the Securities and Exchange Commission's (the "SEC") concept release (the "Concept Release") regarding the use of derivative instruments by investment companies.¹

Stradley Ronon maintains one of the premier investment management practices in the United States, representing investment company clients with more than 700 separate funds and assets under management approaching nearly \$1 trillion. Over 80 years ago, Stradley Ronon name partner, the late Andrew Young, helped establish one of the first mutual funds in the country, and 10 years later, reviewed the legislation that ultimately became the 1940 Act and attended the Congressional hearings on the 1940 Act. This letter expresses the views of Stradley Ronon and not necessarily those of any client.

¹ See Use of Derivatives by Investment Companies under the Investment Company Act of 1940, SEC Release No. IC-29766 (Aug. 31, 2011) (the "Concept Release").

Our comments to the Concept Release are as follows:

General Comments

1. The Concept Release is an excellent first step forward in modernizing the approach under the 1940 Act to address the complexity of today's markets. In studying the Concept Release, our strongest impression is that the task before the SEC and the industry is daunting. The task is to develop an approach that will balance the very real benefits to investors of accessing new asset classes and investment styles through derivatives with the need to protect investors. The SEC poses thoughtful, pointed and relevant questions. In our view, however, it will take the industry more than three months to develop responses to many of these questions.

Among the most challenging questions are those that relate to how derivatives should be valued for purposes of the diversification, concentration and other asset-based tests under the 1940 Act. The current model does not meaningfully address the fact that derivatives can create liabilities (i.e., the instruments can have negative market values) which do not appear in the test results. We urge the SEC to continue to engage with the industry on the appropriate answers, understanding that as a general matter the industry has not used derivatives to circumvent these traditional tests.

Leverage

2. The SEC requested comment on whether derivative instruments that create economic leverage, but do not impose future payment obligations on funds, such as purchased options or commodity-linked notes, raise the same or similar concerns as derivative instruments that create indebtedness leverage. Further, the SEC questioned whether such derivative instruments present any other material concerns for funds or their investors or if they raise any other concerns under the 1940 Act.

We agree with the Investment Company Institute's response to this question.²

3. The SEC questions whether the segregated account approach adequately addresses the investor protection purposes and concerns underlying Section 18 of the 1940 Act.

We believe that the use of "segregated accounts" can help prevent funds from operating without adequate assets or reserves, and prevent fund shares from having a "speculative character," as articulated in the legislative history of Section 18. It should be acknowledged, however, that Congress articulated those goals before derivative instruments as we know them were created. Fund investors have benefited from the leveraging effects of derivatives as asset management techniques and global markets have changed and grown. The SEC and its staff have

² See Letter from the Investment Company Institute (Nov. 7, 2011).

acknowledged this through the issuance of Release No. IC-10666,³ and multiple no-action and interpretive letters addressing investments in certain types of derivative instruments.

The crux of the matter is how much leveraged exposure a fund should be able to obtain through derivative instruments and how large the pool of segregated assets should be. We suggest that the SEC study what has worked and what has not in developing its approach to asset segregation. In light of the lack of current clear guidance in this area, a principles-based approach is now followed by many industry participants whereby an assessment is made of the potential obligation of the fund in order to determine the amount of assets to segregate. This would appear to be an acceptable approach to address the segregation question.

Counterparties

4. The SEC requests comment on the appropriate way to assess and analyze the counterparties to a fund's OTC derivative transactions.

The trading requirements imposed by Title VII of the Dodd-Frank Act⁴ could eliminate or modify the regulation of counterparties. In addition, if the SEC considers fund counterparty rulemaking, it should carefully consider and address the effects of collateral posted by the counterparty on a fund's risk.

Custody

5. We note that the SEC has not specifically requested comment with respect to custody issues that arise in the context of derivative instruments. As noted in the Report of the Task Force on Investment Company Use of Derivatives and Leverage, "[n]either the SEC nor its staff has provided guidance concerning the custody of fund assets in connection with forward contracts, swaps or options (other than options or futures)."⁵ The same can be said for other investments that are basically contractual in nature, such as senior bank loans.

Until final rules are adopted requiring swaps and security-based swaps to be cleared on exchanges and addressing the collateral requirements with respect to such instruments, we believe that it is premature to address custody issues. At such time as it may be appropriate to address custody issues, we would respectfully request that consideration be given to the broader

³ See Securities Trading Practices of Registered Investment Companies, SEC Release No. IC-10666 (Apr. 18, 1979).

⁴ Pub. L. No. 111-203, 124 Stat. 1376 (2010).

⁵ See Report of the Task Force on Investment Company Use of Derivatives and Leverage, Committee on Federal Regulation of Securities, ABA Section of Business Law 38 (July 6, 2010).

custody issues affecting investments that are contractual in nature.

ETFs

6. The SEC asks how ETFs use derivatives, and whether ETFs use derivatives for the same purposes as other open-end funds. The SEC also asks whether an ETF's use of derivatives raises unique investor protection concerns under the 1940 Act. Separately, the SEC notes that the staff of the SEC has deferred consideration of exemptive requests under the 1940 Act relating to ETFs that would make significant investments in derivatives pending completion of the review of the use of derivatives by investment companies.

We note that as described in the exemptive applications and registration statements for ETFs, ETFs use derivatives in the same manner and for the same purposes as similar open-end funds. In addition, we note that ETFs do not seek relief from any of the legal requirements under the 1940 Act relating to the use of derivatives by open-end funds. While the SEC is reviewing the use of derivatives by investment companies, it therefore seems inappropriate to defer indefinitely the review of certain pending exemptive applications for ETFs that would use derivatives in the same manner and subject to the same regulation as other open-end funds. In addition, we note that with respect to applications for relief to permit the operations of actively managed ETFs, it appears that the SEC staff is now prepared to issue orders only for ETFs that agree not to invest in any options contracts, futures contracts, or swap agreements. Thus, for active ETFs, the deferral of review applies to ETFs that essentially would make any investment in derivatives, and not solely to ETFs that would make "significant investments" in derivatives. We encourage the SEC and its staff to resume review of exemptive applications for ETFs that seek to use derivatives in the same manner and subject to the same regulation as other open-end funds.

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We appreciate the opportunity to comment on the Concept Release. If you have any questions about Stradley Ronon's comments or would like any additional information, please contact one of the undersigned.

Ms. Elizabeth M. Murphy
U.S. Securities and Exchange Commission
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Yours truly,



Alison M. Fuller



E. Carolan Berkley

cc: The Honorable Mary L. Schapiro
The Honorable Luis A. Aguilar
The Honorable Daniel M. Gallagher
The Honorable Troy A. Paredes
The Honorable Elisse B. Walter

Eileen Rominger, Director
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