November 7, 2011

Via email: rule-comments@sec.gov

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Concept Release: Use of Derivatives by Investment Companies under the Investment Company – File No. S7-33-11

Dear Ms. Murphy:

Security Investors, LLC ("Rydex|SGI")[1] appreciates the opportunity to comment on Investment Company Act Release No. 29776 (the "Concept Release")[2] in which the Securities and Exchange Commission ("Commission") solicits comments on a variety of matters related to mutual funds' use of derivatives. Rydex|SGI commends the Commission's measured approach in considering whether regulatory initiatives or guidance is needed to update or augment the provisions of the Investment Company Act of 1940, as amended ("1940 Act") and related guidance bearing on mutual funds' use of derivatives. In this letter we intend to address some of the thoughtful questions the Commission has raised in the Concept Release, as well as suggest possible alternative measures to further the protection of shareholders that choose to invest in funds that use derivatives.

Rydex|SGI has long strived to create and offer an innovative suite of products designed to meet investors' diverse and evolving needs. Those products include leveraged and/or inverse mutual funds and exchange-traded funds ("ETFs"), as well as mutual funds that pursue alternative, in some cases hedge fund-like, investment strategies. All of these funds[3] use derivatives to seek to achieve their investment objectives.

---

1 Rydex|SGI, a U.S. registered investment adviser, sponsors more than 175 mutual funds and exchange-traded products and manages more than $24 billion in customer assets.

2 *Use of Derivatives by Investment Companies under the Investment Company Act of 1940*, Investment Company Act Rel. No. 29776, File No. S7-33-11 (August 31, 2011).

3 As used in this letter, the term "funds" encompasses both mutual funds and ETFs. The Rydex|SGI ETFs generally use derivatives in the same manner and for the same purposes as the Rydex|SGI mutual funds. So long as an ETF's use of derivatives is transparent enough to allow for the necessary arbitrage mechanisms to function properly, we do not believe an ETF's use of derivatives presents additional or unique investor protection concerns.

I. The Use of Derivatives Can be Beneficial to Funds and their Shareholders.

Recent market events have garnered derivatives a significant amount of unfavorable attention and press accounts have portrayed derivatives as highly volatile instruments the risks of which are nearly impossible to contain.[4] However, in the hands of responsible fund portfolio managers, derivatives can be highly effective investment tools, the benefits of which are several. For funds, there are three primary benefits to using derivatives – increased shareholder investment options, reduced trading costs, and effective risk management.

A. Derivatives enable mutual fund complexes to offer more diverse investment options to shareholders.

Fund complexes, including the Rydex|SGI Funds, have made use of derivatives to offer alternative investment strategies that are similar to those previously reserved only for investors of hedge funds and other pooled investment vehicles not registered under the 1940 Act. Generally alternative investment strategies encompass those investment strategies that seek to provide investment returns that do not correlate to those of traditional investments. Alternative investment strategies have become increasingly important to retail shareholders as they seek shelter from current volatile market conditions while attempting to remain invested. In this respect, alternative investment strategies provide a welcome investment option for those investors that might otherwise withdraw from the market until such time as more traditional investment strategies are capable of generating positive returns.

While alternative investment strategies employed by funds seek to resemble those employed by hedge funds and other unregistered investment vehicles in several respects, including the use of derivatives to implement their investment strategies, they also differ in several important respects. Chiefly, funds' implementation of alternative investment strategies is subject to the confines of the very regulatory scheme the adequacy of which the Commission is now considering.[5] Essentially, the existing regulatory scheme applicable to funds' use of derivatives has succeeded in motivating fund portfolio managers to develop an investment strategy that both meets investor demand and operates in a manner consistent with the 1940 Act's liquidity and leverage requirements.

As a result of these funds' dependence on the use of derivatives to achieve their investment objectives, they are subject to certain risks that are different from those of a traditional equity fund. We believe that any additional volatility, counterparty and credit risks associated with the use of derivatives can and should be disclosed in detail. With the investor protections provided by the existing regulatory framework and adequate risk disclosure, we believe that investors are capable of making informed investment

[4] *See* Chiragra Chakrabarty and Nikhil Pandey, *Exchange Platform Must for Derivatives*, The Economic Times (Apr 8, 2009) ("Derivatives have emerged as "self-consuming beasts".").

[5] The 1940 Act imposes other important constraints on funds' implementation of alternative investment strategies, including the inability to charge hedge fund-like performance fees that can motivate a hedge fund manager to be more aggressive in managing the hedge fund's assets.

decisions to assume the investment risk associated with derivatives in return for the potential investment return.

B. The use of derivatives can reduce trading costs substantially and increase transaction efficiency.

A fund's portfolio manager can use derivatives to gain or vary investment exposure to issuers, asset classes, market sectors, and geographic regions or foreign countries among other areas of investment just as traditional equity and fixed income securities are used to gain such exposure. Derivatives, however, are frequently a fraction of the cost of traditional equity and fixed income securities. As a result, using derivatives to obtain investment exposure can provide fund portfolio managers with greater flexibility to achieve the desired investment exposure. In addition, the use of less expensive derivatives allows for a greater portion of a fund's assets to be fully invested rather than used to pay for transaction and trading costs. For example, "[b]y purchasing futures on a stock or bond index most closely comparable to the fund's investment universe, the fund can gain full exposure to the market return, potentially minimizing the dilution and relative performance risk introduced by cash."[6] In many cases, exchange-traded futures and options also may be more readily available than comparable equity or fixed income securities, which can enable portfolio managers to be more responsive to changes in the market.

For the reasons discussed above, derivatives also can be a useful tool to limit the adverse effects of trading activity in a fund triggered by shareholders' purchase and redemption of shares of the fund ("shareholder turnover"). The hypothetical example below demonstrates the potential cost savings afforded by a hypothetical S&P 500 Fund's and Russell 2000 Fund's use of derivatives when faced with increasing rates of shareholder turnover. It is not uncommon for funds that provide for unlimited exchange privileges and accommodate shareholders who wish to trade their shares on a daily and intra-day basis, as do many of the Rydex|SGI Funds, to have annual rates of shareholder turnover well in excess of the percentages provided in the example below.

Annual Performance Drag Caused by Shareholder Turnover*				
Shareholder Turnover Rate	100%	200%	400%	800%
Hypothetical S&P 500 Fund				
Futures**	-0.31 bps	-0.62 bps	-1.24 bps	-2.48 bps
Stocks	-4.28 bps	-8.56 bps	-17.12 bps	-34.24 bps
Improvement in Performance Resulting from use of Futures	3.97 bps	7.94 bps	15.88 bps	31.76 bps
Hypothetical Russell 2000 Fund				
Futures***	-0.27 bps	-0.54 bps	-1.08 bps	-2.16 bps

6 *Board Oversight of Derivatives*, Independent Directors Council Task Force Report (July 2008) at 9, available *at* http://www.ici.org/pdf/ppr_08_derivatives.pdf.

Stocks	-12.2 bps	-24.4 bps	-48.8 bps	-97.6 bps
Improvement in Performance Resulting from use of Futures	11.93 bps	23.86 bps	47.72 bps	95.44 bps

* This hypothetical example considers the costs of commissions only and does not include the cost of future rolls.

** Commissions on S&P 500 e-mini futures are about 0.31 basis points. At 1.5 cents per share, trading an equity basket of all S&P 500 stocks would be almost 14 times more expensive at 4.28 basis points.

*** Commissions on Russell 2000 e-mini futures are about 0.27 basis points. At 1.5 cents per share, trading an equity basket of all Russell 2000 stocks would be almost 45 times more expensive at 12.20 basis points.

As reflected in the table above, a shareholder of the hypothetical Russell 2000 Fund could potentially save close to one percent in trading costs due to the Fund's use of futures to trade cash flows into and out of the Fund with 800% shareholder turnover.

C. Derivatives can be used to effectively manage risk.

The Commission has long recognized the utility of derivatives to effectively manage risk in fund portfolios,[7] and the current volatile market conditions have served only to underscore the importance of this utility. Funds frequently use derivatives to hedge or otherwise manage the myriad investment risks associated with the market, including unwanted exposure to changes in interest rates, currency exchange rates, the creditworthiness of an issuer, and general market volatility. Funds may also use "derivatives as a substitute for direct investment when the desired direct investment is less liquid or is restricted."[8] Derivatives can be used effectively in this capacity because they "permit investors to manage separately the fundamental risks and other characteristics that are components of traditional financial instruments."[9]

As the example above illustrates, the Rydex|SGI Funds frequently rely on derivatives to quickly accommodate shareholder redemptions and invest incoming cash from shareholder purchases. This practice is crucial in enabling the Rydex|SGI Funds to

---

7 *See* Memorandum to Chairman Levitt from the Division of Investment Management, *Mutual Funds and Derivative Instruments* (Sept. 26, 1994) ("1994 Derivatives Report") ("Mutual funds, other than money market funds, use derivative products for a wide variety of purposes, including hedging interest rate, currency, and other market risks; substituting for a direct investment in the underlying instrument; or increasing returns. Money market funds also invest in debt instruments sometimes referred to as derivatives that have interest rates that are adjusted periodically based on changes in market interest rates.").

8 Georgia Bullitt, Thomas Harman, Christopher Menconi, Bill Zimmerman, and Christopher Jackson, *Legal Considerations for Registered Investment Companies Investing in Derivatives: Part 1*, Investment Lawyer, p. 1 (Aug. 1, 2010).

9 Clifford J. Alexander and Kathy Kresch Ingber, *A Fund Director's Guide to Derivatives*, Investment Lawyer (Feb. 1, 2008).

manage market risk by mitigating potential market impact from large purchases and sales of stock.

II. A Uniform Regulatory Approach to the Valuation of Derivatives is Necessary.

Central to many, if not most, of the questions and concerns raised by the Commission is the question of how best to value derivatives. We believe that clear and uniform guidance on how funds are expected to value derivatives is crucial to the continued successful evolution of the existing derivatives regulatory framework. Moreover, we believe this guidance should be in the form of a well-defined and principle-based approach that is flexible enough to accommodate a multitude of derivative instruments that may be used for a variety of purposes.[10] We also suspect that such an approach may obviate many of the questions raised in the Concept Release with respect to asset segregation, diversification, concentration and exposure to securities-related issuers.

Rydex|SGI's approach has been to consistently value all exchange-traded derivatives at their current fair market value. Currently, to the extent that a Rydex|SGI Fund invests in swap contracts, it values such contracts at their notional amount as described in the Concept Release. However, Rydex|SGI acknowledges that this practice might change in the near future in response to rulemakings initiated by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") aimed at regulating security-based swaps. In general, Rydex|SGI believes that funds that invest in non-exchange-traded derivatives should disclose both the gross and net notional exposure of such derivative positions.[11]

In addition to the fact that Rydex|SGI generally seeks to invest in highly liquid, exchange-traded derivatives in order to better serve the purposes for which they are acquired, Rydex|SGI has adopted and maintains rigorous valuation policies and procedures among other policies and procedures geared toward monitoring risks posed by the Funds' investment in derivatives. Rydex|SGI believes that these measures have been effective to date in ensuring the protection of the Rydex|SGI Fund shareholders while permitting Rydex|SGI to offer a variety of leveraged, inverse, and alternative investment strategies.

---

[10] We note that the American Bar Association's Committee on Federal Regulation of Securities recommended a similar approach in its Report of the Task Force on Investment Company Use of Derivatives and Leverage. *See Report of the Task Force on Investment Company Use of Derivatives and Leverage*, ABA Section of Business Law Committee on Federal Regulation of Securities (July 6, 2010) (Hereinafter, "ABA Report").

[11] For example, if a long/short fund has a 200% long position in S&P 500 futures and a 100% short position in Russell 2000 futures, the fund should be required to disclose that the fund's gross notional exposure is equal to 300% of the fund's assets and that its net notional exposure is equal to 100% of the fund's assets.

III. The Current Regulatory Position Regarding Asset Segregation has Evolved in Step with the Market While Continuing to Ensure Adequate Investor Protections.

We believe that the practice of asset segregation as it has evolved to date is a fundamental protection necessary to prevent a fund from knowingly or inadvertently assuming more leverage than it can support. We further believe that the Commission's guidance on the requirement to segregate assets has been effective and continues to be practical and sufficient to ensure the protection of fund investors.[12] Therefore, we encourage the Commission to consider taking steps to improve upon its existing guidance through clarification and additional guidance rather than materially changing the Staff's various positions.

Specifically, we support the ABA's recommendation to require funds to develop and "adopt policies and procedures that would include, among other things, minimum asset segregation requirements for each type of derivative instrument, which would be based on relevant factors."[13] We believe this approach is optimal because funds, their investment advisers, and the boards of trustees or directors that oversee the funds are in the best position to appreciate the risks posed by any particular derivatives transaction and thus, to determine an appropriate segregation amount under the circumstances. In addition, we think it would be difficult, if not impossible, for the regulatory guidance to address all of the various combinations of derivatives and uses of such derivatives with sufficient specificity to ensure that the guidance is relevant in all situations.

IV. Diversification, Concentration, and Exposure to Securities-Related Issuers can be Effectively Addressed through Improved Disclosure and Increased Regulation of Derivatives Counterparties.

The 1940 Act's provisions relating to diversification, concentration, and exposure to securities-related issuers are all aimed, in large part, at limiting a fund's exposure to a single issuer or group of similarly situated issuers that could potentially result in significant harm to the fund if such issuer or group of issuers were adversely affected by market movements, regulatory developments, speculative activities or the like. While we acknowledge that significant exposure to a single counterparty can be potentially harmful to a fund, we think the most appropriate way to address this risk is through (i) disclosure and (ii) policies and procedures designed to improve the evaluation and monitoring of derivatives counterparties. As discussed in more detail below, we also believe that the increased regulation of derivatives counterparties would greatly mitigate counterparty risk. Specifically, we note that once implemented several of the rulemaking initiatives directed by Titles VII and VIII of Dodd-Frank are likely to greatly reduce counterparty risk. Once implemented, the Commission may wish to consider the effects of such rulemaking initiatives before determining how best to improve upon the existing derivatives regulatory scheme.

---

[12] Such guidance includes Investment Company Act Release No. 10666 (Apr. 18, 1979) and the various no-action letters that followed and which are mentioned in the Concept Release.

[13] *See* ABA Report *at* p. 17.

Rydex|SGI and the Rydex|SGI Funds voluntarily limit the amount of a Fund's exposure to any single derivative counterparty. In addition, Rydex|SGI has adopted policies and procedures for counterparty credit review. Rydex|SGI also has established a credit review committee that oversees the implementation of these credit review policies and procedures and to evaluate and regularly monitor the creditworthiness of the Funds' derivatives counterparties. We believe these measures together with the fact it is in Rydex|SGI's best interests to ensure that the counterparties with which the Funds enter into contracts demonstrate the utmost creditworthiness have been effective in limiting the counterparty risk to which the Rydex|SGI Funds are exposed to as a result of their derivatives investment activities.[14]

We would support efforts by the Commission to require that funds disclose their exposure to counterparties. Specifically, we would support a requirement that a fund disclose the extent of its exposure to a particular counterparty if such exposure is significant and the risks of such exposure should the counterparty become insolvent or otherwise default on its obligations to the fund or should regulatory developments adversely affect the financial services industry generally. Because exposure will likely vary over time, we believe that such disclosure would best fit in the semi-annual reports to shareholders and/or through web site disclosure.

We would not, however, be inclined to support revisions to the current regulatory scheme that would require funds to include their exposure to derivatives counterparties in determining whether they are deemed (i) a "diversified fund" or (ii) "concentrated" in the financial services industry or group of industries. We believe that such changes would have an unnecessary chilling effect on funds' ability to invest in derivatives that could be beneficial for the funds and their shareholders. More importantly, we believe several of the Dodd-Frank initiatives will effectively limit counterparty risk whether through the use of central clearing facilities or data collection.

Section 12(d)(3) differs from the provisions relating to diversification and concentration in that it specifically prohibits a registered investment company from purchasing "any security issued by or any other interest in the business of any person who is a broker, a dealer, is engaged in the business of underwriting, or is either an investment adviser of an investment company or an investment adviser registered under the [Investment Advisers Act of 1940]." There has been some debate as to the risks Section 12(d)(3) was intended to mitigate, but "the SEC has stated that the provision was designed to prevent the abuses that Congress noted occurred during the 1920s and led to the 1929 Crash in connection with which mutual fund trust assets were exposed to the risks of the underwriting business of financial institutions."[15]

---

[14] We note that such counterparty credit review is similar to the review done by many investment advisers for repurchase agreement counterparties, broker-dealers, and issuers of debt securities.

[15] Bullitt, Harman, Menconi, Zimmerman, and Jackson, *supra* note 8 at p. 8 *citing* Exemption for Acquisition by Registered Investment Companies of Securities Issued by Persons Engaged Directly or Indirectly in Securities Related Businesses, Securities Act Rel. No. 6505, Exchange Act Rel. No. 20,570,

As acknowledged by the Commission in the Concept Release, a fund's investment in a derivative instrument may raise Section 12(d)(3) concerns in two ways. First, the issuer of the derivative's reference asset may be deemed to be a securities-related issuer and second, to extent the derivative counterparty is providing credit support or other similar protection, it, too, may be considered to be a securities-related issuer. The Commission adopted Rule 12d3-1 under the 1940 Act to provide an exclusion from the general prohibition of Section 12(d)(3) provided certain conditions are met, but by its terms Rule 12d3-1 applies only to the acquisition of "any security" of a securities-related issuer that satisfies the conditions of the Rule. It is not clear that a fund's investment in derivatives with counterparties that may be deemed to be securities-related issuers would be able to rely on the exclusion provided by Rule 12d3-1 assuming all of the requisite conditions are met. We note, however, that in the Concept Release the Commission seems to imply that a fund could determine "whether such derivative is an equity or debt security."[16] Therefore, we think the Commission should consider taking action to clarify the intended scope of Rule 12d3-1. Specifically, we believe the Commission should provide guidance (i) as to when it is appropriate to consider the reference asset versus the counterparty in its Section 12(d)(3) analysis and (ii) confirming that when considering exposure to a derivative counterparty for purposes of Section 12(d)(3), the fund may factor in all collateral and offsetting positions in determining such exposure.[17]

V. Certain Alternative Measures May be Effective in Protecting Funds and their Shareholders.

We support the Commission's efforts to review and reassess the current regulatory framework applicable to funds' use of derivatives; however, we also encourage the Commission to consider alternative measures to achieve the goal of increased investor protections that may be as effective, but less disruptive, than altering the existing regulatory scheme. We believe a recognized key to achieving the Commission's mission "to protect investors, maintain fair, orderly, and efficient markets, promote the prompt and accurate clearance and settlement of securities transactions, and facilitate capital formation" with respect to the use of derivatives is greater transparency into the activities of both funds and derivatives counterparties.

Investment Company Act Rel. No. 13,725, 1984 WL 482559, at *3 (Jan. 17, 1984) (noting that testimony of Chief Counsel of Investment Trust Study in 1940 and statements of SEC Staff indicate that "purpose of section 12(d)(3) was principally to prevent investment companies from exposing their assets to the entrepreneurial risks of securities related businesses.").

16 Concept Release *at* 62.

17 We note that the ABA recommends a similar approach in the ABA Report. *See* ABA Report *at* p. 33.

A. Improved disclosure about a fund's use of derivatives would help to ensure that investors appreciate the attendant risks.

One of the Commission's first actions shortly after it commenced its review of funds' use of derivatives[18] was to put funds on notice that it believed much of the existing disclosure about funds' investments in derivatives to be inadequate.[19] Since that time many of the Commission Staff charged with reviewing fund registration statements have continued to generally request that funds provide more detailed disclosure of their use of derivatives. Like other recipients of these requests, we have augmented our registration statement and shareholder report disclosure in an effort to accommodate the Staff's concerns.[20] As a result of these efforts, increased disclosure about a fund's use of derivatives is becoming more prevalent. However, the quality and extent of such derivatives disclosure still varies greatly from registrant to registrant.

Nonetheless, we are hopeful that with the passage of time, funds will be uniformly encouraged to provide a higher level of disclosure in their registration statements. The Commission's efforts to encourage funds to include more targeted derivatives disclosure in their registration statements are still relatively recent. When combined with the fact that the direction as to the content of derivatives disclosure has been general in nature, some funds appear to be somewhat reluctant to be the first to streamline the disclosure regarding the types of derivatives in which they will invest or augment the risk disclosure concerning such derivatives. A more uniform approach requiring all funds to include improved derivatives disclosure and specifying the type and extent of such disclosure would provide the necessary reassurance that no fund would be an unwitting outlier in terms of disclosure.

We also believe that if there were greater flexibility by the Staff in interpreting the content requirements of Form N-1A, greater strides could be made in making derivatives disclosure more effective at conveying the risks of a fund's use of derivatives. The Staff's strict interpretation of the content requirements of Form N-1A have placed many funds in the impossible position of trying to limit the amount of disclosure included in the summary section of the prospectus, which is often the only disclosure document that an investor will receive, while simultaneously trying to ensure that it includes detailed disclosure of the fund's principal investment strategies, the instruments used to implement such strategies and the risks of such strategies and instruments. The latter is important not only because of the Commission's focus on improved derivatives disclosure, but because of the potential liability associated with incomplete or inadequate

---

[18] *See* "SEC Staff Evaluating the Use of Derivatives by Funds," SEC Press Release 2010-45 (Mar. 25, 2010) available *at* http://www.sec.gov/news/press/2010/2010-45.htm.

[19] *See* Letter from Barry Miller, Commission, to Karrie McMillan, Investment Company Institute, *Derivatives-Related Disclosures by Investment Companies* (Jul. 30, 2010).

[20] We note also that the disclosure regarding derivatives investments included in shareholder reports has increased significantly over the past several years in response to guidance from the Financial Accounting Standards Board ("FASB"), such as Financial Accounting Standards No. 161- "Disclosures about Derivative Instruments and Hedging Activity."

disclosure.[21] For example, if a fund determines that substantive derivatives disclosure in Item 4 of Form N-1A is important to an existing or prospective shareholder given the fund's investments, Form N-1A and the Staff should be flexible enough to accommodate such enhanced disclosure. While the content requirements of Form N-1A are crucial to ensuring complete and uniform disclosure, we think it is important to guard against becoming slaves to the requirements of a form at the risk of compromising the purpose of the form – "to provide investors with information that will assist them in making a decision about investing in an investment company."[22]

B. Greater transparency into the activities of derivatives counterparties would help funds to mitigate counterparty risk.

In addition to focusing on the protection of fund investors, we hope the Commission also will consider how best to protect mutual funds from the potentially harmful activities of derivatives counterparties.[23] We believe this protection is best afforded by increased transparency into the activities of derivatives counterparties. Events surrounding the collapse of Lehman Brothers demonstrated that a fund's vigilance in monitoring the creditworthiness of a derivative counterparty based on publicly available information was only partially effective in insulating the fund from the highly leveraged and speculative investment activities of its derivative counterparty.

Subjecting all derivatives to mandatory trading on an exchange or via an electronic trading system and central clearing would mitigate substantially many of the risks associated with investing in derivatives and may foster additional liquidity.[24] To this end, the rulemakings directed in Title VII of Dodd-Frank should serve to increase significantly the transparency of the derivatives markets, and the over-the-counter ("OTC") derivatives market in particular. In her testimony before the United States

---

[21] *See* Maura McDermott, *SEC Rejects 'Laundry Lists' of Derivatives,* Attorneys Say, Board IQ (Oct. 25, 2011) ("The SEC's emphasis on tightening up disclosure language poses a challenge for fund advisers and directors, says Andrew "Buddy" Donohue, a partner at Morgan Lewis & Bockius and former director of the SEC's Division of Investment Management. On the one hand, they want investors to have a full understanding of the fund's use of derivatives, and they don't want to overload investors with information. On the other hand, they want to disclose all the fund's potential investments in the prospectus in order to get the legal protection that comes with full disclosure. "There's a natural reaction, which is: We don't know whether we're going to do this, so let's put it in there in case we do," he says.").

[22] Form N-1A.

[23] *See* James Hamilton, *Senate Bill Divides Derivatives between SEC, CFTC*, U.S Financial Services News (May 24, 2010) ("Excessive risk taking by AIG and certain monoline insurance companies that provided protection against declines in the value of such asset backed securities, as well as poor counterparty credit risk management by many banks, saddled the financial system with an enormous unrecognized level of risk. The sheer volume of these contracts overwhelmed some firms that had promised to provide payment on the credit default swaps and left institutions with losses that they believed they had been protected against.").

[24] Alexander and Ingber, *supra* note 9 ("Derivatives that are privately issued, traded over-the-counter and whose return is tied to or depends upon movements in certain indices, markets, or currencies tend to be less liquid and more difficult to value.").

Senate Committee on Banking, Housing, and Urban Affairs Committee, Commission Chairman Mary Schapiro highlighted improved transparency as a primary benefit of the directives in Title VII of Dodd-Frank.[25] The Chairman further noted that the rulemakings should help to reduce counterparty risk and "enhance investor protection by increasing disclosure regarding security-based swap transactions and helping to mitigate conflicts of interest involving security-based swaps."[26]

In addition, we believe greater transparency into the financial state of derivatives counterparties and, in particular, the amount of leveraged exposure a derivative counterparty has assumed, would greatly improve a fund's ability to assess the creditworthiness of a derivative counterparty. In turn, the ability to more accurately assess the creditworthiness of a derivative counterparty should mitigate the risk that a fund would be harmed by the insolvency or other default of such derivative counterparty.

In conclusion, we believe that the existing regulatory scheme applicable to funds' use of derivatives has functioned well to protect shareholders wishing to invest in such funds while maintaining sufficient flexibility to accommodate the growing use of derivatives for a variety of purposes. Therefore, we do not believe that significant changes to this regulatory scheme are warranted. However, we do believe the existing regulatory scheme could be improved upon through the clarification of existing guidance, including the development of a well-defined and principle-based approach to valuation that would be uniformly applied to funds, the requirement that investment advisers and funds adopt and maintain policies and procedures that implement those principles and define tailored parameters for the use of derivatives, and greater disclosure about funds' investments in derivatives.

*   *   *   *   *

[25] *See* Commission Chairman Mary L. Schapiro, Testimony on "*Building the New Derivatives Regulatory Framework: Oversight of Title VII of the Dodd-Frank Act*" Before the United States Senate Committee on Banking, Housing, and Urban Affairs (Apr. 12, 2011).

[26] *Id.*

We appreciate that many if not most of the issues raised in the Concept Release are complex, not easily resolved and the subject of heightened public interest, but we hope the Commission will continue to thoughtfully consider how best to protect investors while preserving funds' ability to use these important financial instruments. We look forward to working with the Commission as it continues to consider the issues surrounding funds' use of derivatives and the development its regulatory framework in this critical area. In the meantime, if we can provide any information that may be of assistance, please feel free to contact me at 785.438.3226 or Joanna Haigney at 301.296.5241.

Sincerely,

Amy J. Lee
Senior Vice President
Security Investors, LLC

cc: Richard Goldman
W. John McGuire, Esq.
Laura E. Flores, Esq.