Dechert LLP

November 7, 2011

VIA ELECTRONIC DELIVERY

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

Re: Release No. IC-29776 (File No. S7-33-11): Use of Derivatives by Investment Companies under the Investment Company Act of 1940.[1]

Dear Ms. Murphy:

Dechert LLP, on behalf of itself and Guggenheim Funds Investment Advisors, LLC, Russell Investment Management Company, Van Eck Associates Corporation and a number of other investment advisers to exchange-traded funds (the "ETF Advisers"), welcomes the opportunity to submit this letter in response to a request by the Securities and Exchange Commission (the "Commission" or "SEC") for comment regarding the above-referenced Concept Release. The Concept Release solicits public comment on the use of derivatives by management investment companies registered under the Investment Company Act of 1940 (the "Investment Company Act" or "Act") and companies that have elected to be treated as business development companies under the Act (collectively, "funds"), and on the current regulatory regime under the Act as it applies to funds' use of derivatives. In addition to the specific issues highlighted for comment,

[1] 76 FR 55237 (Sep. 7, 2011) (the "Concept Release").

the Commission has invited members of the public to address any other matters that they believe are relevant to the use of derivatives by funds.

This comment letter relates to the limitations on the use of derivatives by actively managed exchange-traded funds ("ETFs") currently imposed by the staff of the Division of Investment Management. These limitations go well beyond the scope of the limitations on ETFs' use of derivatives contemplated by the Commission in its Press Release dated March 20, 2010 (the "Derivatives Press Release"). For the reasons described below, the ETF Advisers believe that the more stringent restrictions on derivative use currently being applied by the staff adversely affect competition and product innovation to the detriment of investors and do not improve the regulatory regime necessary for investor protection.

In the Derivatives Press Release, the Commission announced that the SEC staff was conducting a review to evaluate the use of derivatives by mutual funds, ETFs and other investment companies. The Derivatives Press Release stated:

> Pending the review's completion, the staff has determined to defer consideration of exemptive requests under the Investment Company Act to permit ETFs that would make significant investments in derivatives. The staff's decision will affect new and pending exemptive requests from certain actively-managed and leveraged ETFs that particularly rely on swaps and other derivative instruments to achieve their investment objectives.[2]

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

(Emphases added.)

The Derivatives Press Release thus by its terms clearly contemplates that some level of investment in derivatives by actively managed ETFs is permissible as long as it does not rise to the level of "significant."

The staff of the Division of Investment Management, however, has taken a much more restrictive approach than the one announced in the Derivatives Press Release. Specifically, the staff will not process an exemptive application for an actively managed ETF unless the applicant represents that it will not invest in options, futures or swaps. In other words, no use of options, futures or swaps is permitted for such actively managed ETFs. Each of the ETF Advisers has in fact been required to make this representation in order to obtain exemptive relief to offer actively managed ETFs.[3]

Based on the language of the Derivatives Press Release, we do not believe that the Commission contemplated an absolute ban on the use of options, futures or swaps by actively managed ETFs pending completion of the derivatives study. Nor has any overriding investor protection concern been cited by the staff or in the Concept Release which warrants such onerous restrictions. As noted in the Concept Release, funds use derivatives to implement their investment strategies and

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3 We also note that this absolute ban has been imposed by the staff in practice as of late 2009, and thus precedes the Derivatives Press Release.

to manage risk. For example, funds may use derivatives to gain, maintain or reduce exposure to a market, sector or security more quickly and/or with lower transaction costs and portfolio disruption than investing directly through the securities markets[4] or to hedge portfolio positions. Actively managed ETFs offered subsequent to the moratorium are thus prohibited from utilizing options, futures or swaps for these conventional purposes: this hampers such actively managed ETFs' ability to achieve their investment objectives and manage risks, while also disadvantaging such ETFs relative to conventional mutual funds which face no such prohibition. We note that index based ETFs have been permitted to invest a certain portion of their assets in derivatives throughout their existence (currently index based ETFs may invest up to 20% of their assets in derivatives, including options, futures and swaps), and we are not aware of any unique investor protection issues that have arisen from their use of derivatives. We also are not aware of any unique investor protection issues that have arisen from the use of derivatives by those actively managed ETFs that use derivatives pursuant to exemptive relief that predates the derivatives moratorium.[5]

The absolute ban on the use of options, futures and swaps by actively managed ETFs is not only inconsistent with the Derivatives Press Release, but is also contrary to Section 2(c) of the

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[4] 76 FR at 55240, citing *Board Oversight of Derivatives*, Independent Directors Council Task Force Report (July 2008) at 7-11, *available at* http://www.ici.org/pdf/ppr_08_derivatives.pdf.

[5] This letter addresses only the use of derivatives by actively managed ETFs, and is not intended to address leveraged or inverse ETFs.

Investment Company Act, which provides that "[w]henever pursuant to this title the Commission is engaged in rulemaking and is required to consider or determine whether an action is consistent with the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[6] The ban on the use of options, futures and swaps has significantly hampered actively managed ETF development to the detriment of ETF investors, and has disadvantaged actively managed ETFs relative to other forms of funds such as traditional mutual funds. There are many investment strategies that otherwise would be appropriate for an actively managed ETF which cannot be implemented efficiently[7] without the ability to utilize derivatives to some extent.[8] As a result, product innovation has been impeded. Moreover, the inability to utilize derivatives has served as a disincentive for many active managers to enter the ETF space.[9] The net result is that investors have more limited choice among actively managed ETF products and advisers,[10] and competition

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6 76 FR at 55238, n.9 and accompanying text.

7 It is also the case that numerous strategies currently offered in the form of actively managed ETFs are offered in less efficient form than otherwise would be possible if not for the absolute ban of the use of options, futures or swaps. As set forth above, such actively managed ETFs are disadvantaged relative to other forms of funds which are not subject to this moratorium.

8 We note that since neither the Commission nor the staff has imposed any similar restrictions on other funds, such strategies can continue to be implemented in mutual funds or closed-end funds. No investor protection concerns have been cited for why the Commission should treat actively managed ETFs differently.

9 This disincentive is further accentuated by such active managers' ability – as set forth in the prior footnote – to continue implementing innovative strategies through other forms of funds which are not subject to this moratorium.

10 According to a recent survey of the actively managed ETF market:

on price and product selection is not nearly as robust as would be the case absent the ban on the use of options, futures and swaps.

As an additional consequence, the moratorium has created an uneven competitive playing field among ETF market participants: ETF sponsors that received exemptive relief prior to late 2009 are not affected by the derivatives moratorium and therefore are able to continue to launch new actively managed ETFs that use options, futures and swaps without limitation,[11] while later entrants such as the ETF Advisers are subject to the stringent limitations of the moratorium.[12]

> ...just $5 billion of the current $1 trillion-plus that is invested in ETFs is invested in actively managed funds. Additionally, well more than half of that $5 billion is soaked up by just three ETFs-- PIMCO Enhanced Short Maturity Strategy ETF (MINT), WisdomTree Emerging Markets Local Debt (ELD), and WisdomTree Dreyfus Chinese Yuan (CYB). In fact, equity-based actively managed ETFs make up a fraction of that $5 billion--just $83 million or so....Right now, the pool of active ETF providers is fairly small.

See Robert Goldsborough, "Active ETFs: A State of the Union" (September 15, 2011), *Morningstar* (available at http://news.morningstar.com/articlenet/article.aspx?id=394478&t1=1319559590)

11 Similarly, we note that while the Commission staff has deferred new or pending exemptive requests to offer "leveraged" ETFs (which were specifically identified in the Derivatives Press Release as the type of ETFs which make "significant" investments in derivatives) pursuant to the Derivatives Press Release, neither the Commission nor the staff has imposed a moratorium or other restriction on the ability of ETF sponsors who have already obtained the necessary exemptive relief to continue offering new leveraged ETFs. No investor protection concerns have been offered as to why an absolute bar on the use of options, futures or swaps is necessary for new entrants into the actively managed ETF market, but not for new actively managed ETFs or "leveraged" ETFs offered by sponsors with older exemptive relief.

12 As set forth in note 7 *supra*, this arbitrary distinction based on the timing of when ETF sponsors received exemptive relief means that actively managed ETFs offered by sponsors with older exemptive relief can be offered in a more efficient fashion than actively managed ETFs implementing the same investment strategy but offered by a sponsor with more recent relief.

While we applaud the Commission for the careful and prudent approach it is taking towards determining whether any changes in the regulatory regime governing the use of derivatives by registered investment companies is warranted, the Commission should be mindful of the deleterious effects the staff's ban on the use of options, futures and swaps by actively managed ETFs has and will continue to have on active ETF investors by suppressing competition, product development and innovation in the actively managed ETF area (as well as the basic unfairness of the unlevel playing field it has created). As discussed above, no investor concerns unique to actively managed ETFs have been cited which warrant the onerous restrictions currently being applied and/or outweigh the significant harms to investors caused by such restrictions.

In view of the foregoing, we respectfully request that the ban on the use of options, futures and swaps by actively managed ETFs be lifted and that, instead, consistent with the Derivatives Press Release, only "significant investments" in derivatives by actively managed ETFs be prohibited. Liberalization of the restrictions on the use of options, futures and swaps along these lines would benefit investors by enhancing materially the ability of ETF sponsors to provide necessary and helpful competition in the marketplace and to offer new and innovative ETF products without sacrificing investor protections.

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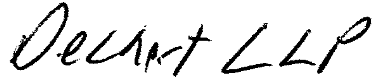
We thank you for the opportunity to comment on the Concept Release. If you have any questions about the foregoing comments or if we can provide any additional information that may assist the

Commission and its staff, please contact Stuart Strauss at (212) 698-3529 or stuart.strauss@dechert.com; Jeremy Senderowicz at (212) 641-5669 or jeremy.senderowicz@dechert.com, or Matthew Wolfe at (212) 649-8703 or matthew.wolfe@dechert.com.

Respectfully submitted,



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