May 9, 2022

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: FINRA Regulation Notice 22-08: Complex Products and Options

Dear Ms. Mitchell:

Rafferty Asset Management, LLC (RAM, d/b/a Direxion), on behalf of the separate series of the Direxion Funds (Direxion Mutual Funds) and Direxion Shares ETF Trust (Direxion ETFs) (collectively with RAM, Direxion),[1] appreciates the opportunity to comment on Notice to Members 22-08 (Notice 22-08) as issued by the Financial Industry Regulatory Authority, Inc. (FINRA) on March 8, 2022.[2]

In Notice 22-08 FINRA states that trading of complex products and options has increased among individual investors, particularly self-directed investors, and implies that such trading has unduly negative consequences; that something must be done to restrict investors' trading activities. Accordingly, FINRA asks, among other things, whether it should move to protect investors, particularly self-directed investors, from complex products, and -- not being able to regulate investors directly -- it posits various potential requirements it could impose on broker-dealers to achieve this goal. In this regard FINRA asks whether, even in the absence of a recommendation, broker-dealers should be subject to "additional requirements." For example, FINRA asks, should broker-dealers be required to employ an enhanced account approval process for accounts that seek to trade complex products? If so, should that account approval process be modeled on the options account approval process? Alternatively, or in addition, should retail investors be required to "demonstrate their understanding" of a complex product before being permitted to trade it? Or,

[1] The Direxion Mutual Funds, all but one of which currently seek to provide investors with monthly leveraged or inverse leveraged investment results, have been publicly offered since 1997. The Direxion ETFs, most of which seek to provide investors with daily leveraged or inverse leveraged investment results, have been publicly offered since 2008. Such Direxion Mutual Funds and Direxion ETFs are referred to in this letter as the "Direxion Funds." Registered funds that seek leveraged or inverse leveraged returns, as described in Rule 6c-11(c)(4) under the Investment Company Act of 1940, as amended (1940 Act), are referred to collectively herein as "Leveraged Funds." For avoidance of doubt, this letter considers the Direxion Funds to be Leveraged Funds, even though certain Direxion Funds do not operate in reliance on Rule 6c-11.

[2] FINRA Reminds Members of Their Sales Practice Obligations for Complex Products and Options and Solicits Comment on Effective Practices and Rule Enhancements, Regulatory Notice 22-08 (March 8, 2022) (available at https://www.finra.org/sites/default/files/2022-03/Regulatory-Notice-22-08.pdf).

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FINRA asks, would such "aforementioned obligations unduly or appropriately restrict investor access to complex products"?

Direxion writes to voice its strong objection to FINRA formally proposing any new rule of a type posited in Notice 22-08 for complex products (such posited types of rules, Conceptual Proposals).[3] Although Direxion appreciates FINRA's concern for investor protection and, as evidenced by Direxion's robust disclosures, strongly supports clear and emphatic disclosure by Leveraged Funds of their complexities and risks, Direxion cannot endorse any of the Conceptual Proposals for at least three simple reasons.

> First, the Conceptual Proposals would represent, for publicly registered securities, an unprecedented departure from the disclosure-based principles that are the cornerstone of our federal securities laws.
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> Second, the Conceptual Proposals would represent, for investors, an unprecedented departure from their reasonable expectation that they ought to be allowed to decide what publicly registered securities to trade for their own accounts, and is not clear to Direxion that FINRA has statutory authority to adopt any rule to the contrary.
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> Third, pursuing any of the Conceptual Proposals would *unduly restrict* and -- in the absence of any empirical data substantiating broker-dealers' abuse of investors -- *inappropriately restrict* investor access to complex products.

For all of these reasons, Direxion strongly opposes the Conceptual Proposals.

Contrary to the Principles Set Forth in the Securities Act, FINRA Suggests in Notice 22-08 that "Complex Products" Warrant Merit Regulation

The capital markets of the United States are the envy of the world. As most investors know, and as FINRA surely knows, our capital markets depend largely on disclosure as a means for issuers to convey to investors their (potential) value as an investment and related risks. This has been true since 1933 and the adoption by Congress of the Securities Act of 1933, as amended (Securities Act).[4] The Securities Act cemented the importance in our regulatory system of a public issuer's disclosure of key characteristics and risks and, at the same time, the equivalent importance of an investor's assessment of such disclosure to determine whether to make an investment.[5] In this

[3] Although Direxion's comments are not specifically designed to address any of the questions posed in Notice 22-08 with respect to the regulation of options, they may be considered by FINRA in that context to the extent applicable. Similarly, although our comments are not specifically designed to explain various practices that broker-dealers have developed to seek to insure that investors transacting in Leveraged Fund shares understand the characteristics of Leveraged Funds, our comments may be considered by FINRA in that regard, to the extent they are responsive to the questions FINRA posed.

[4] 15 U.S.C. §77a *et seq.*

[5] The purpose of registering securities offerings is to provide investors with full and fair disclosure of material information about public issuers so that investors can make their own informed investment decisions. *See, e.g.,* SEC, Concept Release on Harmonization of Securities Offering Exemptions, Securities Act Release No. 10649 (June 18, 2019), at note 3 (citing SEC Commissioner Francis M. Wheat, Disclosure to Investors—A Reappraisal of Federal

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regard, Investor.gov, the investor website of the SEC, describes the Securities Act as having two basic objectives:

> (1) to require that investors receive financial and other significant information concerning securities being offered for public sale (the "Issuer Disclosure Requirement"); and
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> (2) to prohibit deceit, misrepresentations, and other fraud in the sale of securities (the "Fair Dealing Brokerage Requirement").[6]

The website further states that the "primary means of accomplishing these goals is the disclosure of important financial information through the registration of securities. This information enables investors, not the government, to make informed judgments about whether to purchase a company's securities."[7] Indeed, Direxion submits that this is why a significant percentage of the SEC staff is committed to reviewing and commenting on public issuers' disclosures, and why an even larger percentage of the staff of the U.S. Securities and Exchange Commission (SEC or Commission) is committed to pursuing violators of the federal securities laws.[8]

Nevertheless, contrary even to recent statements by the Chair of the SEC that "investors get to decide what risks to take" and that, in the U.S. "[w]e have a disclosure-based regime, not a merit-based one,"[9] FINRA suggests in Notice 22-08 that, in fact, not all investors should be permitted to decide what risks to take. FINRA suggests that, in fact, with respect to so-called "complex products," regardless of whether they are publicly registered securities in compliance with the panoply of disclosure requirements placed on them by the Securities Act and, in many cases the 1940 Act, it may need to consider, in effect, a merit-based regulatory regime for them.

In making this suggestion, FINRA recognizes in Notice 22-08 that there is no precedent for taking such an approach with respect to publicly registered securities. Indeed, the closest precedent FINRA can find for its suggestion is the regulatory regime established for options that, as noted in Notice 22-08, imposes on members account opening requirements that are similar to those it

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Administrative Policies under the '33 and '34 Acts (Mar. 1969)), available at https://www.sec.gov/rules/concept/2019/33-10649.pdf.

[6] *See* Investor.gov, The Laws that Govern the Securities Industry, available at https://www.investor.gov/introduction-investing/investing-basics/role-sec/laws-govern-securities-industry.

[7] *Id.*

[8] *See* FY 2023 Congressional Budget Justification, available at https://www.sec.gov/files/FY%202023%20Congressional%20Budget%20Justification%20Annual%20Performance%20Plan_FINAL.pdf#page=19 (showing approximately 9% of the SEC staff to comprise the Division of Corporation Finance and approximately 29% of SEC staff to comprise the Division of Enforcement).

[9] SEC Chair Gary Gensler, Building Upon a Long Tradition – Remarks before the Ceres Investor Briefing (April 12, 2022) (available at https://www.sec.gov/news/speech/gensler-remarks-ceres-investor-briefing-041222). See also SEC Gary Gensler, A Century with a Gold Standard, (May 6, 2022) (available at https://www.sec.gov/news/speech/gensler-acfmr-20220506) "Going back to the 1930s, we have a disclosure-based regime, not a merit-based one. The core bargain is that investors get to decide which risks to take, as long as public companies provide full and fair disclosure and are truthful in those disclosures."

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suggests for complex products. However, the options regime does not provide an apt model for the type of rulemaking contemplated by Notice 22-08.

To begin, the risks of Leveraged Funds are not comparable to options. Unlike with various types of options strategies, an investor in Leverage Fund shares cannot lose more than the amount that he or she invests.

Further, because Leveraged Fund shares are publicly registered securities, investors receive a prospectus by no later than with the confirmation of his or her initial purchase of fund shares, which is not true of any option because options are not separate registered products with bespoke disclosure documents. Rather, options investors typically only receive the Options Disclosure Document, which is general to all options and describes various options strategies, but no options contract in particular.[10]

Even more significantly, the SEC only adopted the existing options regime after an exhaustive study of the options market and options sales practices (the Options Study), which documented widespread abuses by broker-dealers of options investors. As part of the Options Study, the SEC staff reviewed over 150 options examinations of broker-dealers, reviewed the options complaint files of the SEC, self-regulatory organizations and brokerage firms of all sizes, interviewed compliance and sales personnel at brokerage firms, and reviewed surveys completed by options investors. Based on the information obtained from the Options Study, the SEC reported in a 1,084-page submission to Congress that "significant problems related to options selling practices were found. These problems included solicitation of options transactions unsuited to the customer . . . inadequately trained registered representatives and supervisors, [and] deceptive advertising and sales literature."[11] In sum, the Options Study found widespread violations of basic disclosure and sales practice rules, which laid the foundation for imposing additional regulation on the options market and options sales practices.

Compare the record cited by FINRA in Notice 22-08 to impose an options-like regime on complex products:

> The number of accounts trading in complex products and options has increased significantly in recent years.
>
> *   *   *
>
> While many complex products serve a role in our financial markets, they also may raise a number of regulatory and investor protection concerns. For example, if a product has features or payout structures that would be confusing to retail investors, or if it performs in unexpected ways in various market or economic conditions, investors may not fully

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[10] *See* theocc.com, Characteristics and Risks of Standardized Options, available at https://www.theocc.com/Company-Information/Documents-and-Archives/Options-Disclosure-Document.

[11] REPORT OF THE SPECIAL STUDY OF THE OPTIONS MARKETS TO THE SECURITIES AND EXCHANGE COMMISSION 338 (Dec. 22, 1978).

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> understand the attendant risks. Moreover, depending on how a complex product is structured, some may have built-in statutory protections while others may not, and this may not be clear to the investor. Although complex products do not always translate into more investment risk, their complexity may confuse investors who may not adequately understand their features. These concerns may be heightened when a retail customer is accessing these products through a self-directed platform and without the assistance of a financial professional, who may be in a position to explain the key features and risks of the product to the retail investor.

In short, Notice 22-08 cites to no record of actual abuse -- let alone abuses on the scale comparable to those cited in the Options Study -- sufficient to promulgate an options-like regime for complex products.

This assessment of the record presented in Notice 22-08 as inadequate is reinforced by a review of the record amassed to justify the only other product-specific regulatory regime ever adopted under the federal securities laws, namely the Penny Stock Rules (as defined below).[12] In the case of the Penny Stock Rules, Congress commissioned a special report from the SEC (the Penny Stock Report). The Penny Stock Report described "rampant fraud and manipulation" in the penny stock market and reported that "[p]enny stock swindles are now the No. 1 threat of fraud and abuse facing small investors in the United States." The Penny Stock Report, estimated that penny stock fraud cost investors over $2 billion annually, noted that the Commission established a special task force focused on penny stock fraud, and conducted a coordinated sweep with state regulators of 130 main offices and 30 branch offices of penny stock firms, which at the time was the largest coordinated nationwide effort undertaken by securities regulators. The Report concluded that there was inadequate public information about 'penny' stocks, which facilitated price manipulation. In addition, the Report found that there were large numbers of unscrupulous promoters at both the issuers and in the broker-dealer community who were committing fraud, were repeat offenders under securities laws, including convicted felons and organizations with links to organized crime. As a result of the Penny Stock Report, in 1990 Congress adopted the Penny Stock Reform Act as an amendment to the Securities Exchange Act of 1934, as amended (Exchange Act). The Penny Stock Reform Act gave the Commission express rulemaking authority over the penny stock market and its participants.

Consistent with the directive of Congress when it adopted the Penny Stock Reform Act, the SEC adopted Rule 15g-2 *et seq.* under the Exchange Act (such rules, the Penny Stock Rules), targeting transactions in penny stocks. As most relevant here, Rule 15g-9 under the Exchange Act requires broker-dealers, prior to effecting transactions in penny stocks for an account, to engage in account opening procedures[13] that are comparable to those required for options accounts[14] and that, as noted above, appear now to be under consideration for imposing on standard brokerage accounts

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[12] H. REP. NO. 101-617, 101st Cong., 2d Sess., at 8 (1990) ("Penny Stock Report").

[13] 17 C.F.R § 240.15g-9(b)(1)-(2).

[14] FINRA Rule 2360(b)(16) & FINRA Rule 2360(b)(19).

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that seek to trade complex products. However, FINRA has offered no record of abuse comparable to that underlying the Penny Stock Rules in support of such regulation.

In fact, with respect to Direxion ETF shares (Direxion Shares) broker-dealers do not have any financial incentive to sell them as compared to other financial products and, therefore, the incentive to commit abuse does not exist. In this respect, Direxion notes that--

- Direxion Shares do not pay any fees pursuant to a distribution plan adopted under Rule 12b-1 under the 1940 Act (12b-1 fees). Accordingly, broker-dealers do not receive 12b-1 fees in connection with sales of Direxion Shares.

- Direxion Shares do not pay a sub-transfer agency fee or shareholder servicing fee.

- Direxion Shares are not subject to revenue sharing arrangements.

- Direxion Shares are not offered in multiple share classes, each of which has a different front-end load, back-end sales load and/or trail commission, resulting in broker-dealers receiving different rates of compensation for sales of different classes of shares.

- Direxion Shares are not sold by broker-dealers who are affiliated with Direxion and who may, therefore, have a special incentive to distribute them as proprietary products.

- Broker-dealers do not receive higher commission rates in connection with transactions in Direxion Shares. Rather, they have the same financial incentive to execute a trade in a Direxion ETF as they do to execute a trade in Amazon or Microsoft or shares of other ETFs.

Indeed, brokers have a financial *disincentive* to sell Direxion Shares under many circumstances. Most notably, by Notice to Members 09-53,[15] FINRA reduced the ability of broker-dealers to earn interest on Leveraged ETF shares, including Direxion Shares, held in margin accounts by increasing the maintenance margin requirements for such shares by a factor commensurate with their leverage factor. For example, assuming the standard maintenance margin requirement on a traditional ETF is 25% of its market value, the maintenance margin requirement applicable to a Direxion ETF that provides 300% leverage is 75% of its market value (three times 25%). As a result, broker-dealers cannot earn as much interest (from margin loans) on Leveraged ETFs as on other types of securities. They therefore have a financial *disincentive* to sell them.

In short, all of the financial incentives that have traditionally conspired to create conflicts of interest for broker-dealers and underpinned the abuses documented in the Options Study and Penny Stock Report are absent in the case of Direxion Shares and, Direxion believes, other Leveraged Funds. Accordingly, Direxion doubts that there is widespread abuse of investors by broker-dealers occurring with respect to sales of them, particularly not abuse on the level required to abandon

[15] Increased Margin Requirements for Leveraged Exchange-Traded Funds and Associated Uncovered Options, Regulatory Notice 09-53 (December 1, 2009) (available at https://www.finra.org/rules-guidance/notices/09-53).

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nearly 90 years of disclosure-based regulation in favor of merit regulation and the disempowerment of self-directed investors.

Direxion acknowledges that Notice 22-08 cites to a handful of suitability cases that have been brought by FINRA related to complex products.[16] But as is obvious from the very fact that the cases were brought, laws already exist to protect investors from unsuitable recommendations, and although not discussed in Notice 22-08, such laws were only very recently strengthened with the adoption of Regulation Best Interest. Further, notwithstanding the obvious availability and enforcement of such laws by both FINRA and the SEC, there seems hardly to be an undue number of cases -- again, nothing like the number of cases documented in the Options Study or the Penny Stock Report.

Finally, Direxion fails to see the relevance of suitability cases to FINRA's effort to strip self-directed investors of their ability to exercise authority over their own brokerage accounts. Indeed, to the extent that the suitability cases to which FINRA cites in Notice 22-08 support additional regulation, they hardly recommend regulation that would mandate a role for financial professionals in retail investors' trading decisions. This is the case, of course, because the few cited enforcement actions all relate to improper actions by investment professionals. Yet without irony, FINRA indicates in Notice 22-08 that its concerns about investors' trading complex products are "heightened" when investors do *not* obtain the advice of a financial professional.

> Although complex products do not always translate into more investment risk, their complexity may confuse investors who may not adequately understand their features. These concerns may be heightened when a retail customer is accessing these products through a self-directed platform and without the assistance of a financial professional, who

[16] There, FINRA stated:

> If financial professionals do not fully grasp the complex product's features, they may engage in recommendations and sales that are not in the best interest of the customer. For example, in 2021, FINRA sanctioned:
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> - a member that failed to reasonably supervise its brokers' recommendations of leveraged, inverse and volatility-linked ETPs, leading to unsuitable recommendations of these products that caused customer losses;
> - a member that failed to reasonably supervise a broker who recommended that numerous customers liquidate their retirement accounts and invest the proceeds in structured notes and other speculative and illiquid securities;
> - a member that failed to reasonably supervise a broker who recommended that his customers—many of whom were seniors with conservative investment objectives—concentrate their accounts in a complex mortgage-backed security known as an inverse floating rate collateralized mortgage obligation (CMO), resulting in more than $2 million in customer losses; and
> - a broker who recommended concentrated investments in high-risk business development companies to customers (including customers over the age of 60), resulting in more than $1 million in losses.

See Notice 22-08 at 5 (citations omitted).

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> may be in a position to explain the key features and risks of the product to the retail investor.[17]

The record FINRA presents in support of this contention, however, is completely at odds with the contention itself. Accordingly, given the actual record presented, which is devoid of empirical evidence of abuse of self-directed investors, and in the absence of a mandate from Congress similar to that issued with regard to options and penny stock regulation, Direxion does not believe that FINRA should pursue any of the Conceptual Proposals targeting Leveraged Funds or other complex products.[18]

FINRA Lacks Legal Authority to Restrict Self-Directed Investors' Access to Complex Products

The objectives of the Securities Act, as set forth above, provide some insight into why, shortly after the adoption of the Securities Act, Congress enacted the Exchange Act. In short, the Securities Act prohibited deceit, misrepresentations and fraud in the sale of securities *by issuers,* including their agents and promoters. The Securities Act, however, did not reach deceit, misrepresentations and fraud in the sale of securities by third parties, such as broker-dealers. Thus, in order to address the potential for such behavior by third parties, which could undermine a national market system for securities, Congress adopted the Exchange Act.[19]

Section 15A of the Exchange Act authorizes the SEC to approve one or more "national securities association[s]" for the purposes set forth in that section. Currently, the only such association is FINRA. Under Section 15A, an association of broker-dealers may not register as a national securities association, unless the Commission determines that, among other things, "[s]uch association is so organized and has the capacity to be able to carry out the purposes of [the Exchange Act] and to comply, and… to enforce compliance by its members and persons associated with its members, with the provisions of [the Exchange Act]… ."[20] The Commission must also

[17] *See id.* at 4.

[18] Direxion notes that for approximately 40 years now there has been a secular trend away from involving Wall Street (and away from paying Wall Street) in connection with investment decisions. Although the secular trend may have been driven by retail investors themselves, it has been supported by regulators, including the SEC, that have promulgated regulations that at least tacitly recognize the growing direct involvement of retail investors in the secondary market. *E.g.,* Exchange Act Release No. 11203 (Jan. 23, 1975), 40 FR 7394 (Feb. 20, 1975) (eliminating fixed commission rates and thereby facilitating the development of self-directed brokerage platforms).

[19] 15 U.S.C. §78b (Necessity for Regulation) ("For the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are effected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, including transactions by officers, directors, and principal security holders, to require appropriate reports, to remove impediments to and perfect the mechanisms of a national market system for securities and a national system for the clearance and settlement of securities transactions and the safeguarding of securities and funds related thereto, and to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets in such transactions… .")

[20] 15 U.S.C. § 78o-3.

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determine, generally speaking, that the association's rules will treat members of the association fairly, as between themselves,[21] and that members will treat investors fairly.

In this latter regard, Section 15A requires, among other things, that--

> (6) The rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers, to fix minimum profits, to impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members, or to regulate by virtue of any authority conferred by this title matters not related to the purposes of this title or the administration of the association.
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> *   *   *
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> (9) The rules of the association do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this title.
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> *   *   *
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> (11) The rules of the association include provisions governing the form and content of quotations relating to securities sold otherwise than on a national securities exchange which may be distributed or published by any member or person associated with a member, and the persons to whom such quotations may be supplied. Such rules relating to quotations shall be designed to produce fair and informative quotations, to prevent fictitious or misleading quotations, and to promote orderly procedures for collecting, distributing, and publishing quotations.
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> (12) The rules of the association to promote just and equitable principles of trade, as required by paragraph (6), include rules to prevent members of the association from participating in any limited partnership rollup transaction…

[21] *See, e.g.,* 15 U.S.C. § 78o-3(b)(6), 15 U.S.C. § 78o-3(b)(9), 15 U.S.C. § 78o-3(b)(11), and 15 U.S.C. § 78o-3(b)(12).

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Yet in Notice 22-08, FINRA suggests that its powers are not limited to adopting rules that are designed to ensure that its members treat investors fairly. Rather, FINRA suggests that its powers may be so broad as to allow it to impose requirements on members when they are not treating investors in any way at all. For example, one of the Conceptual Proposals in Notice 22-08 would effectively require members to determine that complex products could be suitable for an investor at the time of opening the investor's account to trade complex products. This would be true whether or not the member made any affirmative outreach to the investor to solicit the account or a trade in a complex product.

Direxion does not believe that FINRA may so broadly read the authority provided by Section 15A to national securities associations. "Under the canon of *noscitur a sociis*, a word is generally known by the company it keeps."[22] So to understand the scope of FINRA's power under Section 15A, including its limits, FINRA must look to Section 15A, which, as relevant here, generally expects a national securities association to adopt rules that promote the fair treatment of investors by members. This explains why, historically, FINRA has limited itself to regulating broker-dealers' actions and recommendations, and not self-directed investors' independent investment decisions.

There are still other reasons why Direxion does not believe that FINRA could pursue the Conceptual Proposals consistent with the standards in Section 15A. Namely, each of the Conceptual Proposals would unfairly discriminate among issuers of publicly registered securities as investors would be cordoned off from transacting in the shares of a somewhat arbitrarily determined group of so-called complex products, notwithstanding their being "on par" with all other publicly registered securities.[23] In addition, the Conceptual Proposals would impose burdens on competition that are not necessary or appropriate in furtherance of the purposes of the Exchange Act, which was adopted to address systemic risks, which do not appear here.

Moreover, Direxion does not believe that FINRA may pursue transactions by self-directed investors consistent with its own Certificate of Incorporation (COI). The COI authorizes FINRA, as relevant here, "to adopt, administer, and enforce rules of fair practice and rules to prevent fraudulent and manipulative acts and practices, and in general to promote just and equitable principles of trade for the protection of investors." Yet the Conceptual Proposals do not satisfy the standards in the COI for several reasons. Most prominently, Direxion does not believe that the Conceptual Proposals may be fairly characterized as rules "to promote just and equitable principles of trade for the protection of investors." Although FINRA has never defined precisely what constitute "just and equitable principles of trade," Direxion submits that the manner in which a self-directed investor deals with *himself or herself* is not a principle of trade and cannot be unjust or inequitable.

Direxion further submits that, to the extent that FINRA, or even the SEC, wants to reduce individual investors' authority over their own trading decisions, additional authority from Congress to do so is necessary, as none of the existing federal securities laws provides such

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[22] Agnew v. Gov't of the District of Columbia, 920 F.3d 49, 56 (D.C. Cir. 2019).

[23] *See infra* note 28.

authority to the Commission, much less a national securities association. Where "decisions of vast 'economic and political significance'" are concerned, the statute must "speak clearly" to authorize the agency's action.[24] Here, the statute in question (i.e., the Exchange Act) is silent as to the authority of both the SEC and a national securities association to pursue rules that regulate an investor's investment decisions. The statute speaks only to the regulation of broker-dealers' sales practices and principles of trade vis-à-vis investors to seek to ensure that they are fair and balanced, and the statute in no way supports the notion that a broker-dealer's simply approving an application to open an account constitutes a principle of trade. Indeed, if it did, the SEC would not have needed a congressional mandate to promulgate the penny stock and options regulatory regimes.

Finally, but significantly, when reviewing proposed rules of FINRA, the SEC is required to consider "in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[25] In this regard, FINRA must know that each of the Conceptual Proposals would, at a minimum, inhibit capital formation. Indeed, Direxion believes that broker-dealers would be unlikely to make necessary revisions to their compliance and related procedures to implement any rule that requires them to run investors through a gauntlet in order to trade complex products. Instead, Direxion believes that they will simply remove complex products from their investment menus. The consequence, of course, will be that assets in complex products, including Leveraged Funds will decline precipitously, resulting in capital destruction in lieu of capital formation and new product development will be significantly limited.

The Conceptual Proposals Would Unduly and Inappropriately Restrict Investor Access to Complex Products

In Notice 22-08, FINRA asks whether any of the Conceptual Proposals would unduly or inappropriately restrict investor access to such products. In fact, *all* of the Conceptual Proposals posited in Notice 22-08 would unduly and inappropriately restrict investor access to any complex product that is a publicly registered security.[26]

As discussed above, in the U.S., the federal securities laws envision full and fair disclosure as the paramount protection for investors in publicly registered securities. Yet all of the Conceptual Proposals imply that such disclosure, which allows investors to decide for themselves whether they want to make a particular investment should be replaced by, or augmented with, a determination by a third party -- namely a broker-dealer or a regulator or a broker-dealer pursuant to standards established by a regulator -- that investors should (or should not) be able to make such an investment. In this respect, every Conceptual Proposal would be a significant departure from the existing legal and regulatory regime and would also raise, without any evidence of need, unnecessary and cumbersome hurdles for investors to overcome.

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[24] Utility Air Regulatory Group v. EPA, 134 S. Ct. 2427, 2444 (2014) (quoting FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 133 (2000)).

[25] 15 U.S.C. § 78c(f).

[26] This letter is not designed to and should not be read to address securities that are not publicly registered.

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Ultimately, such products could become unavailable to investors altogether. To continue making complex products available on their platforms, broker-dealers would need to evaluate the cost of developing additional procedures to onboard complex products and the risk for after-the-fact second-guessing by regulators and plaintiffs regarding broker-dealers' decisions as to whether individual investors should have been permitted to trade complex products. In the worst case scenario, regulators and/or plaintiffs could seek to make broker-dealers insurers of investors' decisions to invest in complex products by allowing investors to obtain compensation from broker-dealers for investment decisions that they understood perfectly well, but can claim otherwise and recoup investment losses. Such a result would entirely upset the balance that the SEC intended when adopting the Exchange Act.[27] Also, this result would further unduly restrict investors' access to such products and, given the unwillingness of FINRA to identify the specific universe of products to which it would apply, a slippery slope would be introduced pursuant to which many more products would likely be made "off limits" to self-directed investors in the future.[28]

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[27] Dura Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336, 345 (2005) (the securities laws are not intended to provide investors with broad insurance against market losses). *See also* Basic Inc., v. Levinson, 485 U.S. 224 (1988) ("allowing recovery in the face of affirmative evidence of nonreliance—would effectively convert Rule 10b–5 into a scheme of investor's insurance. There is no support in the Securities Exchange Act, the Rule, or our cases for such a result" (internal quotation marks and citations omitted)).

[28] Direxion emphasizes that whether a publicly registered security is a complex product appears to rest on an entirely subjective assessment. Consider, for example, Tesla, Inc. (TSLA). Although Tesla is a traditional public issuer whose securities are available for purchase on an exchange, TSLA may not perform as investors expect. For example, one investor may regard TSLA as a car company, yet its performance may not be representative of car companies. Other investors may *not* expect the performance of TSLA to correlate to the performance of bitcoin. Yet because TSLA has a significant investment in bitcoin, when the performance of TSLA does correlate to bitcoin, it may perform in a way that certain investors do not expect. In order for an investor to establish reasonable expectations about how TSLA will perform, an investor must read and understand TSLA's financial statements and disclosures, which Direxion submits are much more complicated to understand than any Leveraged Fund prospectus. Accordingly, it is unclear to Direxion how FINRA could conclude that investors are not capable of understanding Leveraged Funds, but are capable of understanding TSLA.

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In sum, Direxion believes that the current regulatory regime for complex products, which depends largely on robust disclosure, works,[29] and there is no empirical evidence to the contrary. The Direxion Funds provide such full and fair disclosure and are committed to doing so, as well as to working with FINRA and other regulators to advance investor education relating to Leveraged Funds. However, for the reasons explained herein, Direxion strongly opposes FINRA pursuing the Conceptual Proposals set forth in Notice 22-08.

Respectfully submitted,

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cc: The Honorable Gary Gensler
The Honorable Hester M. Pierce
The Honorable Alison H. Lee
The Honorable Caroline A. Crenshaw

William Birdthistle
Director, Division of Investment Management

[29] Direxion observes that many broker-dealers have voluntarily implemented enhanced disclosure processes with respect to Leveraged Funds. In this regard they make additional disclosures about the nature and risks of Leveraged Funds at the point of sale. They may also obtain attestations at the point of sale and/or an annual basis from individual investors, confirming that the investors understand Leveraged Funds for purposes of trading them.

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