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## DERIVATIVES REDUX: A HISTORICAL PERSPECTIVE AS THE SEC PROPOSES RULES GOVERNING INVESTMENT COMPANY USE OF DERIVATIVES

*Four years after it proposed controversial rules governing investment company use of derivatives, the Securities and Exchange Commission has tried again with a new approach designed to address investor protection concerns underlying Section 18 of the Investment Company Act. The new approach would limit a fund's ability to leverage its assets by requiring a "value at risk" test, and would impose "sales practice rules" to cover transactions in "leveraged/inverse investment vehicles." This article traces the history of Section 18 and the evolution of regulation of "senior securities" that create leverage for registered investment companies and business development companies, then summarizes and analyzes the latest proposed rules.*

By Jay G. Baris \*

The U.S. Securities and Exchange Commission (the "SEC" or the "Commission"), on November 25, 2019, proposed sweeping rules to address the use of derivatives by registered investment companies and business development companies.<sup>1</sup> The proposed rules,

which replace the Commission's original December 2015 proposal,<sup>2</sup> take a fundamentally different approach

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*footnote continued from previous column...*

the Proposing Release as the "Proposed Rule" and all the rules contained in the Proposing Release collectively as the "Proposed Rules," as the context requires.

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<sup>1</sup> Use of Derivatives by Registered Investment Companies and Business Development Companies; Required Due Diligence by Broker-Dealers and Registered Investment Advisers Regarding Retail Customers' Transactions in Certain Leveraged/Inverse Investment Vehicles, 85 Fed. Reg. 4446 (Jan. 24, 2020), available at: <https://www.govinfo.gov/content/pkg/FR-2020-01-24/pdf/2020-00040.pdf> (the "Proposing Release"). In this article, we generally refer to proposed rule 18f-4 contained in

<sup>2</sup> Use of Derivatives by Registered Investment Companies and Business Development Companies, 80 Fed. Reg. 80884 (Dec. 28, 2015), available at: <https://www.govinfo.gov/content/pkg/FR-2015-12-28/pdf/2015-31704.pdf> (the "2015 Proposing Release"). For an excellent summary and analysis of the 2015 Proposed Rule, see Amy R. Doberman, *SEC Proposal on*

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### INSIDE THIS ISSUE

- CLE QUESTIONS, Page 71