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FINANCIAL REGULATION

SEC Shelves Measure to Protect Investors in Leveraged ETFs

Proposal requiring leveraged and inverse exchange-traded funds to vet investors needs further study, officials say

The Securities and Exchange Commission is putting off a proposal that would require broker-dealers and investment advisers to vet individual investors before approving them to trade leveraged and inverse exchange-traded funds.

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By Paul Kiernan
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WASHINGTON—The Securities and Exchange Commission on Wednesday shelved a measure intended to protect investors who trade the shares of a class of exchange-traded funds it considers risky, saying it would review the issue later.

The SEC in November had proposed requiring broker-dealers and investment advisers to vet individual investors before approving them to trade the products, known as leveraged

and inverse exchange-traded funds. Such funds use debt to double or triple the gains—and losses—of an underlying index and are often poorly understood by investors.

Leveraged and inverse ETFs are a small part of the fund universe, with $33.4 billion in assets, compared with $19.53 trillion held by mutual funds, excluding money-market funds. But the two companies that offer them, Direxion Investments and Bethesda, Md.-based ProShares, considered the sales-practice provision a threat to their business model.

"ProShares strongly opposes the unprecedented, unnecessary and harmful restrictions on investor choice that would result from the Commission's proposed 'sales practice' rules for transactions in leveraged and inverse exchange-traded funds," the firm's chief executive and co-founder, Michael Sapir, wrote in a March 24 letter to the SEC.

Mr. Sapir's letter included a nearly 300-page legal memo arguing against the proposal. Representatives and lobbyists for ProShares and Direxion met or had teleconferences with SEC officials or commissioners nine times between March and July, according to SEC records.

In explaining the decision to shelve the provision, the commission cited an unusual volume of comment letters—numbering some 6,000—from people identifying themselves as investors concerned about losing access to the funds.

The provision was to have been included in a rule that consolidates and updates a patchwork of regulations governing the use of derivatives by mutual funds, ETFs and other so-called investment companies. The rule was approved by a 3-2 vote, with the SEC's two Democratic commissioners dissenting.

Shortly before Wednesday's vote, SEC Chairman Jay Clayton and three other officials published a statement highlighting investor-protection concerns. They said these concerns applied not only to the ETFs but also to other complex instruments such as exchange-traded notes, and commodity pools that wouldn't have been subject to Wednesday's rule.

"We are concerned that retail investors are independently selecting complex products for which they may not fully appreciate the unique characteristics and risks," the officials said, explaining that the issue needed further study.

One of the two dissenting commissioners, Allison Herren Lee, said she was deeply disappointed by the decision to remove from the rule.

"The fact that other products present similar dangers should not deter us from addressing the harm to retirees, middle-class savers, and other retail investors that is presently and squarely before us," she said in a statement.

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