The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 29920

May 18, 2016

ICI Submits Supplemental Comment Letter on SEC Liquidity Risk Management Proposal

[29920]

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TO: ACCOUNTING/TREASURERS MEMBERS No. 12-16
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VARIABLE INSURANCE PRODUCTS ADVISORY COMMITTEE No. 10-16 RE: ICI SUBMITS SUPPLEMENTAL COMMENT LETTER ON SEC LIQUIDITY RISK MANAGEMENT PROPOSAL

As previously reported, the SEC issued its proposed liquidity risk management rules for mutual funds and open-end ETFs ("funds") in late September. [1] ICI and IDC submitted four comment letters in response in January. [2] Yesterday, ICI submitted a supplemental comment letter, attached below.

Summary of the Proposal

The Proposal aims to promote effective liquidity risk management among funds; reduce the risk that funds will be unable to meet redemptions, or else will meet redemptions in ways that dilute interests of fund shareholders; and enhance disclosure regarding fund liquidity and redemption practices. The Proposal would:

- Require each fund to establish a formal liquidity risk management program that would require the fund to, among other things: (i) assess and manage the fund's liquidity risk; (ii) classify and monitor each portfolio asset's level of liquidity; and (iii) designate a minimum amount of portfolio liquidity;
- Permit, but not require, mutual funds to use swing pricing in pricing their shares; and
- Require each fund to make public its liquidity classifications and information about redemptions and swing pricing (if applicable) through disclosure on proposed Form N-PORT, Form N-1A, and proposed Form N-CEN.

Initial Comment Letters

ICI and IDC submitted four separate comment letters in response to the Proposal and the SEC's related Division of Economic and Risk Analysis ("DERA") study in January. These ICI comment letters:

- Generally supported requiring funds to adopt liquidity risk management programs, and most disclosure aspects of the proposal;
- Opposed the six-bucket asset classification scheme and related reporting requirements and provided an alternative;
- Opposed the three-day liquid asset minimum and provided an alternative; and
- Recognized the advantages and disadvantages of swing pricing, and addressed the operational and other hurdles that presently impede funds from adopting it.

Supplemental Comment Letter

Since submitting our initial comment letters, we have continued to analyze the proposal, reviewed other comment letters submitted, and engaged in further dialogue with our members, SEC staff, and other regulatory agencies. The supplemental ICI comment letter recommends:

- An enhancement to the proposed 15% limitation on illiquid assets. Specifically, we recommend that the SEC require a fund to report to the SEC if, after five business days, its illiquid assets continue to exceed 15% of its net assets.
- Principles that the SEC should follow as it further considers any asset classification requirement. We reiterate our view that in place of a uniform asset classification requirement, the SEC should require each fund, as part of its written liquidity risk management program, to determine how best to classify and monitor the liquidity of its portfolio assets.
  If the SEC remains committed to requiring a uniform asset classification scheme, however, we strongly recommend that it incorporate several principles as it moves forward:
    - Employ a "top-down" approach;
    - Encourage tailoring in applying factors;
    - Avoid an overly-prescriptive methodology;
    - Recognize the tension in the objectives underlying a uniform asset classification requirement; and

    - Make the classifications non-public and provide a safe harbor.

- Revisions to the proposed definition of “liquidity risk". As in the initial comment letter, we recommend that the SEC eliminate the portion of the “liquidity risk” definition requiring consideration of material impact to a fund’s NAV. Additionally, we recommend that if the SEC wishes to adopt a comprehensive definition of liquidity risk that avoids the inherent difficulties associated with examining price fluctuation, then it should instead incorporate language relating directly to dilution.

The supplemental ICI comment letter also reiterates ICI’s opposition to the proposed “three-day liquid asset minimum” requirement.

Dorothy M. Donohue
Deputy General Counsel - Securities Regulation

Matthew Thornton
Assistant General Counsel

Attachment

endnotes

[1] *Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release*, SEC Release No. IC-31835 (the “Proposal”), available at www.sec.gov/rules/proposed/2015/33-9922.pdf. *See* Institute Memorandum No. 29370, dated September 28, 2015, for a more complete summary of the Proposal. Unless otherwise indicated, references to “funds,” “mutual funds,” and “open-end funds” do not include money market funds.

[2] *See* Institute Memorandum No. 29643, dated January 14, 2016, for links to and summaries of the comment letters.