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January 10, 2018

VIA ELECTRONIC DELIVERY

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Request for Delay: Investment Company Act Release No. 32315 (File No. S7-16-15)
Investment Company Liquidity Risk Management Programs

Dear Mr. Fields,

We are writing to request that the U.S. Securities and Exchange Commission ("***SEC***" or "***Commission***") delay the compliance dates of Rule 22e-4 under the U.S. Investment Company Act of 1940 (the "***1940 Act***") (17 C.F.R. § 270.22e-4). Currently, the compliance date for fund complexes with $1 billion or more in net assets as of the end of the most recent fiscal year is December 1, 2018. For fund complexes with less than $1 billion in net assets as of the end of the most recent fiscal year, the compliance date is June 1, 2019. For the reasons discussed below, we believe that each of these compliance dates should be delayed for at least one additional year.

Dechert LLP is an international law firm with a wide-ranging financial services practice that serves clients in the United States and abroad. In the United States, we represent a substantial number of U.S. registered fund complexes, closed-end funds, open-end exchange-traded funds ("***ETFs***"), fund boards, fund independent directors, fund advisers and fund service providers.[1] In developing this request, we have drawn on our experience in the financial services industry generally. Although we have discussed certain matters related to Rule 22e-4 with some of our clients, the request that follows reflects only the views of a group of attorneys in our financial services practice, and does not necessarily reflect the views of our clients, other members of our financial services group or the firm generally.

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1 Unless the context indicates otherwise, the term "***fund***" is intended to be interpreted consistently with the definition at Rule 22e-4(a)(5) (17 C.F.R. § 270.22e-4(a)(5)).

We acknowledge the obvious care and thoughtfulness that the Commission and its staff put into the preparation of Rule 22e-4 and the associated adopting release[2] and appreciate the opportunity to offer this request.

We agree with the Commission that "[a] hallmark of open-end funds is that they must be able to convert some portion of their portfolio holdings into cash on a frequent basis because they issue redeemable securities,"[3] and, therefore, we support the Commission's goal of promoting effective liquidity risk management throughout the fund industry. Although funds have been highly successful in meeting shareholder redemption obligations on a timely basis since the passage of the 1940 Act, we support the SEC's adoption of Rule 22e-4.

However, we believe that certain fundamental interpretive matters and related issues have arisen under Rule 22e-4, which have been magnified by the operational complexity of implementing these interpretations in coordination with internal groups and external service providers. In our view, these issues warrant a delay in the compliance dates of Rule 22e-4, which would benefit both fund investors and fund complexes. We also believe that, by providing more time for funds' efforts at compliance with Rule 22e-4, a delay would further the Commission's objectives in adopting the rule. These views are informed by our experiences since Rule 22e-4's adoption in assisting with the development of written liquidity risk management programs, in responding to related inquiries and discussions with a wide variety of parties and in working to assess the steps to be completed prior to the compliance dates.

I. INTERPRETIVE MATTERS ARISING WITH KEY DEFINITIONS UNDER RULE 22e-4

Certain key terms and concepts are critical to multiple aspects of the liquidity risk management program required under Rule 22e-4. For example, the "value impact standard" and the concepts of "current market conditions" and reasonably-anticipated trade size underlie the liquidity classification regime, and therefore also impact compliance with the 15% limit on purchases of illiquid investments, the highly liquid investment minimum provisions and the requirement to assess, manage and review liquidity risk. Additionally, the concepts of "significant dilution" and "reasonably foreseeable stressed conditions" are central to the fundamental goals under Rule 22e-4 of assessing and managing liquidity risk. As such, it is appropriate for fund complexes and service providers to invest time and effort to determine reasonable and appropriate interpretations and models of these terms and concepts, consistent

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[2] *See* Investment Company Liquidity Risk Management Programs, 81 Fed. Reg. 82,142 (Nov. 18, 2016) ("***Adopting Release***").

[3] Adopting Release at 82,145.

with the intent of the rule, and it has been our experience that many fund complexes are continuing to consider how best to interpret and model them.

Accordingly, it is our view that a delay in the compliance dates of Rule 22e-4 would facilitate funds' efforts at compliance with Rule 22e-4 and, as a result, further the Commission's objectives in adopting the rule.

A. "Significantly Changing the Market Value"

Each of the liquidity categories under Rule 22e-4's classification requirement is defined with respect to a reasonable expectation regarding the amount of time required to convert a portfolio investment to cash (or, with respect to the less liquid and illiquid categories, the time required to sell or dispose of the portfolio investment) without significantly changing the market value of the investment.[4] As the Commission explained in the Adopting Release, this value impact standard "does not require a fund to actually re-value or re-price the investment for classification purposes, nor does the standard require the fund to incorporate general market movements in liquidity determinations or estimate market impact to a precise degree;" the value impact standard also does not require "capturing very small movements in price" but reflects the Commission's "desire to capture the risk of dilution in cases of inadequate liquidity."[5] In view of this guidance, the Commission stated its belief "that a fund's classification policies and procedures should address what it would consider to be a significant change in market value."[6]

In our experience, fund complexes, especially those with investments in a wide variety of asset classes and markets, are continuing to work toward determining reasonable interpretations of the value impact standard. While some general assumptions and practices appear to be gradually gaining traction, we believe that fund complexes would benefit from additional time to consider and determine appropriate interpretations of the value impact standard with respect to the varied asset classes and markets in which they invest.

Importantly, because of the foundational importance of the value impact standard to the classification regime, a fund's interpretation of this standard informs many other parts of its classification systems and practices. Liquidity models, interpretations of data and vendor inputs, among other features of a fund's classification system, depend upon how the value impact standard is understood. Further, as Rule 22e-4's "15% limitation on funds' purchases of

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4 *See* Rule 22e-4(a)(6), (8), (10) and (12) (17 C.F.R. §§ 270.22e-4(a)(6), (8), (10) and (12)).

5 Adopting Release at 82,172-73.

6 Adopting Release at 82,173.

illiquid investments [is] harmonized with the classification system,"[7] and as Rule 22e-4's highly liquid investment minimum provisions are predicated on the interpretation of "highly liquid investments,"[8] establishing systems for compliance with these fundamental elements of Rule 22e-4 depends upon interpretation of the value impact standard. Moreover, to the extent funds' liquidity risk assessment, management and periodic reviews of liquidity risk involve consideration of fund holdings in the various liquidity categories, they, too, depend upon interpretation of the value impact standard.[9]

B. "Current Market Conditions"

Each liquidity category under Rule 22e-4's classification requirement is also defined with respect to a reasonable expectation regarding the amount of time required to convert a portfolio investment to cash (or, with respect to the less liquid and illiquid categories, the time required to sell or dispose of the portfolio investment) in current market conditions.[10] As with the value impact standard, in our experience, fund complexes are continuing to consider a variety of approaches to modelling "current market conditions." These models may vary according to

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7 Adopting Release at 82,144; *see also* Adopting Release at 82,197 ("[W]e believe . . . it is . . . appropriate to harmonize the rule 22e-4 limit on illiquid investments . . . with the rule's broader liquidity classification requirement.").

8 *See* Rule 22e-4(b)(1)(iii) (17 C.F.R. § 270.22e-4(b)(1)(iii)).

9 *See* Rule 22e-4(b)(1)(i) (17 C.F.R. § 270.22e-4(b)(1)(i)). Indeed, in discussing the requirement under Rule 22e-4(b)(1)(i)(A) to consider "whether the investment strategy is appropriate for an open-end fund," the Commission noted that the requirement would "likely cause funds to evaluate the suitability of investment strategies . . . [involving] significant holdings of securities with extended settlement periods." Adopting Release at 82,162 (emphasis added). Investments with extended settlement periods are addressed in some detail in the Commission's discussion of the category of "less liquid investments." *See* Adopting Release at 82,176 ("As an example, certain foreign securities . . . may be subject to capital controls that would limit the extent to which the foreign currency could be repatriated or converted to dollars within this time frame. Thus, these securities would be considered to be less liquid investments . . . . In the event of an extended settlement period, at some point, a fund may need to consider re-classifying such an investment as illiquid.") (emphasis added). Moreover, the Commission noted in its discussion of the category of "illiquid investments" that "extended settlement period securities have the potential to pose heightened liquidity risks for funds, and thus policies and procedures that are reasonably designed to assess and manage the liquidity risk of a fund that holds such securities would take into account the particular liquidity risks raised by such holdings." Adopting Release at n.417 (emphasis added).

10 *See* Rule 22e-4(a)(6), (8), (10) and (12) (17 C.F.R. §§ 270.22e-4(a)(6), (8), (10) and (12)).

investment and asset class, and additional variance is introduced when third-party vendor services' models for "current market conditions" are considered.

Similar to the value impact standard, the interpretation of "current market conditions" is of foundational importance to the classification regime, and a fund's interpretation of "current market conditions" informs many other parts of its classification systems and practices. Similarly, as described above, because Rule 22e-4's 15% limitation on funds' purchases of illiquid investments and highly liquid investment minimum provisions depend upon the liquidity classification system, they, in turn, depend upon the interpretation of "current market conditions," which underpins each liquidity category. And, as noted above, to the extent funds' liquidity risk assessment, management and periodic reviews of liquidity risk involve consideration of fund holdings in the various liquidity categories, they, too, depend upon interpretation of "current market conditions."

C. "Liquidity Risk" and "Significant Dilution"

The central feature of Rule 22e-4 is the requirement to adopt and implement written liquidity risk management programs reasonably designed to assess and manage liquidity risk.[11] As such, a fund's understanding of "liquidity risk" is essential to its compliance with Rule 22e-4. The Commission has defined "liquidity risk" to mean "the risk that the fund could not meet requests to redeem shares issued by the fund without <u>significant dilution</u> of remaining investors' interests in the fund."[12]

The Commission's primary discussion of this standard in the Adopting Release implicates a value impact component, and, therefore, the discussion above concerning determining reasonable interpretations of such a standard is also applicable in this context.[13] However, further Commission discussion points to a broader meaning of "liquidity risk" and an additional component of the "significant dilution" standard. Indeed, in addition to value impact, the Commission's statements in the Adopting Release indicate that a fund's liquidity risk and its

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11 *See* Rule 22e-4(b) (17 C.F.R. § 270.22e-4(b)).

12 *See* Rule 22e-4(a)(11) (17 C.F.R. § 270.22e-4(a)(11)) (emphasis added).

13 *See* Adopting Release at 82,158-60 ("While we agree that liquidity and valuation are distinct concepts, we consider these concepts as having certain inter-relationships. . . . [I]n the final rule we have modified <u>the NAV-impact standard in the definition of 'liquidity risk'</u> to substitute the phrase 'without significant dilution of remaining investors' interests in the fund' for the phrase 'without materially affecting the fund's net asset value.'").

remaining investors' interests depend also on redemption practices and the liquidity profile that results from such practices.[14]

In our experience, many fund complexes are continuing to invest time and effort to determine a reasonable model for "significant dilution" that appropriately addresses these complex, interconnected considerations. In light of the central significance of this concept to the purpose of Rule 22e-4, we believe these endeavors are appropriate and worthwhile, and that a delay in the Rule 22e-4 compliance dates would facilitate funds' efforts at compliance with Rule 22e-4 and, as a result, further the Commission's objectives in adopting the rule.

D. "Reasonably Foreseeable Stressed Conditions"

Two of the three enumerated liquidity risk considerations in Rule 22e-4 applicable to all funds' assessment, management and periodic review of liquidity risk involve consideration of the underlying factors during "reasonably foreseeable stressed conditions."[15] As each of the liquidity risk considerations also informs a fund's determination of its highly liquid investment

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14 The Commission noted that:

> [M]eeting redemption obligations is fundamental for open-end funds, and funds must manage liquidity in order to meet those obligations. Several factors influence how liquidity management by open-end funds affects the equitable treatment of investors in a fund, investor redemption behavior, and potentially the orderly operation of the markets when fulfilling redemption obligations.
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> First, it is important to consider how a fund meets redemptions . . . . A fund that chooses to sell its most liquid assets to meet fund redemptions may minimize the effect of the redemptions on short-term fund performance for redeeming and remaining shareholders, but may leave remaining shareholders in a potentially less liquid and riskier fund . . . .
>
> There can be significant adverse consequences to remaining investors in a fund that does not adequately manage liquidity. As noted above, the proportion of illiquid assets held by a fund can increase if the fund sells its more liquid portfolio assets to meet redemptions. This in turn could adversely affect the fund's risk profile and cause the fund to have difficulty meeting future shareholder redemptions.

Adopting Release at 82,150-51 (internal footnote omitted). Although included in the Adopting Release's introductory section and not the section specifically discussing the definition of liquidity risk, the substantive and linguistic parallels with the definition of liquidity risk demonstrate the relevance of this discussion to funds' understanding of "liquidity risk" and "significant dilution."

15 *See* Rule 22e-4(b)(1)(i)(A), (B) (17 C.F.R. §§ 270.22e-4(b)(1)(i)(A), (B)).

minimum,[16] the concept of "reasonably foreseeable stressed conditions" is relevant to such determination.

Regarding "reasonably foreseeable stressed conditions," the Commission noted in the Adopting Release that "funds should consider historical experience but should recognize that such experience may not necessarily be indicative of future outcomes," that "'stressed' conditions will likely entail different scenarios for different types of funds," and that "[a]ssessment of stressed conditions also should take into account stresses originating outside of market stress [such as] geopolitical stresses."[17]

In our experience, fund complexes generally have insightful approaches to considering stressed conditions. We understand that fund complexes have been and are working diligently to develop data sources and analyses specifically tailored to the liquidity risk and highly liquid investment minimum considerations mandated under Rule 22e-4, particularly in light of the Commission's guidance. We also understand that interpreting new and existing data on stressed conditions in the context of these requirements and considerations, particularly in light of the additional interpretive matters impacting such requirements as discussed in this letter, is taking substantial time and effort. Thus, we believe that delaying Rule 22e-4's compliance dates would allow fund complexes valuable additional time to further develop and tailor data and approaches for considering stressed conditions as they relate to Rule 22e-4's liquidity risk assessment and highly liquid investment minimum provisions.

E. Reasonably-Anticipated Trade Size

Rule 22e-4's liquidity classification provisions require funds to, among other things, "determine whether trading varying portions of a position in a particular portfolio investment or asset class, in sizes that the fund would reasonably anticipate trading, is reasonably expected to significantly affect its liquidity."[18] Fund complexes, in our experience, are continuing to work diligently to incorporate the required market depth considerations into their liquidity classification systems and to test various approaches. We understand that doing so, particularly for fund complexes with investments in a wide variety of asset classes and markets, is taking time. Moreover, we understand that harmonizing funds' views regarding reasonably-

16 *See* Rule 22e-4(b)(1)(iii)(A)(*1*) (17 C.F.R. § 270.22e-4(b)(1)(iii)(A)(*1*)). In the highly liquid investment minimum context, the relevant "reasonably foreseeable stressed conditions" are those "reasonably foreseeable during the period until the next review of the highly liquid investment minimum." *Id.*

17 Adopting Release at 82,163-64.

18 Rule 22e-4(b)(1)(ii)(B) (17 C.F.R. § 270.22e-4(b)(1)(ii)(B)).

anticipated trade size with vendor products' system settings, flexibility and features can prove challenging and time consuming. We believe that these considerations, particularly in light of the implications of liquidity classification systems for other parts of funds' liquidity risk management programs, as discussed above, also support delaying Rule 22e-4's compliance dates.

II. IMPLEMENTATION CONSIDERATIONS

Importantly, the development, testing and implementation of systems for compliance with Rule 22e-4 not only depend upon interpretations of and models for the fundamental terms and concepts discussed above, but also require significant investments of time and resources. Indeed, implementation requires coordination among numerous internal groups at fund complexes as well as external service providers, and demands systems and processes that are administratively workable. As the Commission explained:

> Funds will incur one-time costs to establish and implement a liquidity risk management program in compliance with rule 22e-4 . . . . These estimated one-time costs are attributable to the following activities, as applicable to each of the funds within the complex: (i) Developing policies and procedures relating to each of the required program elements, and the related recordkeeping requirements of the rule; (ii) planning, coding, testing, and installing any system modifications relating to each of the required program elements; (iii) integrating and implementing policies and procedures relating to each of the required program elements (including classifying the liquidity of each of the fund's portfolio investments pursuant to rule 22e-4(b)(1)(ii)), as well as the recordkeeping requirements of the rule; (iv) preparing training materials and administering training sessions for staff in affected areas; and (v) costs associated with educating the fund's board and obtaining approval of the program. These activities are likely to cut across many different functional groups within a fund or fund complex, including legal, compliance, risk, portfolio management, accounting, and technology staff.[19]

Each of the operational matters that the Commission identified interacts in an iterative way with the interpretive and implementation issues described above. For example, policies and procedures and the coding for information systems relating to liquidity classification depend on determinations of the meaning of the value impact standard and reasonably-anticipated trade size. The latter requires quantitative values for many (often hundreds or thousands of)

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19 Adopting Release at 82,237-38 (internal footnote omitted).

positions that are in turn informed by the implementation of procedures and systems. These operational complexities are often magnified by the need for these procedures and systems to build in the ability to consult in real time with the investment professionals who are frequently the best source of information about a position's liquidity.

In our experience, fund complexes have been and are working diligently on these and related implementation matters, both internally and with external service providers. However, given the complexity of the coordination and operational issues, many fund complexes simply need more time to prepare for compliance with Rule 22e-4.

In the sub-advised fund context, implementation can require even more time and effort where multiple organizations' inputs (and, in some cases, suggested outputs) are being coordinated. The Commission acknowledged this fact in the Adopting Release, for example when it stated that monitoring portfolio investments for compliance with the highly liquid investment minimum provisions "may result in operational costs, which could be greater for funds with multiple sub-advisers to the extent that these funds would need to build or otherwise implement systems to coordinate portfolio liquidity information provided by each sub-adviser."[20] We believe this principle is applicable not only in the highly liquid investment minimum context, but also with regard to compliance with the 15% limit on purchases of illiquid investments and, more generally, sub-advised funds' liquidity risk assessments and liquidity classification systems.[21]

In our view, the interpretive and implementation challenges described in this letter may be compounded when sub-advised funds consider ways to coordinate portfolio liquidity-related inputs (and, in some cases, suggested outputs) from sub-advisers consistent with the Commission's guidance. For example, differences in approaches to interpreting the value impact standard or "current market conditions" could result in greater expenditures of time and

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20 Adopting Release at 82,204.

21 Indeed, the Commission noted that "in certain circumstances, a fund's service providers might assist a fund and its investment adviser by providing information relevant to a fund's assessing and managing liquidity risk." Adopting Release at 82,213-14. And, as it discussed the requirement to classify investments individually (rather than by asset class) where the fund or its adviser has information about any market, trading or investment-specific considerations that are reasonably expected to significantly affect the liquidity characteristics of that investment (see Rule 22e-4(b)(1)(ii)(A) (17 C.F.R. § 270.22e-4(b)(1)(ii)(A)) and Adopting Release at 82,168), the Commission noted in a footnote accompanying this discussion that "[t]he term 'adviser' as used in this Release and rule 22e-4 generally refers to any person, including a sub-adviser, that is an 'investment adviser' of an investment company as that term is defined in" the 1940 Act. Adopting Release at 82,168 n.279.

resources in order to coordinate liquidity classification systems, which, as described above, would also impact many other Rule 22e-4 compliance efforts.

In light of these considerations, delaying Rule 22e-4's compliance dates would be beneficial as fund complexes continue working diligently on the numerous, complex and interconnected implementation matters presented by Rule 22e-4.

III. OUR EXPERIENCE IN ADVISING ON MATTERS RELATING TO RULE 22e-4

We continue to work with a number of fund complexes to develop their written liquidity risk management programs as required by Rule 22e-4 and to discuss related questions and issues as they arise. These fund groups represent a wide range of investment types and styles and include large and small fund complexes, ETFs and sub-advised funds. In many cases, the issues that have arisen in our work with these fund complexes reflect the interpretive and implementation challenges described in this letter.

Additionally, interpretive and implementation challenges, and related risk and liability considerations, have, in our experience, resulted in complicated vendor agreements and time-consuming negotiations. As entering into vendor relationships represents only one step in preparing for Rule 22e-4 compliance, and many preparations (including systems integration with vendors) cannot begin or be completed until vendor relationships are settled, this is another factor prolonging the process of preparing for compliance with Rule 22e-4.

Although many fund complexes are diligently working to develop appropriate data sources, review vendor products, address the interpretive questions arising under Rule 22e-4, assign various responsibilities to internal personnel and groups, coordinate with service providers (including sub-advisers) and communicate with fund boards, in our estimation a significant number of fund complexes are not close to completing their preparations for Rule 22e-4. For fund complexes with comparatively fewer personnel and resources, these matters are proving particularly challenging.

As the first compliance deadline is now just under eleven months away, although fund complexes' efforts continue in earnest, we believe that a delay in the compliance dates by at least one year would be beneficial to fund complexes, fund investors and, ultimately, the Commission's objectives in adopting Rule 22e-4.

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We appreciate the opportunity to offer this request. Please feel free to contact Stephen H. Bier at [redacted], Julien Bourgeois at [redacted], Brenden P. Carroll at [redacted], Allison M. Fumai at [redacted], Mark D. Perlow at [redacted], Jeffrey S. Puretz at [redacted] or Aaron D. Withrow at [redacted] with any questions about this submission.

Very truly yours,

Dechert LLP

Dechert LLP