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February 6, 2018

VIA E-MAIL RULE-COMMENTS@SEC.GOV

Ms. Dalia Blass
Director, Division of
Investment Management
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Liquidity Risk Management Rule 22e-4 (File No. S7-16-15).

We recommend that Rule 22e-4 be re-proposed to materially amend and simplify the current bucketing requirement.

Dear Ms. Blass:

This letter presents the comments of Federated Investors, Inc. and its subsidiaries ("Federated") with respect to final rule 22e-4 (the "Rule") issued by Securities and Exchange Commission (the "Commission") requiring significant new reporting obligations for non-2a7 mutual funds.[1] Federated appreciates the recent decision by the Commission to delay the implementation of the reporting obligations of the Rule pending a review of risks attendant to the reporting process.[2] During this review period, we strongly advise that the Commission also review new evidence that the public disclosure requirements of the Rule may have unanticipated damaging effects.

Among other things, the clear intent of the public disclosure requirement of the Rule is to alert investors to the potential liquidity risk inherent in fluctuating funds during periods of market stress. Over the past year, important new information has come to light raising a concern that, as currently worded and under certain circumstances, the bucketing regime required by Rule could inadvertently

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[1] Federated is one of the largest investment management firms in the United States (the "U.S."), managing $ 264.8 billion in mutual fund assets and $ 397.6 billion in total assets as of December 31, 2017, Federated provides comprehensive investment management to more than 8,400 institutions and intermediaries including corporations, government entities, insurance companies, foundations and endowments, banks and broker/dealers.

[2] https://www.sec.gov/news/press-release/2017-226

lead to potentially false and misleading information being reported to shareholders that may cause them to materially underestimate the liquidity risk in many funds. We therefore recommend that the rule be re-proposed to eliminate the onerous and defective bucketing framework in favor of simpler and more reliable liquidity metrics.

The reporting obligation of the Rule requires that the advisor of each fund assign each portfolio holding into one of four liquidity buckets. To summarize the process required, the advisor must: (i) project what reasonably foreseeable stressed market conditions might prevail; (ii) estimate what redemptions might foreseeably take place during such period; (iii) determine what portion of each portfolio holding would be sold to meet such redemptions; (iv) determine the horizon over which such holding could be converted to cash without imposing significant harm on remaining shareholders; (v) assign each portfolio holding to one of the four liquidity buckets depending upon the answer to (iv); (vi) monthly report these results to the Commission; and (vii), disclose the aggregate portfolio percentages in each liquidity bucket to shareholders on a quarterly basis.

The origin of the aforementioned concern regarding the current Rule lies in the fact that, in performing step (iv) in the above-referenced process, the advisor is directed to use ***current market conditions*** for the expected transaction costs associated with each position to be sold. In particular, the advisor is not required to base liquidity assessments on the transaction costs that might reasonably be expected to prevail during the stress market conditions that are otherwise presumed.[3] Unquestionably the bid-ask spreads in a potential future stress market environment would be highly uncertain, and therefore, in certain circumstances the use of current market conditions may be a well-intentioned simplification of the obligation on the advisor. Nonetheless, it has become apparent that this difference could potentially result in misleading understatements of the liquidity risks disclosed to shareholders.[4]

Recently developed data that illustrate this risk are provided below:

- The ICI's November 3rd 2017 letter to the comment file provides detailed analysis of liquidity bucketing for equity, high yield and municipal portfolios of varying sizes.[5] This data was compiled based on a several vendor assessments of these portfolios as of September, 2017. The data illustrate that, as of that time, all but the largest portfolios assessed had very high percentages in "Highly Liquid Assets". At the discretion of the vendors, a 1% transaction cost was sometimes used as be the threshold for defining "significant" impact on remaining shareholders. For high yield portfolios in particular, even the largest portfolios (over $10 billion in AUM) were sometimes estimated to have a high percentage of assets in the Highly Liquid category.

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[3] Rule at 82172 "As discussed further below, in a modification to the proposed standard, each of the liquidity categories included in the classification requirement we are adopting requires a fund to determine the time period in which an investment would be reasonably expected to be converted to cash (or in some cases, sold or disposed of) in current market conditions without the conversion to cash (or in some cases, sale or disposition) significantly changing the market value of the investment. This modification highlights that the 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."

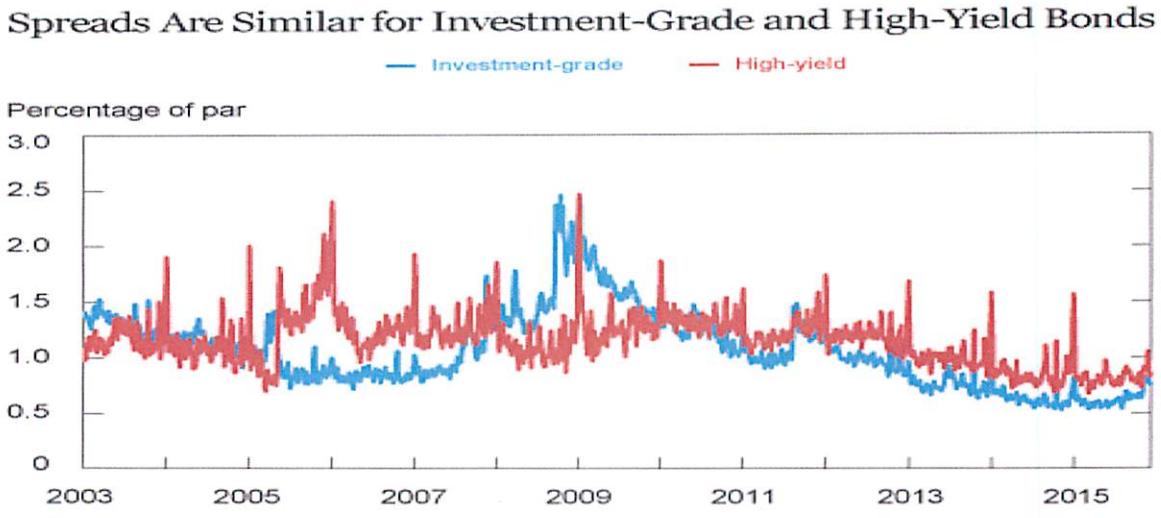
[4] Such potentially misleading disclosures could create new forms of liability for fund advisors and directors that might then be mitigated through measures not entirely intended or contemplated by the Rule.

[5] ICI November 3rd, 2017 comment letter: Supplemental Comments on Investment Company Liquidity Risk Management Programs; Request for Delay (File No. S7-16-15)

- Data from a particular vendor demonstrates in a March 2016 survey of 133 advisors, that over 25% of advisors expected to use 1% as the threshold for defining "significant" impact. A subsequent June 2017 survey demonstrated that 63% of advisors expected to use 1% or less.[6]

- Informal evidence from industry forums demonstrates that a majority of advisors intend to use current market conditions as the basis for judging the liquidity of portfolio holdings, consistent with the guidance provided in the Rule.

- To cite just one example of the potential adverse outcome resulting from the use of ***current market conditions*** in forming liquidity estimates, we now draw particular attention to high yield portfolios. It is our belief that a motivating factor for the Commission's rulemaking on liquidity risk was FSOC's particular concern regarding the redemption rights in open-end mutual funds, where "reaching for yield" in high yield portfolios was a specific concern.[7] The chart below illustrates the estimated fluctuation in corporate bond bid-ask spreads over time, as carefully compiled by economists at the New York Fed.[8] Notice that in recent years, the bid-ask spread of high yield bonds has been trending somewhat lower, but spikes well above 1% occur in a regular seasonal pattern and during times of market stress.



Source: Authors' calculations, based on Trade Reporting and Compliance Engine (TRACE) data from the Financial Industry Regulatory Authority (FINRA).

Notes: The chart plot the five-day moving averages of realized bid-ask spreads. The spreads are computed daily for each bond as the difference between the average (volume-weighted) dealer-to-client buy price and the average (volume-weighted) dealer-to-client sell price, and then averaged (on an equal-weighted basis) across bonds within each credit category. We use FINRA's classification of bonds as either investment-grade or high-yield.

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[6] https://www.theice.com/article/view-fund-liquidity-new-liquidity-rules. ICE Liquidity Indicators: Presentation by Robert Haddad, Head of Product Strategy and Innovation, September 2017.

[7] www.treasury.gov/initiatives/fsoc/rulemaking/Documents/Notice%20Seeking%20Comment%20on%20Asset%20Management%20Products%20and%20Activities.pdf

[8] http://libertystreeteconomics.newyorkfed.org/2016/02/corporate-bond-market-liquidity-redux-more-price-based-evidence.html.

The implications of these data are now clear. Many advisors, including high yield portfolio advisors, following the requirements of the Rule may be likely to: (i) use current market conditions to determine transactions costs in determining the liquidity classification of portfolio securities; and (2), use 1% as the transaction cost threshold for determining potential harm to remaining shareholders when selling securities to meet projected redemptions in a stress market scenario. In normal circumstances, this will often lead to very high percentages of portfolio assets reported and disclosed to shareholders as "Highly Liquid". However, if the redemptions are taking place in a period of stress market conditions, the chart above illustrates that expected transaction costs under similar circumstances potentially may exceed 1% and may potentially cause significant harm to remaining shareholders. Similar conclusions are expected through analysis of other less-liquid asset classes.[9]

In these circumstances, the possibility exists that investors that rely on disclosures pursuant to current rule 22e-4 could be misled and potentially significantly harmed when large redemptions occur during periods of market stress. Numerous commenters have observed that the current bucketing scheme provided in rule 22e-2 is onerous and may potentially result in false and misleading information being provided to shareholders. After careful evaluation, the recent U.S. Treasury report concurs in the determination that a principles-based regime is strongly preferred to the bucketing currently required in rule 22e-4.[10]

Federated believes that investors are likely to assume that the Rule is intended to protect them precisely during the stress market conditions for which the Rule was envisioned, that is, when liquidity is impaired. It is therefore both ironic and contrary to public interest for a possible effect of rule 22e-4 under certain circumstances to be that investors may be misled regarding liquidity risk in exactly the circumstances that the Rule was designed to protect them.

We strongly recommend that rule 22e-4 be re-proposed to eliminate the current bucketing and resulting portfolio-level liquidity disclosures that are now required. We instead propose that the Commission adopt a more principles-based regime as suggested in the Federated [11] and ICI [12] comment letters. In particular, we recommend that the bucketing regime be replaced by simpler methods that would enable advisors to provide portfolio level estimates of liquidity risks in both normal and stressed market conditions based on practical but realistic liquidity assessments.

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[9] In its own work, Federated has anticipated the potential for unintended consequences to shareholders from using current market conditions and, among other things including disclosure of the limitation of these estimates, does not intend to use a 1% threshold.

[10] U.S. Treasury Report at 34. "Treasury supports robust liquidity risk management programs and believes they are imperative to effective fund management and the health of the financial markets. For this reason, Treasury supports the 15% limitation on illiquid assets. However, Treasury rejects any highly prescriptive regulatory approach to liquidity risk management, such as the bucketing requirement. Instead, Treasury supports the SEC adopting a principles-based approach to liquidity risk management rulemaking and any associated bucketing requirements." https://www.treasury.gov/press-center/news/Pages/A-Financial-System-That-Creates-Economic-Opportunities---Asset-Management-and-Insurance.aspx

[11] Federated comment letter, January 13, 2016. https://www.sec.gov/comments/s7-16-15/s71615-50.pdf

[12] ICI comment letter, January 13, 2016. https://www.sec.gov/comments/s7-16-15/s71615-59.pdf

Federated hopes that the Commission finds these comments helpful and constructive and is happy to provide additional information relating to our comments or discuss any questions you may have.

Yours very truly,

Michael R. Granito
Chief Risk Officer

cc: The Honorable Jay Clayton
The Honorable Michael S. Piwowar
The Honorable Hester M. Peirce
The Honorable Kara M. Stein
The Honorable Robert J. Jackson Jr.
Mr. Brent J. Fields, Secretary