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May 17, 2018

Submitted via electronic filing: www.sec.gov/rules/proposed.shtml

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Investment Company Liquidity Disclosure Proposed Rule, Release Number IC-33046, File Number S7-04-18

Dear Mr. Fields:

This letter responds to the request of the Securities and Exchange Commission ("Commission" or "SEC") for comment on Investment Company Liquidity Disclosure.[1] As we highlighted in our January 2016 letter regarding Rule 22e-4,[2] BlackRock, Inc. (together with its affiliates, "BlackRock") is supportive of the Commission's focus on liquidity risk management ("LRM"). **This letter focuses primarily on the disclosure-related requirements in the Proposal.** We are proponents of Rule 22e-4 and believe this new rule will effectively "raise the bar" on LRM across the US mutual fund industry, subject to adoption of the Proposed Rule Change around LRM disclosure. BlackRock supports transparency where such transparency yields information that helps investors understand their investment products and associated risks, as such information can facilitate informed investment decisions. ***However, data is not the same as information.***

We strongly support the Proposal and believe that the revised approach to disclosure of LRM information is far superior to the current approach. By replacing hard-to-understand, isolated data points with a narrative discussion of the operation and effectiveness of the fund's LRM program, the effect will be to increase the consumable information available to investors. We believe the Proposal finds an appropriate balance given the potential negative unintended consequences that could result from public dissemination of liquidity classification data, as discussed further in this letter.

While we recognize that the Proposed Rule Change includes other elements besides disclosure, this letter focuses on the disclosure elements of the Proposal.

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1 SEC, Investment Company Liquidity Disclosure Proposed Rule, 83 Fed. Reg. 53 (Mar. 19, 2018), available at https://www.gpo.gov/fdsys/pkg/FR-2018-03-19/pdf/2018-05511.pdf ("Proposed Rule Change" or the "Proposal").

2 BlackRock, Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release, File Number S7-16-15; S7-08-15 (Jan. 13, 2016), available at https://www.blackrock.com/corporate/literature/publication/sec-liquidity-risk-management-proposal-011316.pdf ("Jan. 2016 Comment Letter").

I. <u>Executive Summary</u>

Key points from our comments are as follows:

- ***The addition of the narrative disclosure will increase information about fund LRM available to investors.***

- ***Disclosures to investors should be straightforward and based on factual information. Liquidity classification data does not meet this standard.***

- ***Liquidity classifications are ex ante forecasts that are sensitive to manager assumptions and entail significant uncertainty and data limitations.***

- ***Liquidity classifications could be misunderstood as reflective of fund liquidity risk during current or even stressed markets, rather than as a forecast of the potential liquidity of a portion of fund holdings based on a hypothetical scenario.***

- ***Liquidity classifications are isolated data points that require significant prior knowledge of Rule 22e-4 and liquidity modeling to understand their limitations.***

- ***Publication of liquidity classification data embeds perverse incentives and could undermine the usability of the data for the Commission.***

- ***Even were fund investors not to rely heavily on liquidity classification data to make investment decisions, the public availability of the data could undermine a key regulatory supervision objective of Rule 22e-4.***

- ***The Commission acknowledged in the Rule 22e-4 Adopting Release that publication of liquidity classifications for individual securities is "neither necessary nor appropriate".[3] The same logic applies to an aggregation of individual security classifications.***

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3 SEC, Investment Company Liquidity Risk Management Programs, 81 Fed. Reg. 223 (Nov. 18, 2016), available at https://www.gpo.gov/fdsys/pkg/FR-2016-11-18/pdf/2016-25348.pdf ("Rule 22e-4") at 82196.

II. <u>Concerns Regarding Public Disclosure of Liquidity Classifications</u>

Disclosures to investors should be straightforward and based on factual information. Liquidity classification data does not meet this standard. We believe strongly that information about a fund's LRM practices and the liquidity risks associated with its investment strategy should be disclosed to investors. However, this information must be disclosed in a straightforward manner, using factual information. <u>Disclosure that is based on projections, forecasts, or subjective judgements on the part of the fund manager can be problematic for many reasons</u>. For example, it would be concerning if fund managers were allowed to project the future expected performance of their funds and use such information in marketing materials about a fund. The same standard should hold true for other types of disclosure that might be used by investors in connection with investment decisions.

Liquidity classifications are ex ante forecasts that are sensitive to manager assumptions and entail significant uncertainty and data limitations. The number of days the fund manager believes it will take to liquidate fund holdings and receive cash represent forecasts on the part of the fund manager, since time to liquidation of existing fund holdings cannot be known in advance. This concern is particularly acute in over-the-counter ("OTC") markets, where significant data limitations persist.[4] As such, predicting the time it will take to liquidate a position for cash within a given price range in the future is a highly subjective exercise for many types of assets. While ex-ante measures are appropriate when used as tools to evaluate aspects of portfolio risk, and could, therefore, be useful for the Commission, they can have unintended consequences when used as regulatory mandated disclosures to investors. As a result, there can be no guarantee that any liquidity classification will hold true in any circumstance in the future, making such predictions, at this time, unreliable and possibly misleading. As such, we believe this data is inappropriate for disclosure to retail investors.

Liquidity classifications could be misunderstood as reflective of fund liquidity risk during current or even stressed markets, rather than as a forecast of the potential liquidity of a portion of fund holdings based on a hypothetical scenario. Rule 22e-4 requires funds to classify the liquidity of assets based on the time it is "reasonably expected" to take to liquidate each fund holding "in sizes that the fund would reasonably anticipate trading" "without significantly changing the market value of the investment" in "current market conditions."[5] This is a very specific scenario that requires knowledge of Rule 22e-4 to understand. Further, liquidity is not static and the liquidity of fund investments changes dynamically as market conditions and the circumstances of the fund evolve. The focus on current markets is, therefore, especially confusing since the data will be disclosed to the public with a 60 day lag, meaning that <u>the data may no longer reflect current market conditions by the time it is reviewed by the investor</u>. We believe it is unlikely that investors would fully understand the specific scenario under which liquidity classification data is derived.

Liquidity classifications are isolated data points that require significant prior knowledge of Rule 22e-4 and liquidity modeling to understand their limitations. BlackRock has a team of data scientists who produce liquidity analytics that can be used for LRM purposes

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[4] Jan. 2016 Comment Letter. However, we note progress made by FINRA in relation to data gaps in US fixed income markets. *See* SEC, Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving Proposed Rule Change To Make Available A New TRACE Security Activity Report, 82 Fed. Reg. 153 (August 10, 2017), available at https://www.gpo.gov/fdsys/pkg/FR-2017-08-10/pdf/2017-16831.pdf.

[5] Rule 22e-4 at 82,172, 82181 and 82265.

and Rule 22e-4 liquidity classifications. While we believe these techniques represent some of the most sophisticated liquidity analytics employed today, these models have their limitations. Users of the analytics must be properly informed as to the simplifying assumptions and simulated nature of the results. While this understanding can be achieved through collaboration and ongoing dialogue between our data scientists and risk managers, we do not believe this information will be properly captured through the disclosure of isolated liquidity classifications on Form N-PORT. In other words, data that requires a team of PhDs to produce and a 1940 Act lawyer to interpret will likely not translate to usable information for the vast majority of the investing public, and may, in fact, lead to incorrect inferences.

Publication of liquidity classification data embeds perverse incentives and could undermine the usability of the data for the Commission. The combination of public disclosure of the data and a high degree of discretion given to fund managers to select the assumptions and underlying methodology used to derive the data embeds perverse incentives, as disclosures to investors can have marketing implications for a fund if used by investors as a means of comparing funds. We recognize that there is no way to prove the extent to which investors will rely on this data given that this is a new requirement. However, we believe it is logical to assume that this information could be referenced by investors considering investment in asset classes that are generally understood to entail greater liquidity risk, as this is where liquidity risk might be of greatest concern to the investor. It is in these asset classes, where the perverse incentive to engineer assumptions to make funds appear more liquid would be the greatest, and at the same time the most concerning given the greater inherent liquidity risk in these products. While the presence of independent risk management functions and compliance oversight can mitigate this potential conflict, it would be preferable for the Commission to avoid creating this conflict altogether.

Even were fund investors not to rely heavily on liquidity classification data to make investment decisions, the public availability of the data could undermine a key regulatory supervision objective of Rule 22e-4. If liquidity classifications are made public, fund managers are likely to review the liquidity classifications of competitors to determine how their funds compare. Reviewing the liquidity classifications of other fund managers could, given the bands of uncertainty around the “true” estimates of days to liquidate, encourage greater uniformity among managers over time, as funds will want to avoid being seen as outliers. This convergence could undermine the Commission’s ability to spot outliers from the data. As such, if the Commission’s objective is to understand how fund managers are thinking about the liquidity of their funds and to identify outliers, it would be best for the Commission to receive the data on a confidential basis.

The Commission acknowledged in the Rule 22e-4 Adopting Release that publication of liquidity classifications for individual securities is “neither necessary nor appropriate”.[6] The same logic applies to an aggregation of individual security classifications. The Commission itself acknowledged the shortcomings and potential for misunderstandings of liquidity classifications by investors in the initial Adopting Release for Rule 22e-4 when it stated in the Adopting Release that: *“For these reasons, we find that it is neither necessary nor appropriate in the public interest or for the protection of investors to make liquidity classification information for each portfolio investment publicly available.”*[7] If the Commission believes that individual security liquidity classifications are problematic when

[6] Rule 22e-4 at 82196.

[7] Rule 22e-4 at 82196.

disclosed publicly, the summation of those liquidity classifications are equally inappropriate for public disclosure.

For all these reasons, we do not believe liquidity classification data forms the basis for appropriate or meaningful disclosure to investors. To the contrary, the disclosure of this data could be harmful were investors to misinterpret it and use it to inform their understanding of the liquidity risks associated with a given fund.

III. Narrative Disclosure Proposal

We agree with the Commission that "it is important for investors to understand the liquidity risks of the funds they hold and how those risks are managed."[8] It is for this reason, that we support the Proposal that funds provide a narrative discussion of the operation and effectiveness of LRM programs for the most recent fiscal year in Form N1-A. A narrative disclosure, rather than isolated data points, would provide the necessary context that would allow investors to understand the LRM practices of the funds in which they invest and whether there have been any material changes to market liquidity of the underlying asset classes in which the fund investors and/or any liquidity challenges experienced by the fund over the course of the year.

The addition of the narrative disclosure will increase information about fund LRM available to investors. We agree that as part of this disclosure funds "might opt to discuss the particular liquidity risks that it faced over the past year, such as significant redemptions, changes in the overall market liquidity of the investments the fund holds, or other liquidity risks, and explain how those risks were managed and addressed."[9] We believe that this narrative discussion would provide useful information to investors as to how a fund addresses liquidity risk and whether any material issues related to liquidity arose over the course of the year and how the fund manager addressed those issues.

We further agree that this disclosure would "complement existing liquidity risk disclosure that funds provide in their prospectus (if it is a principal investment risk of the fund)."[10] While we appreciate the concern that has been raised that elimination of the public disclosure of liquidity classification data could reduce information about liquidity risk available to investors, we believe that the inclusion of this new disclosure as a replacement for liquidity classification will actually *increase* the availability of information about a fund's LRM practices and specific liquidity risks that it has faced in the recent past. This is because this Proposal will replace isolated data points about fund liquidity that are difficult to interpret, with a consumable discussion about fund LRM. In addition, such an approach preserves the utility of the liquidity classification data for the Commission's purposes, while avoiding potential unintended consequences that could come about from the public disclosure of the data.

We encourage the Commission to review the disclosures included in Form N1-A regarding liquidity risk, and after a period of time, provide staff guidance regarding the expectations as to the contents of that disclosure, if necessary. As to the question of whether the Commission should mandate specific components of this disclosure, we agree with

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8 Proposed Rule Change at 11909.

9 Proposed Rule Change at 11910.

10 Proposed Rule Change at 11909.

the Commission's view that not prescribing specific components of the disclosure at this time would "allow funds to provide context and an accessible and useful explanation of the fund's liquidity risk in relation to its management practices and other investment risks as appropriate."[11] That said, to the extent the Commission was concerned about the informational value it observed in fund liquidity disclosures, the staff of the Division of Investment Management could issue guidance indicating more specifically, any elements that should be addressed in such disclosures at a later point in time. This would permit the Proposed Rule Change to evolve over time as the Commission and fund managers gain more familiarity with the liquidity classification data and the liquidity risk disclosures on Form N1-A.

We suggest inclusion of the LRM disclosure on a different portion of Form N1-A, rather than the management's discussion of fund performance ("MDFP"). While ultimately, a lack of proper LRM practices could impact fund performance, LRM does not regularly affect fund performance, and arguably, the importance of LRM goes well beyond a fund's performance. Inclusion of the discussion of LRM in the MDFP could encourage investors to focus on LRM solely as a driver of investment performance, rather than as a necessary component of prudent fund management. This overemphasis on LRM as a component of performance could especially be confusing for investors in funds where liquidity risk is not a material risk to the fund. We believe that it would be more appropriate for the discussion of the LRM program to be placed in a separate portion of Form N1-A.

IV. Conclusion

We commend the Commission for seeking to address concerns regarding the publication of liquidity classification data and for finding a suitable alternative that addresses the potential issues with the disclosure of liquidity classification, while actually increasing the amount of usable information provided to investors about the functioning of fund LRM programs.

We encourage the Commission to finalize the Proposed Rule Change prior to the June 2019 effective date of the liquidity classification-related reporting requirements. We thank the Commission for providing BlackRock the opportunity to express our support for your efforts and to provide our comments and suggestions on the Proposal. Please contact the undersigned if you have any questions or comments regarding BlackRock's views.

Sincerely,

Kristen Walters
Global Chief Operating Officer, Risk & Quantitative Analysis

Aaron Wasserman
Deputy Chief Compliance Officer, BlackRock Funds

Alexis Rosenblum
Director, Global Public Policy Group

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[11] Proposed Rule Change at 11910.

cc:

The Honorable Jay Clayton
Chairman
Securities and Exchange Commission

The Honorable Robert J. Jackson, Jr.
Commissioner
Securities and Exchange Commission

The Honorable Hester M. Peirce
Commissioner
Securities and Exchange Commission

The Honorable Michael Piwowar
Commissioner
Securities and Exchange Commission

The Honorable Kara M. Stein
Commissioner
Securities and Exchange Commission

Dalia Blass
Director
Division of Investment Management
Securities and Exchange Commission

I. <u>Responses to Individual Questions</u>

1. Should we eliminate this public disclosure of funds' aggregate liquidity profiles? Why or why not?

Yes. We support eliminating public disclosure of funds' aggregate liquidity profiles and replacing it with a narrative discussion in the fund's annual report of the operation and effectiveness of a fund's LRM program.

2. To what extent would investors have relied on a fund's aggregate liquidity profile in making investment decisions? Is it likely that this disclosure would have been informative rather than confusing to investors in making these decisions?

Please refer to our comments on the previous pages for a discussion of why liquidity classification is likely to be confusing for investors, rather than informative.

Given that data of this kind has not previously been disclosed to investors, it is difficult to know the extent to which this data would be relied upon by investors. We do believe, however, that it is likely that this information would be used by investors considering investments in asset classes that are generally understood to entail greater liquidity risk. It would be in these asset classes, where the perverse incentive to engineer assumptions to make funds appear more liquid would be the greatest, and at the same time the most concerning given the greater inherent liquidity risk in these products.

As such, while we are unable to anticipate the rate at which investors would use this data, the fact that it could be used by investors to compare funds and make investment decisions should be concerning to the Commission. We believe a similar analogy can be drawn to why the Commission would be concerned if fund managers were projecting future performance and using it in marketing materials. While it is possible investors would ignore this information, that fact that it could influence an investment decision and potentially lead to incorrect inferences about a fund by investors, this type of disclosure to investors is not permitted. We believe the same reasons would apply for disclosure of liquidity classifications.

3. If, as proposed, we were to eliminate the requirement that funds publicly disclose their aggregate liquidity profile, would investors have sufficient information about a fund's liquidity risk to make an informed investment decision?

Yes. We do not believe the liquidity classification data will provide meaningful information to investors about a fund's liquidity risk, and therefore investors would be no worse off were this requirement to be eliminated. Further, we believe that the addition of the narrative description of the operation and effectiveness of a fund's LRM program in the annual report would enhance investors' understanding of how funds manage liquidity risk.

4. **Should we retain the public disclosure of a fund's aggregate liquidity profile and otherwise seek to address the concerns discussed above? For example, would making the disclosure more frequent (i.e., monthly), reducing the lag on public disclosure, providing funds the opportunity to publicly provide additional context and explanation on the Form or elsewhere, or other changes address the concerns discussed above? Should we permit funds to choose to make any explanatory notes related to liquidity disclosures in Part E of Form N-PORT publicly available?**

   No. We do not believe these approaches would be helpful.

5. **Instead of eliminating the public disclosure of a fund's aggregate liquidity profile as proposed, should we instead make the profile non-public for some additional period of time (e.g., 2 to 3 years) to allow us to evaluate the quality of the information provided and its potential impact on investors?**

We believe there is merit in the Commission evaluating the data before it determines whether or not it should be made public. However, we believe it is highly likely that upon review of the data, the Commission finds the data unsuitable for public disclosure given the concerns we raised throughout this letter about the publication of liquidity classification data.

6. **Should we make current Item B.8.b of Form N-PORT (highly liquid investments segregated to cover less liquid derivatives) non-public as proposed? If it was retained as public, would investors understand it without accompanying classification information? Alternatively, should we rescind the requirement entirely?**

Yes. In light of the proposed changes to the liquidity classification disclosure, we believe Item B.8.b should also be kept confidential but reported to the SEC.

7. **Should we require a fund to provide a discussion of the operation and effectiveness of its liquidity risk management program, as we are proposing? Why or why not? Should we instead require disclosure about the extent to which and the manner in which the fund took liquidity risk and managed liquidity risk during the period in question and how those risks and management affected performance?**

We believe that the proposed discussion of the operation and effectiveness of the fund's LRM program is an appropriate disclosure that would provide meaningful information to investors. We believe it should be located in a separate section of Form N1-A rather than included as part of the MDFP.

8. **As part of this proposed disclosure, should we require a fund to discuss specific elements of the fund's liquidity risk program such as the 15% illiquid investment limit, HLIM, classification process or specific liquidity risk observations? Why or why not?**

No. At this time, we believe it is sufficient for the Commission to avoid prescribing specific elements of the disclosure to permit funds sufficient flexibility to provide information that is tailored to the particular fund and investment strategy. However, as the Commission observes the disclosures over time, it could produce staff guidance detailing more specific expectations as to the elements funds should consider including in their disclosure, if it deemed this necessary.

9. Should we require a fund to include a discussion of any relevant changes made to its liquidity risk management over the course of the reporting period?

No. It would be difficult to define what is meant by “relevant changes” to LRM, as prudent fund managers are always working to enhance their processes. As mentioned, if greater specificity as to the contents of the liquidity disclosure proved necessary at a later point in time, the Division of Investment Management staff could issue guidance in this regard. In addition, fund boards will receive a written report at least annually by the person(s) designated to administer the program, which will reflect any material changes to the program, if applicable.

10. Should we require this liquidity risk disclosure to be included in the annual report? Should it instead be included in another disclosure document such as the fund’s statutory prospectus, summary prospectus, or statement of additional information? If so, under what item should it be included?

We believe that the annual report is an appropriate place for this disclosure given that the disclosure would discuss the operation and effectiveness of the LRM program during the prior year.

11. Are there alternative approaches to providing relevant liquidity information to investors? If so, what are they, and why should we use them?

We believe the proposed approach is appropriate. We do not have further comments.

12. Are there advantages to the approach that Treasury recommends? If so, what additional steps, if any, should we consider to shift toward a principles-based approach? To what extent have funds already implemented the existing liquidity classification requirement?

While we appreciate the Treasury’s recommendation encouraging a principles-based approach, it should be recognized that compliance with Rule 22e-4 is well underway at this point in time given that roughly 18 months have passed since Rule 22e-4 was finalized. Any material changes to the requirements of fund managers under Rule 22e-4 at this point in time would have a cost of its own that would need to be factored in. We believe the proposed refinements to the disclosure associated with Rule 22e-4 would be sufficient to address the material concerns raised by the industry, which were reflected in the Treasury report recommendation, without materially altering the rule at this late stage (a development that would be counterproductive at this point in time).