Marc R. Bryant
Chief Legal Officer
Fidelity Management & Research Company
245 Summer Street V13E, Boston, MA 02210
617.563.2076 MARC.BRYANT@FMR.COM

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Submitted electronically through http://www.regulations.gov

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

Re: **Investment Company Liquidity Disclosure Release**
File Number S7-04-18

Dear Mr. Fields,

Fidelity Investments ("Fidelity")[1] appreciates the opportunity to provide comments to the Securities and Exchange Commission ("SEC" or "Commission") on its proposed amendments to improve the reporting and disclosure of liquidity information by registered open-end investment companies and on the Commission's request for feedback regarding its approach to liquidity risk management.[2]

We strongly support the SEC's proposal to replace public disclosure of aggregate liquidity classification information with a narrative disclosure of a fund's liquidity risk management program in its annual report. We agree that disclosure should be relatively simple, avoiding complexities and ambiguity that could cause confusion or be misleading. We support the SEC's goal to provide information to shareholders so they can better understand liquidity risk and we believe the SEC's proposed narrative disclosure squarely accomplishes this objective.

We also appreciate the SEC Staff's extensive outreach during the implementation of the Liquidity Rule.[3] Indeed, we believe that further opportunities exist to harmonize the SEC's goal

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[1] Fidelity and its affiliates are leading providers of mutual fund management and distribution, securities brokerage, and retirement recordkeeping services, among other businesses.
[2] Throughout this letter, our comments relating to mutual funds exclude money market mutual funds.
[3] On October 13, 2016, the Commission adopted rule 22e-4 under the Investment Company Act of 1940 ("Rule 22e-4") and related disclosure rule and form amendments to enhance the regulatory framework for liquidity risk management of registered open-end investment companies (collectively, the "Liquidity Rule"). Specifically, the Commission adopted rules 22e-4 and 30b1-10, new Form N-LIQUID, as well as amendments to Forms N-1A, N-PORT, and N-CEN. *See* Investment Company Liquidity Risk Management Programs, Investment Company Act Release No. 32315 (Oct. 13, 2016) [81 FR 82142 (Nov. 18, 2016)]; Investment Company Reporting Modernization, Investment Company Act Release No. 32314 (Oct. 13, 2016) [81 FR 81870 (Nov. 18, 2016)] ("Reporting Modernization Adopting Release"). We previously provided comments on the proposals relating to the Liquidity Rule in our letter to the Commission dated January 13, 2016. *See* Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release, Release Nos. 33-9922, IC-31835 (Sept. 22, 2015) [80 Fed. Reg. 62275 (Oct. 15, 2015)]; Letter from Marc Bryant, Senior Vice President and Chief Legal Officer, Fidelity Management & Research Company, to the U.S.

of effective liquidity risk management with the manner that fund managers actually manage liquidity. We suggest modifications below to certain prescriptive elements of the Liquidity Rule based on our implementation efforts, and encourage the Commission to consider further rulemaking or guidance to address previously unanticipated issues.

I. INTRODUCTION AND EXECUTIVE SUMMARY

On March 14, 2018, the SEC proposed amendments to the Liquidity Rule that would: (i) replace current Form N-PORT public reporting of a fund's aggregate liquidity classifications with a narrative discussion of the operation and effectiveness of the fund's liquidity risk management program in the fund's annual report, (ii) allow reporting on Form N-PORT of split liquidity classifications for a single position under certain circumstances, (iii) allow the SEC to periodically publish reports on aggregated and anonymized liquidity data for funds, (iv) direct an SEC report by June 2020 on whether public disclosure of fund-specific liquidity classification information should be required, and (v) require new reporting of cash and cash equivalents on Form N-PORT (the "Proposal").[4] The Proposal also requested industry comment on whether the SEC should shift towards a principles-based approach to liquidity risk management recommended by the Department of Treasury in its Asset Management and Insurance Report.[5]

Our comments on the Proposal include the following points:

- We strongly support the SEC's proposal to rescind public disclosure of aggregate liquidity classifications on Form N-PORT and replace it with a brief narrative description of a fund's liquidity risk management program in the annual report. However, we suggest that the SEC extend the compliance date for including the narrative disclosure in the annual report until January 1, 2020 so that funds can base their disclosure on a full year of operations under their liquidity risk management programs.

- We support reporting of "cash and cash equivalents" on Form N-PORT but believe Form N-PORT should allow for explanatory disclosure to make the disclosure of cash and cash equivalents more meaningful to the SEC and shareholders.

- We support the SEC's proposals permitting split classifications as they will allow funds to more precisely classify the liquidity of investments.

- We agree with the recommendations in the Treasury Report that the SEC should

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Securities and Exchange Commission (Jan. 13, 2016), *available at* https://www.sec.gov/comments/s7-16-15/s71615-45.pdf (the "Fidelity Comment Letter").

[4] Investment Company Liquidity Disclosure; Investment Company Act Release No. IC-33046 (Mar. 14, 2018) [83 Fed. Reg. 11905 (Mar. 19, 2018)] (the "Release"). *See also* Reporting Modernization Adopting Release.

[5] Release at 11911-11912. *See* A Financial System That Creates Economic Opportunities; Asset Management and Insurance, U.S. Department of the Treasury, Oct. 2017 available at https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-That-Creates-Economic-Opportunities-Asset_Management-Insurance.pdf (the "Treasury Report").

adopt a principles-based approach to liquidity risk management and, in that regard, suggest that the SEC simplify liquidity classification and eliminate the highly liquid investment minimum requirement.

II. OPEN-END FUND LIQUIDITY DISCLOSURE

Removal of Public Disclosure of Aggregate Liquidity Classifications and New Narrative Disclosure in Fund Annual Reports

Currently, Form N-PORT requires a fund to publicly disclose on a quarterly basis (with a 60-day lag) the aggregate percentage of its portfolio investments in each of the four liquidity classification categories required under Rule 22e-4. The Proposal would rescind this public disclosure requirement and replace it with a new requirement for a fund to describe briefly in its annual report the operation and effectiveness of its liquidity risk management program during the reporting period.

We strongly support rescinding public reporting of liquidity classifications on Form N-PORT. Public disclosure of aggregate liquidity classification information, without sufficient context, would not meaningfully or accurately portray a fund's liquidity risk to investors and could lead to imprudent investor behavior.[6] The SEC acknowledged these concerns in the Release noting that the risks of subjectivity, lack of context, liquidity risk in isolation, and coordinated investment behavior justified the SEC's proposal to rescind public disclosure of liquidity classifications on Form N-PORT.[7] We also agree with the SEC that it would not be appropriate to modify Form N-PORT to provide additional detail regarding liquidity classifications as such modifications are unlikely to provide sufficient information for investors to understand a fund's liquidity risk profile and may lead to additional confusion.[8]

For these reasons, we do not support public disclosure being revisited, as contemplated by the proposed June 2020 report from the Divisions of Investment Management and Economic and Risk Analysis to the Commission which will contain recommendation addressing whether, and if so how, there should be public dissemination of fund-specific liquidity classification information.[9] The risks that currently justify rescinding public disclosure on Form N-PORT will exist in June 2020 and beyond. To the extent the Commission believes re-consideration of public disclosure is warranted, we recommend that it be conducted through a formal rulemaking process subject to industry review and comment.

We believe that the proposed narrative disclosure will provide investors with more meaningful information about a fund's liquidity risk than the current public classification

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[6] *See also* Fidelity Comment Letter at 10.
[7] *See* Release at 11908-11909.
[8] We also support rescinding the current requirement for a fund to publicly disclose on Form N-PORT the percentage of a fund's highly liquid investments segregated to cover or pledged to satisfy margin requirements in connection with certain derivatives transactions. We agree with the SEC that this information would only be meaningful when viewed together with full liquidity classification information.
[9] *See* Release at 11911.

disclosure on Form N-PORT. We agree with the Commission's non-prescriptive approach to this disclosure as we believe that mandating specific disclosures, including but not limited to a fund's liquidity classifications or highly liquid investment minimum, could cause confusion by providing data without sufficient context for a shareholder to understand a fund's liquidity risk.[10] We also agree that including the disclosure in the fund's annual report, as part of its management discussion of fund performance, is appropriate because this discussion provides information on events impacting fund operations during the period.

Compliance Date for Narrative Disclosure in Annual Report

While we agree with the SEC's proposal to require annual report disclosure, we suggest that the SEC delay the compliance date for including such disclosure until January 1, 2020. Under our proposed extension, funds would not begin including annual report disclosure until the reports coinciding with fiscal years ending December 31, 2019. We believe that this change will facilitate better disclosure to shareholders because it would be based on a full year under each fund's new liquidity risk management program.

Reporting of Cash and Cash Equivalents

The Proposal would require a fund to report "cash and cash equivalents" on Form N-PORT that are not already included in Parts C and D of Form N-PORT as portfolio investments or miscellaneous securities.[11] We do not oppose these additional disclosures but recommend that Form N-PORT allow for explanatory disclosure to accompany the disclosure of cash and cash equivalents.

Our concern is that disclosure of cash and cash equivalents as a separate line item on Form N-PORT could mislead shareholders by suggesting that a fund holds fewer highly liquid investments than is actually the case. Under the Proposal, the new "cash and cash equivalents" item would consist largely of uninvested cash and other highly liquid investments "readily convertible into cash" that a fund does not already classify as portfolio investments or miscellaneous securities under Parts C and D of Form N-PORT. In our experience, many funds do not hold large uninvested cash positions as any cash is invested or swept into short term investment vehicles or other instruments to maximize shareholder returns. Although many of these short term investments and cash sweep vehicles would be considered "cash and cash equivalents" and highly liquid investments under Rule 22e-4, they would not be included under the newly proposed cash and cash equivalents line item under Part B of Form N-PORT. Instead, they would be classified as investments under the Schedule of Portfolio Investments in Section C

[10] *See* Release at 11910 and fn. 38. We agree with the SEC that disclosure should be "brief", without any requirement to include specific details regarding liquidity classifications or the highly liquid investment minimum. Keeping this disclosure concise will help to prevent liquidity risk from outsized significance, which was the SEC's motivation for the new narrative disclosure.

[11] Release at 11913. As proposed, we understand that cash and cash equivalents would be disclosed publicly the third month of each quarter consistent with the public reporting of other items included on Form N-PORT, such as portfolio investments. As an alternative to our suggestion for explanatory disclosure to accompany the disclosure of cash and cash equivalents, we would recommend that this information not be made public.

of Form N-PORT (or less frequently, as miscellaneous securities under Part D of Form N-PORT).[12]

Even where a fund has sufficient highly liquid investments to satisfy investor redemptions, the fund's "cash and cash equivalents" reported under Part B of Form N-PORT may be low or even zero temporarily. This disclosure could be misinterpreted to suggest that a fund does not hold sufficient highly liquid investments, when the opposite may be true.[13] To avoid potential confusion, we recommend that Form N-PORT allow for explanatory disclosure regarding a fund's holdings of cash and cash equivalents. As an additional step, the SEC could consider modifying the title of the disclosure requirement on Form N-PORT, for example, to "cash and other short-term net assets not otherwise included as portfolio investments or miscellaneous securities," which would more accurately reflect Form N-PORT disclosure requirements.

Split Classifications

We support the SEC's proposed amendments to Form N-PORT that would allow, but not require, a fund to split certain of its holdings into more than one liquidity classification category in the three specified circumstances described by the SEC. We appreciate the added flexibility, which will allow funds to classify their investments in a manner more consistent with their liquidity management program.

III. RECONSIDERATION OF CURRENT LIQUIDITY CLASSIFICATIONS AND THE HIGHLY LIQUID INVESTMENT MINIMUM

Rule 22e-4 currently requires a registered open-end fund to classify its portfolio investments into four liquidity "buckets" – "highly liquid", "moderately liquid", "less liquid", and "illiquid" – and determine a minimum percentage of highly liquid investments that the fund will hold. While we strongly support a requirement for funds to adopt a liquidity risk management program, we continue to believe that these requirements can be simplified by placing greater emphasis on how fund managers actually manage liquidity, while still providing relevant information to the SEC. In this regard, we agree with the principles-based approach to liquidity risk management recently recommended by the Department of Treasury.[14] In its Report, the Department of Treasury rejected "any highly prescriptive regulatory approach to liquidity risk management, such as the bucketing requirement", instead recommending that the SEC adopt "a principles-based approach to liquidity risk management rulemaking and any associated bucketing requirements."[15]

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[12] In the Release the SEC specifically stated that any cash and cash equivalents disclosed under Parts C and D of Form N-PORT should not be double counted as "cash and cash equivalents" under the newly proposed line item under Part B. *See* Release at 11913.

[13] We note further that the cash and cash equivalents amounts proposed to be reported on Form N-PORT could differ from amounts reported on a fund's financial statements.

[14] *See* Treasury Report at 34.

[15] *See id.*

We agree that a principles-based approach to liquidity risk management could be more effective because fund managers use a variety of approaches to manage fund liquidity. The asset management industry has a strong track record of meeting shareholder redemptions through various market conditions.[16] Indeed, responsible fund managers focus on the liquidity needs of their funds as an integral part of portfolio construction, a practice they undertook prior to the adoption of the Liquidity Rule. Simplifying the current four bucket approach and eliminating the highly liquid investment minimum would conform to Treasury's recommendations for a more principles-based approach to liquidity risk management and provide a more useful framework for liquidity management.[17]

Liquidity Classifications

Consistent with Treasury's recommendations for a less prescriptive approach to liquidity risk management, we propose that the SEC eliminate the "moderately liquid" and "less liquid" investments categories and instead adopt three classification categories consisting of "highly liquid", "liquid", and "illiquid" investments. Under this proposal the "highly liquid" and "illiquid" investments categories would conform to the current definitions in Rule 22e-4, and "liquid investments" would consist of any asset or investment that is not classified as either highly liquid or illiquid investments.[18]

We originally proposed three liquidity classification categories in the Fidelity Comment Letter, and continue to believe, based on our implementation of the Liquidity Rule, that a three category approach provides a simple, workable, and effective framework for liquidity management. We do not believe that a four-bucket approach is the *most* effective method for funds to manage liquidity risk.[19] Though funds have had effective liquidity risk programs for

[16] Fidelity Comment Letter at 3-4. The SEC's issuance in December 2015 of a temporary order to allow a mutual fund to suspend redemptions was a rare event. *See* SEC Release No. IC-31943 (Third Avenue Trust and Third Avenue Management LLC; Notice of application and temporary order under Section 22(e)(3) of the Investment Company Act) (Dec. 16, 2015).
[17] SEC Commissioner Hester Peirce in her March 2018 speech to the ICI Investment Management Conference suggested that the Proposals, combined with other rule requirements, "might be a more efficient and effective alternative to the liquidity classification requirement." *See* Commissioner Hester M. Peirce Remarks at the 2018 Mutual Funds and Investment Management Conference, "Looking at Funds through the Right Glasses," available at https://www.sec.gov/news/speech/peirce-looking-funds-through-right-glasses ("In light of the proposed changes—the proposed qualitative liquidity disclosure and the proposed N-PORT cash and cash equivalents disclosure—and the additional complexities the Commission has witnessed since adoption of the bucketing requirement, wouldn't it make sense to ask for comment on whether bucketing remains a meaningful requirement?").
[18] *See* Rule 22e-4(a). Under our proposed approach, taking into consideration the current definitions of "less liquid investment" and "moderately liquid investment" under Rule 22e-4, "liquid Investments" would include those investments that (i) the fund reasonably expects to convert into cash in current market conditions in more than three calendar days but in seven calendar days or less and/or (ii) the fund reasonably expects to be able to sell or dispose in current market conditions in seven calendar days or less but where the sale or disposition is reasonably expected to settle in more than seven calendar days, in either case without the conversion to cash or sale or disposition significantly changing the market value of the investment, as determined pursuant to Rule 22e-4(b)(1)(ii).
[19] There was broad debate during the Liquidity Rule comment period about the number of "buckets" supporting the need for a more simplified approach. *See* Letter from SIFMA AMG to the U.S. Securities and Exchange

decades, the proposed four-bucket approach will require investment companies to build systems and engage vendors to classify their portfolio assets without enhancing liquidity risk management.

We believe that a three-bucket approach may enhance liquidity management, without requiring funds to engage in nuanced determinations of "moderately liquid" investments versus "less liquid" investments. In addition to simplifying liquidity classification, our proposed categories would significantly reduce costs and operational burdens of liquidity management while providing for risk oversight and monitoring. When combined with the SEC's Proposal to require a narrative description of a fund's liquidity management program in its annual report and the disclosure of cash and cash equivalents on Form N-PORT (alongside the current portfolio holdings disclosure on Form N-PORT each quarter), this would provide the SEC and shareholders transparency into fund liquidity.[20]

Highly Liquid Investments Minimum

We recommend that the SEC eliminate the prescriptive requirement that a fund maintain a specified minimum level of highly liquid investments. While we strongly support a requirement to maintain adequate liquidity to meet shareholder redemptions, a pre-determined minimum is not an effective method for funds to ensure appropriate portfolio liquidity.

Even though funds would be allowed to set their own levels, portfolio asset and fund liquidity change constantly. A pre-established minimum may require a fund to be overly conservative during normal market conditions and could limit a fund's ability to take advantage of buying opportunities.[21] A fund's ability to purchase out-of-favor assets is valuable to facilitate liquid and orderly markets and can enhance shareholder returns over the long-term.[22]

In addition, during a shortfall of the highly liquid investments minimum, although Rule 22e-4 does not prohibit a fund from acquiring non-highly liquid investments, it does impose burdensome reporting requirements on funds and prohibits changes to the minimum threshold absent Board approval.

A minimum highly liquid investments requirement could also be detrimental to long-term investors. If funds are required to hold a set level of highly liquid investments, certain funds will be forced to manage their portfolios in a way that is potentially more conservative than they would otherwise – and counter to investor expectations for those funds to be fully invested according to their investment mandates. This constraint could impact fund performance

Commission (Apr. 12, 2016), *available at* https://www.sifma.org/wp-content/uploads/2017/05/sifma-amg-submits-supplemental-comments-to-the-sec-on-open-end-fund-liquidity-risk.pdf.
[20] *See* Commissioner Peirce Speech, supra note 17.
[21] For example, the assumption that funds only sell the most liquid assets to meet redemptions is not always consistent with effective liquidity management.
[22] *See* Fidelity Comment Letter at 8.

significantly over time without improving fund liquidity.[23] Accordingly, we recommend that the SEC eliminate this highly prescriptive requirement of the Liquidity Rule.

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Fidelity would be pleased to provide further information, participate in any direct outreach efforts the Commission undertakes, or respond to questions the Commission may have about our comments.

Sincerely,

cc: The Honorable Jay Clayton, Chair
The Honorable Robert J. Jackson Jr., Commissioner
The Honorable Hester M. Peirce, Commissioner
The Honorable Michael S. Piwowar, Commissioner
The Honorable Kara M. Stein, Commissioner

Dalia Blass, Director, Division of Investment Management

[23] *See* Fidelity Comment Letter at 8-9.