Americans for Financial Reform Education Fund

May 18, 2017

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: RIN 3235-AM30, Investment Company Liquidity Disclosure (File Number S7-04-18).

Dear Mr. Fields,

Americans for Financial Reform Education Fund ("AFR") appreciates the opportunity to comment on the above referenced proposed rule (the "Proposed Rule") by the Securities and Exchange Commission (the "Commission" or "SEC"). AFR is a coalition of more than 200 national, state, and local groups who have come together to advocate for reform of the financial industry. Members of AFR include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups.[1]

The Commission is proposing to change the public and non-public disclosure rule due to enter into effect in 2019. The proposed rule would amend Form N-PORT and Form N-1A in four ways. First, it rescinds the requirement in Form N-PORT that funds report to the public what percentage of their portfolio investments fall within each of the four defined liquidity categories—i.e., the so-called "buckets."[2] Second, the proposed rule substitutes the public disclosure of the liquidity buckets with a requirement in Form N-1A that funds include in their annual report to shareholders a narrative description of their liquidity management operations. Third, the proposed rule requires that funds report to the SEC on a monthly, non-public basis the amount of cash and cash equivalents they hold, which would be disclosed to the public on a quarterly basis with a 60-day lag through the SEC's EDGAR search tool. Finally, the Commission proposes to amend Form N-PORT to allow funds to classify a single holding across multiple liquidity buckets in their non-public reports.

AFR commented on the original liquidity rule proposal.[3] In that comment, we highlighted the importance of registered fund liquidity for the protection of both investors and the financial system more broadly. We also criticized the proposed process of liquidity classification as excessively self-regulatory and called for more guidance and oversight from regulatory bodies into how assets were classified into different liquidity buckets. However, we strongly supported the detailed, granular disclosures of liquidity classifications for specific assets that were included

[1] A list of coalition members is available at http://ourfinancialsecurity.org/about/our-coalition/.
[2] Through this letter we use the term "funds" for those registered investment companies to which the proposed rule applies.
[3] See Letter from AFR to the SEC, January 13, 2016, available at: https://bit.ly/2L7T2FT.

in the original proposal. We expressed the hope that these detailed disclosures would to some degree substitute for regulatory oversight by creating market discipline in how funds performed their liquidity classification. That is, investors would use asset-level disclosures of liquidity classification to judge whether funds were making highly unrealistic liquidity classifications, and would gravitate away from such funds.

In the final rule, the disclosures of liquidity classifications in the proposed rule were greatly weakened.[4] The requirement was changed from giving full asset-level information on the liquidity classifications of different assets to simply telling investors the percentage of the total fund portfolio placed into each liquidity bucket. By reducing the information content of liquidity disclosures, this vaguer and more general liquidity disclosure in the final rule left investors less able to judge the plausibility of fund judgements about liquidity. They also greatly reduced any potential for market discipline of fund liquidity classifications.

Having greatly weakened liquidity disclosures in the final rule, the Commission now returns to finish the job and eliminate them almost entirely in this new rule proposal. To add insult to injury, the vagueness and lack of context in the aggregate liquidity disclosures put in place in the final rule are now used as the excuse for eliminating the disclosures altogether. By weakening the disclosures in the first place, the Commission made them more opaque and harder to understand for investors, and now this opacity is used as the reason for their elimination.

We believe that the Commission moved in the wrong direction by weakening the disclosures in the final liquidity rule passed in 2016. We believe that the amendments in this proposed rule move even further in the wrong direction and are not consistent with the stated policy objective in the rule of "promoting investor understanding of the liquidity risks of the funds in which they have invested, while minimizing risks of investor confusion."[5] On the Commission's own web site the mission statement includes the following:[6]

> "The laws and rules that govern the securities industry in the United States derive from a simple and straightforward concept: all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it. To achieve this, the SEC requires public companies to disclose meaningful financial and other information to the public. This provides a common pool of knowledge for all investors to use to judge for themselves whether to buy, sell, or hold a particular security. Only through the steady flow of timely, comprehensive, and accurate information can people make sound investment decisions."

[4] U.S. Securities and Exchange Commission, Investment Company Liquidity Risk Management Programs, Final Rule, October 13, 2016, available at: https://bit.ly/2dQwj5q.
[5] U.S. Securities and Exchange Commission, Investment Company Liquidity Disclosure, Proposed rule [hereinafter, "Proposed Rule"], March 14, 2018, at 7, available at: https://bit.ly/2IvjI65.
[6] U.S. Securities and Exchange Commission, "What We Do," accessed May 17, 2018, available at: https://bit.ly/2phvq9i.

From the initial proposed rule to this new proposal for amendment of the final rule, liquidity disclosures have moved steadily away from the Commission's stated mission of "comprehensive and accurate information." Should this proposed rule be finalized as currently stated, the goal of providing substantive disclosure to investors on fund liquidity will have been almost abandoned.

Concerns Related to the Aggregate Liquidity Profiles

As noted by Commissioner Stein in a public statement, the current rule, approved in a unanimous and bipartisan vote, reflected a middle ground between the advantages that regular, comprehensive disclosures would create for the public and the industry's unwillingness to completely reveal liquidity classifications. This was the source of the current requirement that funds disclose to the public only aggregate liquidity information about their portfolio investments.[7]

But now the goal posts are being moved and this bipartisan consensus is being dismissed based on two general industry arguments—concerns about "subjectivity and "context". The subjectivity concern refers to the differing methodologies and assumptions underlying funds' liquidity classifications of portfolio holdings. Because that information is offered to the public in the standard format of Form N-PORT, funds argue it "inaccurately implies to investors that the classifications for all funds were formed through a uniform process and that the resulting classifications would be comparable across funds."[8]

The "context" concern relates to the subjectivity argument in that industry commenters believe they need a space to contextualize the assumptions and methodologies underlying their liquidity classifications, as well as a space to situate liquidity risk management within the broader strategy of the fund and against other risks faced by the fund.

The Commission has decided the best way to address the concerns is by re-proposing the rule to remove altogether the requirement that funds disclose to investors' information about the percentage of their investments that fall within each liquidity bucket. In its place, the Commission proposes to inform investors through a new "narrative discussion of the operation and effectiveness of the fund's liquidity risk management program over the reporting period," which is to be included in funds' annual report to shareholders.[9]

It should be obvious to everyone that substituting a quantitative measure with a qualitative discussion is an inherently more subjective approach. In Commissioner Jackson's words, "it is hard to see how inviting fund's lawyers to write essays about liquidity will make the information

[7] Kara M. Stein, "Statement on Proposed Amendments to Public Reporting of Fund Liquidity Information," Public Statement, March 14, 2018, available at: https://bit.ly/2IqGb3P.
[8] Proposed Rule, at 10.
[9] Proposed Rule at 7.

less subjective."[10] Furthermore, eliminating quantitative disclosures is not necessary in order to provide context to fund liquidity determinations, as quantitative disclosures can easily be supplemented with an additional qualitative discussion.

The end-of the year narrative approach also does not address the Commission's concern that public disclosures of the liquidity profiles could create pervasive incentives for funds to "classify their securities as more liquid in order to make their funds appear more attractive to investors, further increasing the risk of investor confusion."[11] It is also hard to see how the new narrative could overcome this problem or remove those incentives. If anything, the narrative would make it easier to act on those incentives—a skillful narrator can provide plenty more persuasive metaphors than there are liquidity buckets. And on a rhetorical note, we should not equate "*investor confusion*" with funds cheating, deceiving, or defrauding their investors. It should be the Commission's objective to monitor funds' liquidity assessments and their liquidity risk management program to ensure funds are not manipulating their reports to appear more liquid than they actually are and they are not engaged in an unethical race to the bottom to attract investors.

Funds are required by law to pay investors seeking to cash out in seven days, which justifies monitoring their liquidity levels as part of the SEC mission of protecting investors. It is essential that investors have the tools and data they need to understand the liquidity risks of the funds they hold. The potential systemic risk implications of poor liquidity management should also discourage the Commission from reversing its position on disclosure requirements, particularly after a prolonged period of low interest rates that have motivated funds to accumulate less-liquid securities in order to maintain returns.[12]

In short, we oppose the elimination of the public disclosure of fund's aggregate liquidity profiles and its substitution by a narrative discussion of the liquidity management operation. If the Commission truly wants to improve the reporting requirements it should increase the transparency and consistency in the methodologies used by funds to classify their investments, which would help reduce investor confusion. The Commission could also allow funds to contextualize their liquidity management program in a narrative that offer investors a more holistic view of a fund's liquidity profile. This could be done in Form N-PORT or elsewhere, in addition to the quantitative disclosures, rather than as a replacement for them.

Proposed Disclosure of Cash and Cash Equivalents

We support the decision to include in Form N-PORT an additional disclosure of cash and cash equivalents held by funds on monthly basis. As the proposed rule notes, "without the aggregate

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[10] Robert J. Jackson, Jr., "Statement on Proposed Amendments to Public Reporting of Fund Liquidity Information," Public Statement, March 14, 2018, available at: https://bit.ly/2KAJEJR.
[11] Proposed Rule at 11.
[12] Timothy W. Martin, "Pension Funds Pile on Risk Just to Get a Reasonable Return," *The Wall Street Journal*, May 31, 2016, available at: https://on.wsj.com/2GtOd6h.

liquidity profile, [the Commission] may not be able to effectively monitor whether a fund is compliant with its [Highly Liquid Investment Minimum] unless we know the amount of cash held by the fund."[13] However, in the same way that the SEC requires this information for effectively monitoring fund's liquidity management, investors would also benefit from a shorter delay in making the information publicly available. The Commission should consider disclosures on a quarterly basis with a 30-day lag, instead of a 60 day-lag. Especially during times of market stress, it is essential for investors to have access to up to date information that they can use to make informed decisions.

Conclusions

In a recent public statement Commissioner Jackson noted that industry commenters "can and should provide their insight to us, but we should not confuse industry arguments with empirical evidence."[14] The subjectivity and context concerns are not an unintended result of the final rule, but the natural result of weakening disclosures. As we stated in our initial comment on the proposal, we continue to believe the Commission should require granular information about the liquidity classification of individual assets; provide strong oversight of fund liquidity classifications; or strengthen and enforce the 15 percent illiquid investments limit.[15]

The revised rule simply rolls back transparency disclosures, with nothing substantive to replace them. It seems an unwarranted concession to financial institutions that simply wish to avoid providing information to investors that could create market pressures not to invest in illiquid assets.

Thank you for the opportunity to comment on this proposed rule. For more information please contact AFR's Policy Director, Marcus Stanley, at [redacted] or [redacted].

Sincerely,

Americans for Financial Reform
Educational Fund

[13] Proposed Rule at 28.
[14] Robert J. Jackson, Jr., "Statement on Proposed Amendments to Public Reporting of Fund Liquidity Information," Public Statement, March 14, 2018, available at: https://bit.ly/2KAJEJR.
[15] Letter from AFR to the SEC, January 13, 2016, available at: https://bit.ly/2L7T2FT.