IDC
INDEPENDENT DIRECTORS COUNCIL

1401 H Street, NW, Suite 1200
Washington, DC 20005-2148
Phone 202/326-8300
Fax 202/326-5828
www.idc.org

August 11, 2015

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

Re: Investment Company Reporting Modernization; File No. S7-08-15

Dear Mr. Fields:

The Independent Directors Council[1] appreciates the opportunity to submit comments on the Securities and Exchange Commission's proposal to enhance and modernize investment company portfolio and data reporting.[2] We recognize the importance to the SEC, as the primary regulator of the asset management industry, of receiving comprehensive and timely information about registered investment companies to enhance its regulatory oversight of the fund industry, including to monitor industry trends, inform policy and rulemaking, and identify risks. We fully support the SEC's efforts to collect information in a structured data format to enhance its ability to aggregate and analyze the information and data. We appreciate that the proposal offers the SEC a viable mechanism by which to accomplish this goal and we therefore support it. Against this backdrop of overall support, we offer our views on a few specific aspects of the Release, namely website posting of shareholder reports, data security, liquidity determinations, risk metrics, disclosures specific to fund directors, and the compliance deadlines.

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[1] IDC serves the U.S.-registered fund independent director community by advancing the education, communication, and policy positions of fund independent directors, and promoting public understanding of their role. IDC's activities are led by a Governing Council of independent directors of Investment Company Institute member funds. ICI is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds, and unit investment trusts. Members of ICI manage total assets of $18 trillion and serve more than 90 million shareholders, and there are approximately 1,900 independent directors of ICI-member funds. The views expressed by IDC in this letter do not purport to reflect the views of all fund independent directors.

[2] *See Investment Company Reporting Modernization*, Investment Company Act Rel. No. 31610 (May 20, 2015) (the "Release"), *available at* http://www.sec.gov/rules/proposed/2015/33-9776.pdf.

Website Posting of Shareholder Reports

Before commenting on specific aspects of the Release, we want to commend the SEC for proposing rule 30e-3 under the Investment Company Act of 1940, which conditionally would permit a fund to provide shareholders with access to annual and semiannual reports, rather than transmit the reports in paper via U.S. mail.[3] Posting shareholder reports online, will, as the Release notes, provide investors easy access to the documents and result in significant cost savings by funds, and ultimately fund shareholders.[4] Proposed rule 30e-3 represents a welcome extension of earlier Commission initiatives to modernize the manner in which fund information is accessible to investors. We applaud the Commission for recognizing the significant increase in the use of the Internet and the preferences of many investors to access fund information online. Likewise, we strongly encourage the Commission to permit a similar regime for the electronic delivery of both summary and statutory fund prospectuses.

Data Security

A significant issue that was not discussed in the Release is the Commission's ability to secure the non-public data and information funds would be required to report under these proposals. The SEC proposes to require funds to report portfolio information on a monthly basis, but to make public only the information reported for the third month of each fund's fiscal quarter, with a 60-day lag. As noted above, we generally support the proposal—so long as funds can be confident that the monthly data and information is secure within the SEC and not vulnerable to being hacked.

Monthly portfolio information can reveal a fund's proprietary investment strategies, which are critical assets of the fund and its shareholders. Persons with access to this information could use it to front-run the fund or engage in other abuses that would negatively affect the performance of the fund. If fund proprietary information were vulnerable to exploitation by others, it would be devastating to fund shareholders, individual fund sponsors, the overall fund industry, the SEC, and even the capital markets generally.

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[3] The conditions relate to the following: (i) availability of the report and other materials; (ii) shareholder consent; (iii) notice to shareholders; and (iv) delivery of materials upon request of the shareholder.

[4] We note that there may be ways for the SEC to revise the proposal to facilitate the use of proposed rule 30e-3, reduce operational burdens, increase efficiency, and provide additional cost savings for shareholders. *See* Letter from David W. Blass, General Counsel, Investment Company Institute, to Brent J. Fields, Secretary, U.S. Securities and Exchange Commission (August 11, 2015) ("ICI Letter") (providing reasonable recommendations to achieve these goals, such as modify the proposed requirement of a postage-paid reply form, and permit funds to provide a toll-free phone number or a pre-addressed, postage-paid reply form).

The possibility of a data breach is very real, as demonstrated by numerous publicized security breaches, both at governmental entities and private corporations. Indeed, the SEC's last GAO information security audit questioned the SEC's ability to protect data and information and noted that "[u]ntil SEC mitigates control deficiencies and strengthens the implementation of its security program, its financial information and systems may be exposed to unauthorized disclosure, modification, use, and disruption."[5] It is therefore critically important that the SEC demonstrate its ability to keep any monthly reports of portfolio holdings secure initially and on an on-going basis before it requires such frequent reporting.

In light of the foregoing, we recommend that the SEC defer moving forward with the proposal until it has adequately addressed concerns about potential threats to the security of the information it would collect. We do not have expertise to offer in this regard, but we support the recommendation made by the Investment Company Institute for the SEC to have an independent third-party expert test and verify its data security capabilities, before it moves forward, and revisit these capabilities on an on-going basis.[6]

Liquidity Determinations

The SEC proposes to require funds to disclose liquidity determinations for individual portfolio holdings on both proposed Form N-PORT and in a fund's financial statements. We are concerned about the public dissemination of this information and recommend that it not be included in the N-PORT data made publicly available at the end of each quarter or in a fund's financial statements.

Form N-PORT would define an "illiquid asset" as "an asset that cannot be sold or disposed of by the [f]und in the ordinary course of business within seven calendar days, at approximately the value ascribed to it by the [f]und." The process for making liquidity determinations and the factors forming the basis of those determinations involve subjective judgments regarding the market and the specific fund in question, including investment professionals' projections of future potential trading volume and price volatility, and the fund's ability to exit its position at or near its current value. Accordingly, it is well recognized that different funds can and do reasonably make different liquidity determinations regarding the same security. This variation could lead to confusion among investors who may be invested in multiple funds, some of which treat a particular security as liquid and others that treat it as

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[5] *See* "SEC Needs to Improve Controls over Financial Systems and Data," GAO-14-419 (April 2014), available at http://gao.gov/products/GAO-14-419.

[6] *See* ICI letter, *supra* n. 4; *see also* Testimony of Richard G. Ketchum, Chairman & CEO, Financial Industry Regulatory Authority, Before the Committee on Financial Services, U.S. House of Representatives (May 1, 2015) (announcing plans for FINRA to address concerns about its data collection proposal by conducting analyses and engaging third-party experts to analyze potential threats prior to taking further action on the proposal), available at http://financialservices.house.gov/uploadedfiles/hhrg-114-ba16-wstate-rketchum-20150501.pdf.

illiquid. Public disclosure of liquidity determination also could unnecessarily cause fund advisers to seek more consistent liquidity determinations from consultants and third-party vendors.

In addition, due to the subjective nature of the judgments that form the basis of liquidity determinations, we are concerned that fund auditors would have difficulty assessing and auditing liquidity determinations. Moreover, if the financial statements were required to list a fund's illiquid holdings, the auditor would need to audit those determinations, as well as assess the illiquidity of each holding not deemed illiquid by the fund in order to ensure that each holding received proper treatment. This would result in substantially more work by fund auditors and this increased cost would ultimately be borne by the fund's shareholders without any corresponding benefit to them.

As the Release notes, Form N-PORT is not primarily designed for disclosing information to the public, but rather, to assist the SEC in its role as the primary regulator of funds. We believe that the public disclosure of the illiquidity determinations would not benefit fund shareholders and could in fact confuse them, and that this information should therefore be made available only to the SEC.

Risk Metrics

We also recommend that the SEC keep confidential the risk metric information a fund would be required to report. We recognize that risk metric information would be of value to the SEC as the regulator. While the Commission has the ability and resources to evaluate and understand this information, we are concerned that investors would be confused by it and, consequently, could make inappropriate investment decision.[7]

We also believe that, absent a universally accepted uniform approach to risk metrics, it would be premature to disclose such information to investors. Investors may inadvertently view risk metric information as indicative of overall fund risk even though each metric seeks to represent only a portion of that risk. In addition, requiring public disclosure about particular risk metrics may exaggerate the importance of those risks to the detriment of others. Finally, investors may incorrectly conclude that they can compare risk metrics between funds in different fund complexes when in fact there is variation across the fund industry in how fund complexes identify, calculate, and report risk metrics.

[7] IDC has previously raised concerns over risk measurements and investor confusion. *See* Letter to Mr. Kevin M. O'Neill, Secretary, U.S. Securities and Exchange Commission, from Amy B.R. Lancellotta, Managing Director, Independent Directors Council, re Investment Company Advertising: Target Date Retirement Fund Names and Marketing; File No. S7-12-10 (June 9, 2014) (noting that different concepts of risk cannot be captured in a single risk measure and raising investor confusion concerns about risk-based glide paths).

Other Disclosures: Fund Directors and Securities Lending Arrangements

The SEC proposes that funds file a new form—Form N-CEN—on which they will report census-type information in a structured format. In connection with the proposed form, the Release requests comment on two subjects pertaining to directors. First, the Release asks about the information regarding fund directors that is proposed to be included in Form N-CEN, which includes each director's name, whether they are an "interested person" and the Investment Company Act file number of any other fund for which they serve as a director. Specifically, the Release asks whether funds should be required to include on Form N-CEN any additional information concerning the board or individual directors, such as information about the length of service of directors.[8] The Release does not discuss why the Commission might be interested in this or other possible director-related information or how it would be used. Absent a clear statement of how information about directors would assist the Commission in carrying out its regulatory functions, and the opportunity to comment on any such information, we do not support adding it to Form N-CEN.

Second, the Release requests comment on whether proposed disclosures regarding compensation and other fee and expense information relating to a securities lending agent and cash collateral manager would be useful to fund boards in evaluating securities lending arrangements. Directors have advised us anecdotally that it is already standard practice in the industry for boards to receive such information. We are concerned that, among other things, public disclosure of the compensation paid to the lending agent could disrupt current pricing practices and ultimately diminish the fund's ability to negotiate, and the board's ability to oversee, the fund's securities lending activities. We therefore recommend that the Commission keep non-public the compensation and other fee and expense proposed disclosures relating to securities lending arrangements.

Compliance Deadlines

Finally, the proposed reporting regime imposes a comprehensive and complex set of new filing responsibilities. The implementation of the required changes will necessitate that firms undertake significant systems development and operational updates. This challenge comes at a time when much of the industry is currently implementing major operational changes to comply with the recently-adopted money market fund reforms. It is critical that funds and their advisers have sufficient time in which to comply with these new responsibilities. We therefore urge the Commission to extend the compliance periods in order to ensure the success of the new reporting regime.

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[8] We note that Item 17 of Form N-1A already requires detailed disclosure about directors, including their length of service.

If you have any questions about our comments, please contact me at (202) 326-5824.

Sincerely,

Amy B.R. Lancellotta
Managing Director
Independent Directors Council

cc: The Honorable Mary Jo White
The Honorable Luis A. Aguilar
The Honorable Daniel M. Gallagher
The Honorable Kara M. Stein
The Honorable Michael S. Piwowar

David Grim, Director
Diane Blizzard, Associate Director
Division of Investment Management