

August 11, 2015

VIA ELECTRONIC DELIVERY

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

Re: Investment Company Act Release No. 31610 (File No. S7-08-15) Investment Company
Reporting Modernization

Dear Mr. Fields,

We appreciate the opportunity to respond to the request by the U.S. Securities and Exchange Commission (“SEC” or “Commission”) for comments regarding the above-referenced release (the “Proposing Release”).¹ The Proposing Release proposes new rules and forms as well as amendments to existing rules and forms to modernize the reporting and disclosure of information provided by registered investment companies (“funds”). The Proposing Release contains four key components: (i) proposed Form N-PORT, for reporting portfolio-wide and position-level holdings information, and the rescission of Form N-Q; (ii) proposed revisions to Regulation S-X that would standardize reporting of derivatives holdings in financial statements; (iii) proposed Rule 30e-3 under the Investment Company Act of 1940, as amended (the “1940 Act”), to allow funds to provide website disclosure of shareholder reports in lieu of mailing; and (iv) proposed Form N-CEN, for reporting census-type information, and the rescission of Form N-SAR.

Dechert LLP is an international law firm with a wide-ranging financial services practice that serves clients in the United States and abroad. In the United States, we represent a substantial number of U.S. mutual fund complexes, closed-end funds, exchange-traded funds (“ETFs”), fund boards, fund independent directors, fund advisers and service providers to funds. In developing these comments, we have drawn on our extensive experience in the financial services industry generally. Although we have discussed certain matters addressed in the Proposing Release with some of our clients, the comments that follow reflect only the views of a group of attorneys.

¹ Investment Company Reporting Modernization, Investment Company Act Release No. 31610, 80 FR 33589 (June 12, 2015).

We acknowledge the obvious care and thoughtfulness that the Commission put into the preparation of the comprehensive Proposing Release. Because we strongly support the Commission's goal of modernizing its reporting and disclosure system, we offer these comments to address certain areas where we believe the Commission either should provide more guidance to industry participants or should modify its approach.

I. FORM N-PORT

Form N-PORT would replace Form N-Q as the new portfolio holdings reporting form for registered management investment companies and ETFs organized as unit investment trusts (for the purposes of our discussion of Form N-PORT, "funds"). While we generally support the use of Form N-PORT to modernize the collection of portfolio holdings data, we urge the Commission to consider certain issues as part of its consideration of the adoption of this Form.

A. Timing of Filing Form N-PORT after Month-End

The Commission requested comment as to whether 30 days after the close of each month would provide sufficient time for funds to gather and report the information included on Form N-PORT. Currently, as the Commission noted in the Proposing Release, funds have up to 70 days to report their aggregate schedule of investments on Forms N-CSR and N-Q on a quarterly basis.² The frequency of filings on Form N-PORT would be monthly as opposed to quarterly and the amount of information that funds would be required to collect and report on the Form would substantially increase.

The compilation of the portfolio holdings requires funds to dedicate time, money and other resources to ensure the accurate reporting of information. Various business units, including, among others, those associated with a fund's investment adviser, administrator, accounting agent and EDGAR filing agent, would be responsible for collecting, calculating and conveying the information that would be reported on Form N-PORT. In addition, in some cases, funds may employ a third-party service provider to assist in aggregating the information and making the filings. In order to reduce potential errors in the information reported, new processes would need to be implemented and such processes would likely include several levels of review.

Based on the feedback we have received from our clients, we understand that there are challenges in submitting Form N-PORT filings within 30 days after the close of each month. We understand that some clients will need to hire additional personnel and/or pay for additional services to be provided by third-party service providers in order to meet the 30 day filing requirement. While we are unable to quantify the costs on a fund, we urge the Commission to

² *Id.* at n.27.

carefully consider the impact that Form N-PORT and the 30 day filing requirement could have on the business units discussed above and related costs as part of its consideration of whether to provide a longer period to file the information. Alternatively, the Commission could consider providing a longer compliance period to enable the systems necessary to produce accurate information to be developed and implemented.

B. Portfolio Level Risk Metrics

The Commission proposed Item B.3. of Form N-PORT, which would require a fund that invests in debt instruments, or derivatives that provide exposure to debt instruments or interest rates, representing at least 20% of the fund's notional exposure, to provide a portfolio level calculation of duration and spread duration across the applicable maturities in the fund's portfolio. In connection with the Commission's proposed requirement to report these portfolio level risk metrics, we suggest the Commission consider: (1) increasing the 20% threshold that would require a fund to provide a portfolio level calculation of duration and spread duration across the applicable maturities in the fund's portfolio; and (2) making any risk metric calculations non-public or, in the alternative, including a disclaimer that the risk metric calculations are estimates and may not reflect the actual change in the fund's value.

1. The 20% Threshold to Report Risk Metrics

The Commission noted that it proposed the 20% threshold because it believes that, at this level, the Commission would receive measurements of duration and spread duration from "funds that make investments in debt instruments as a *significant part of their investment strategy*, while providing an appropriate threshold so that funds that do not invest in debt to achieve their investment strategy *would not have to monitor each month whether they trigger the requirement for making such calculations.*"³ The Commission requested comment as to whether 20% is an appropriate threshold for determining which funds must provide risk metrics.

We recommend that the Commission consider a higher threshold because we believe that a 20% threshold does not necessarily reflect a *significant* part of a fund's investment strategy and because it *would* require funds to closely monitor each month whether they trigger the requirement for making such calculations. We note that many funds, including certain types of equity funds, may invest in debt instruments for various reasons. For example, in accordance with Rule 35d-1 under the 1940 Act, an equity fund is required to invest under normal circumstances at least 80% of its net assets (plus borrowings for investment purposes) in equity securities ("Names Rule Policy"), but the remaining amount (up to 20%) can be invested in

³ *Id.* at 33599 (emphasis added).

other securities, including debt instruments. Under Rule 35d-1, a fund measures its compliance with the Names Rule Policy at the time of investment. Therefore, in the example of an equity fund, if the value of its equity holdings decreases, it is possible that the equity fund's investment in debt instruments could exceed 20% of its notional exposure on a reporting date, without violating its Names Rule Policy, and, thus, trigger the reporting of risk metrics on Form N-PORT. Further, consistent with Commission guidance, such an equity fund could take a "temporary defensive position" and invest in short-term debt instruments in excess of 20% of its notional exposure on a reporting date to respond to adverse market, economic, political or other conditions. In light of the foregoing, we urge the Commission to consider modifying the 20% threshold to a higher threshold and/or exempting position taken as part of temporary defensive positions from the calculation of the threshold.

2. Risk Metrics Calculations

The Commission noted that one of the purposes of the proposed requirement to include risk metrics information is to "help investors better understand how changes in interest rate or credit spreads might affect their investment in a fund. . . . thereby potentially helping all investors to make more informed investment choices."⁴ However, it is our understanding that the calculation of credit and spread risk involves a level of subjectivity. Indeed, the Commission sought comment regarding how "the values reported for these risk metrics [may] be affected by the inputs and assumptions underlying the methodologies by which funds would calculate these metrics, including assumptions regarding the valuation of the investments or underlying securities of investments, particularly for investments that have pre-payment options, such as mortgage-backed securities."⁵ In addition, certain securities in which a fund may invest would not be subject to the proposed calculations. For example, the proposed calculations would not include investments in preferred stock, underlying funds and other securities, the value of which could be impacted by changes in interest rate and credit spreads. As such, we believe that public reporting is of limited value to (and could, in some case, be confusing for) investors. In light of the foregoing, we recommend that the Commission consider making any risk metric calculations non-public or, in the alternative, allow the inclusion of a disclaimer that the risk metric calculations are estimates and may not reflect the actual change in a fund's value.

C. Explanatory Notes

The Commission proposed Part E – Explanatory Notes ("Part E") of Form N-PORT to provide explanatory notes. In the Proposing Release, the Commission noted that providing information

⁴ *Id.* at 33598-99.

⁵ *Id.* at 33601.

in Part E is optional and is intended to be used to explain assumptions made by a fund in responding to other items on Form N-PORT. The Commission stated that Part E would “provide context for anomalous responses or discuss issues that could not be adequately addressed elsewhere given the constraints of the form.”⁶

The Commission requested comment on whether the explanatory notes on Form N-PORT should be non-public, even for publicly available filings (*i.e.*, those Form N-PORT filings made for the third month of a fund’s fiscal quarter). We suggest that the Commission consider an approach that would allow funds to have the ability to designate an explanatory note as either public or non-public. This approach would provide a fund with a mechanism through which to explain certain information on Form N-PORT to only the Commission and its staff for publicly available filings while also providing the fund with the flexibility to provide information to the public, if it wishes to do so.

II. WEB SITE TRANSMISSION OF SHAREHOLDER REPORTS

The Commission is proposing new Rule 30e-3 under the 1940 Act, which would permit, but not require, a fund to satisfy requirements under the 1940 Act and rules promulgated thereunder to transmit reports to shareholders if the fund makes the reports accessible on its web site. We laud the Commission’s continued recognition of overarching trends regarding technological advancements in the industry. We support the Commission’s intention to reduce various burdens on funds, including printing and mailing costs, but we wish to comment on certain requirements set forth in proposed Rule 30e-3.

As proposed, Rule 30e-3 would require that a fund receive each shareholder’s consent prior to relying on the rule, which can be obtained through the transmission of an “Initial Statement” to the shareholder. The Commission has proposed that the Initial Statement would be accompanied by a reply form that is pre-addressed with postage provided. Rule 30e-3 also would require the fund to provide a “Notice” within 60 days after the close of the period for which each report to shareholders is being made. Similar to the Initial Statement, the Notice would be required to be accompanied by a reply form that is pre-addressed with postage provided.

In light of the technological advancements noted by the Commission, we believe that the requirement for the Initial Statement and Notice to provide a reply form that is pre-addressed with postage should be removed. Instead, we recommend that the Initial Statement and Notices include a toll-free number and an e-mail address or web site where an investor can request to

⁶ *Id.* at 33610.

receive a shareholder report. Removing the requirement to include the reply form that is pre-addressed would allow funds to more fully realize a reduction in mailing costs.

Under the proposal, Rule 30e-3 would require that an Initial Statement and Notices be provided by each fund intending to rely on the Rule. We note that certain groups of funds may be part of the same investment program and shareholders may own multiple funds in that program. In such cases, it would be unnecessary and burdensome to provide an Initial Statement and Notice to the shareholder for each fund held by the same shareholder. Therefore, we suggest that the Commission adopt an approach that would allow multiple funds to provide one Initial Statement and Notice in order to allow those funds to more fully realize a reduction in printing and mailing costs.

Finally, proposed Rule 30e-3 would require that a fund file a form of the Notice with the Commission within 10 days after it is sent to shareholders. This requirement would impose a new cost on a fund that relies on Rule 30e-3, because it would be in addition to the fund's existing Form N-CSR filing requirement. In the interest of reducing costs further and alleviating this burden on a fund, we urge the Commission to reconsider the requirement that the fund file the Notice to shareholders for each shareholder report. Instead, we request that the SEC permit a fund to retain the Notice in the records of the fund, and provide it to the SEC upon request. Alternatively, the SEC could consider adding a requirement that a fund include the Notice as an exhibit to its Form N-CSR filing or otherwise indicate on Form N-CEN that it provided Notices during its previous fiscal year.

III. FORM N-CEN

The SEC proposed new Form N-CEN, which would replace Form N-SAR as the form on which funds would report census-type information. We support the use of Form N-CEN to modernize the collection of census-type data, but we urge the Commission to consider certain issues with respect to the reporting of financial support.

The Commission proposed a requirement that a fund disclose in response to Item 15 of Part B of Form N-CEN whether the fund received "financial support" from a first- or second-tier affiliate and disclose additional information about such financial support in an attachment to the Form. The Proposing Release noted that the proposed definition of "financial support" under Form N-CEN is substantially similar to the definition of "financial support" on Form N-CR, which is applicable to money market funds. The Commission proposed to extend the reporting of financial support beyond money market funds to all funds in order to "better understand instances when funds receive financial support from an affiliated entity."⁷ We

⁷ *Id.* at 33637.

suggest that, if the reporting of financial support is extended to all funds, it should be modified and additional guidance should be provided.

Many funds have historically entered into various transactions with affiliates that could be deemed to be reasonably intended to increase or stabilize the value or liquidity of the fund's portfolio. For example, funds may engage in inter-fund lending or borrow under lines of credit with an affiliated bank. In addition, an investment adviser to a fund may provide a voluntary waiver from time-to-time or compensate a fund for a trade error made by adviser. While we recognize that the Commission would provide an exclusion from the definition of financial support when a fund's board of directors determines that the support was not to be reasonably intended to increase or stabilize the value or liquidity of the fund's portfolio, we believe that, if the Commission provided a broader list of exclusions, it would mitigate the costs associated with requesting a board determination.

Finally, we request that the Commission clarify the definition of "financial support" in relation to the third enumerated instance of financial support – "a provision of financial support includes any . . . (3) purchase of any defaulted or devalued security at fair value."⁸ We note that, while in some cases the purchase of a defaulted or devalued security at fair value could improve a fund's liquidity, the purchase would not necessarily have the effect of increasing or stabilizing the value of the fund's portfolio, because the fund could be valuing the defaulted or devalued security at fair value. We note that this portion of the definition of financial support was changed from the definition provided in Form N-CR, likely to accommodate various types of securities other than debt securities, which are the only type of securities held by money market funds. In order to clarify this item, we recommend that the Commission specify that the purchase of a defaulted or devalued security would constitute financial support only when it is intended to increase or stabilize the value or liquidity of the fund's portfolio.

⁸ *Id.* at 33702. We note that the definition of financial support in Form N-CR uses "*par value*" instead of "*fair value*."



We appreciate the opportunity to comment on the Proposing Release. Please feel free to contact Megan C. Johnson at 202.261.3351 or Stephen T. Cohen at 202.261.3458 with any questions about this submission.

Very truly yours,

/s/ Dechert LLP

Dechert LLP