



INVESTMENT
MANAGEMENT

211 Main St.,
San Francisco, CA 94105-1905
Tel (415) 667-7000

August 11, 2015

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

RE: Investment Company Reporting Modernization – File No. S7-08-15
Amendments to Form ADV and Investment Adviser Act Rules – File No. S7-09-15

Dear Mr. Fields:

Charles Schwab Investment Management, Inc., (“CSIM”)¹ appreciates the opportunity to comment on the Securities and Exchange Commission’s (the “Commission”) request for comment on the above referenced rule proposals² that would require registered investment companies (“Funds”) to engage in expanded reporting of portfolio holdings and characteristics, allow Funds to provide shareholder reports via websites, and require investment advisers to provide information regarding their separately managed account business.

I. CSIM Strongly Supports the Proposals

CSIM strongly supports many aspects of the Proposals. The proposed increase in the amount and quality of information the fund industry would provide to the Commission and its staff will not only be of value to the Commission in fulfilling its role as the fund industry’s primary regulator, but will also benefit fund shareholders and the investing public by providing greater transparency into fund investment practices. The proposed rule reflects a thoughtful and balanced consideration of the types of information and reporting that can enhance the Commission’s ability to monitor and oversee the asset management industry generally and the fund industry more

¹ CSIM, a wholly-owned subsidiary of The Charles Schwab Corporation (“Schwab Corporation”), is registered with the Commission and serves as investment adviser to 95 mutual funds and ETFs with over \$260 billion in total assets. Schwab Corporation is a leading provider of financial services. Through its operating subsidiaries, the company provides a full range of securities brokerage, banking, money management and financial advisory services to individual investors and independent investment advisers.

² Investment Company Reporting Modernization, SEC Release Nos. 33-9776; 34-75002; IC-31610 (May 20, 2015) (the “Fund Reporting Proposal”); Amendments to Form ADV and Investment Advisers Act Rules, SEC Release Nos. IA-4091 (May 20, 2015) (the “Adviser Reporting Proposal”) (collectively, the “Proposals”).

specifically. We recognize that implementation of the Proposals by Funds will be a significant and costly undertaking. It will require extensive system builds and design changes, new data processing procedures and requirements, development of additional business and compliance oversight and supervisory procedures, the hiring of personnel, by both Funds and their vendors, to support implementation and on-going compliance and maintenance, among other things—and Funds will need a substantial period of time to effect all the proposed changes and requirements. However, CSIM believes the benefits of the Proposals ultimately outweigh the burdens Funds will bear in effecting their implementation.

While CSIM strongly supports the stated purpose and many aspects of the Proposals, we do believe there is an opportunity to enhance and clarify certain components of the Proposals. The Investment Company Institute (the “ICI”) and the Securities Industry and Financial Markets Association (“SIFMA”) have each submitted a comment letter on the Proposals (the “ICI Comment Letter” and “SIFMA Comment Letter,” respectively). CSIM generally supports the recommendations of the ICI and SIFMA, and, in particular, we share the concerns articulated in the ICI Comment Letter relating to data security. In this comment letter, CSIM wishes to emphasize a few of those recommendations, and we offer some additional suggested enhancements and modifications of our own. Principally, and as discussed in greater detail below, CSIM recommends the following:

- *Permitted Use of T+1 Accounting on Form N-PORT:* The instructions to Form N-PORT should be amended to permit Funds to submit information on portfolio and security holdings on a “T+1” basis rather than on a “T+0” basis. As most Funds currently account for their day-to-day transactions on a T+1 basis, this would avoid a needless and costly conversion to T+0 accounting. Alternatively, Funds should be required to file Form N-PORT within a minimum of 45 days from month end, rather than the proposed 30 days.
- *Confidentiality of Certain Reported Data:* At a minimum, certain information the Commission has proposed to include on Form N-PORT—specifically, portfolio level risk metrics, illiquidity determinations, and country of risk determinations—should remain confidential and not be released publicly given this information could potentially confuse or mislead investors.
- *Ability to Obtain Implied Consent for Electronic Transmission of Shareholder Reports through the Summary Prospectus:* The Commission should allow Funds the option to obtain the implied consent of its shareholders to electronic transmission of shareholder reports through the Fund’s summary and statutory prospectus in lieu of providing the Initial Statement under proposed Rule 30e-3(c). CSIM believes this will result in additional cost savings to Funds and shareholders without compromising the transparency and effectiveness of shareholder notice that the Initial Statement is intended to provide.

II. Form N-PORT

The Commission is proposing new Form N-PORT which would require all Funds that are registered management investment companies and exchange traded funds (except those that are money market funds or small business investment companies) to file with the Commission on a

monthly basis complete portfolio holdings in a structured data format. The filing of Form N-PORT is proposed to be made in XML format no later than 30 days after month-end. It is proposed that the filings made on a Fund's fiscal quarter would be made public with a 60 day delay and that those filed for the other month-ends would remain confidential. In addition, the Commission is proposing to rescind Form N-Q and require Funds to file as attachments at the end of the first and third fiscal quarters schedules of investments in a form substantially identical to the current Form N-Q.

A. Public Availability of Form N-PORT

Form N-Port will provide substantial additional information to the Commission and strengthen its ability to oversee and carry out its regulatory responsibilities for the asset management industry. CSIM is supportive of the Commission collecting additional information about Funds to more effectively oversee the industry; however, we have concerns about the utility of certain of this information to individual investors. Moreover, we are also concerned about potential harm to Fund shareholders that could result if sophisticated market participants are able to use this information to front-run a Fund or reverse engineer its investment strategy.

The Commission notes in the Fund Reporting Proposal that the information in Form N-PORT is primarily designed for use by the Commission and its staff. Certain data elements have a high probability to create investor confusion and misunderstanding if released publically. In addition, the proposed format of Form N-PORT is not the most accessible for individual investors: the Commission has recognized this issue by requiring the complete portfolio holdings to be attached to Form N-PORT as of the end of the first and third quarter of the Fund's fiscal year end presented in accordance with Regulation S-X.³

Therefore, we believe the most efficient way for the Commission to achieve its goal to obtain the enhanced information and continue to provide individual shareholders with periodic comprehensible portfolio holdings reports would be to maintain Form N-Q with its current filing and release schedule and keep Form N-PORT confidential for all monthly filings. We support SIFMA in its response on this point.

However, if the Commission determines not to maintain the entire Form N-PORT filing confidential for each monthly filing, we believe that several items should remain confidential on Form N-PORT, including the following for the reasons outlined:

- *Portfolio Level Risk Metrics*: While we understand that risk metrics may be beneficial to the Commission and its staff, we have concerns that making these risks metrics generally available to the investing public may be misleading rather than beneficial. Each of the risk metrics captures only a single element of risk for a bond fund; however, investors may think that the risk metric represents the key risk for a Fund or the overall risk of a Fund. In addition, there are certain assumptions required by each investment adviser regarding the

³ This portfolio holdings schedule substantially replicates Form N-Q but it is proposed that it be filed with the Commission on a shorter timeframe. We are concerned that 30 days is not a sufficient period of time to make the conversion from T+1 accounting to T+0 accounting and conduct the necessary due diligence reviews prior to filing, as discussed further in the letter.

characteristics of a security that might impact the calculation of the risk metric, creating differences between even Funds that hold substantially identical securities. Investors may think that there is more commonality for comparison on risk metrics between Funds than may exist in actuality.

- *Illiquidity Determinations:* Form N-PORT would define an “illiquid asset” as “an asset that cannot be sold or disposed of by the Fund in the ordinary course of business within seven calendar days, at approximately the value ascribed to [it] by the Fund.”⁴ This definition is long-standing, but the actual liquidity determinations can be subjective. Funds and advisers develop their own policies for determining the liquidity of assets, which include Funds and advisers making reasonable judgments about the factors affecting liquidity. While Funds and advisers each can have sound methodologies and processes for determining illiquidity, they may reasonably differ in the determination for any particular security. Due to the subjectivity of these determinations, publicly disclosing liquidity determinations could lead to confusion among investors. Also, it is important that Funds and their advisers be able to use sound methodologies and processes to make liquidity determinations as appropriate in individual Fund circumstances without public confusion.
- *Country of Risk Determinations:* Form N-PORT would require a Fund to report the country “that corresponds to the country of investment or issuer based on the concentrations of the risk and economic exposure of the investments.”⁵ The Fund would also have to report the country where the issuer is organized if different from the above determination. Similar to liquidity determinations, country of risk determinations are subjective, and will vary among fund complexes and may even vary among portfolio managers within a fund complex. Again, while different country of risk determinations among Funds and advisers may be an appropriate exercise of judgment, public disclosure of this fact may lead to investor confusion.⁶

B. Filing of Form N-PORT

It is proposed that Form N-PORT would be filed by Funds monthly within 30 days of the end of the month. From General Instruction A to Proposed Form N-PORT, it appears that information on the portfolio and each holding is to be prepared in accordance with GAAP on a “T+0” basis.⁷ Most Funds, including those which CSIM advises, account for their day-to-day transactions on a T+1 basis, as permitted for NAV determination. To convert from T+1 accounting to T+0, CSIM

⁴ See General Instruction E of Proposed Form N-PORT.

⁵ See Item C.5 of Proposed Form N-PORT.

⁶ If the Commission decides to release the country of risk determinations publicly, CSIM believes the Commission should explore requiring issuers to designate the country of risk for each of its securities. This would ensure a level of uniformity and consistency in disclosures and help mitigate any potential confusion.

⁷ See General Instruction A of Proposed Form N-PORT.

would need to obtain the information from the Funds' third party service providers and make manual adjustments to the opening and closing balances for each Fund. This process would add approximately 6-10 days to the process of compiling the data necessary for the Form N-PORT. Currently, these adjustments are made only four times per year when Funds file Forms N-CSR and N-Q. In each of these circumstances, Funds have 60 days to prepare the reports. Therefore, we would strongly urge that Form N-PORT be permitted to be prepared on a T+1 basis. Alternatively, because we believe Funds would require more than the proposed 30 days to file the form, we would recommend a minimum of 45 days to file the form.

C. Confirmation that No “Look-Through” is Required for Fund of Funds

Form N-PORT requests information regarding direct fund holdings and certain characteristics. We note that the Commission is proposing to request a specific look through of controlled foreign corporations (“CFC”) and would request that the form specifically provide instructions that the Reporting Fund is not required to look through any entities in its portfolio holdings except as specifically identified in the form.

D. Recommendations on Certain Data Elements

In their letters, both the ICI and SIFMA have made comments regarding reformulating certain of the requested data. We support these recommendations and would like to specifically comment on the following items:

- *Securities Lending Disclosure:* It is proposed that a Fund would disclose on Form N-PORT all securities lending counterparties and the aggregate value of securities on loan to each counterparty.⁸ Funds have multiple approved counterparties and the loans outstanding to any particular counterparty may change frequently. In addition, this data is maintained by the Fund's securities lending agent. Rather than collect this information for all counterparties, we believe that providing it for a Fund's top five counterparties will provide the Commission and its staff with meaningful information on the Fund's exposure without being excessively burdensome to the Fund. In addition, the Commission should not require Funds to disclose non-cash collateral received from securities lending on the portfolio holdings.
- *Certifications:* We strongly support the Commission's proposal not to require certification from the principal executive officer and financial officer of a Fund with respect to the filings on Form N-PORT. As we discussed above, we would propose that the certifications remain with Forms N-CSR and N-Q. However, if the Commission determined to rescind Form N-Q, we would support changing the certifications for Form N-CSR to semi-annual certifications.

⁸ See Item B.4 of Proposed Form N-PORT.

III. Form N-CEN

The Commission proposes to rescind Form N-SAR, which collects census-type data on Funds semi-annually, and require this type of data to be filed on Form N-CEN annually 60 days after the Fund's fiscal year-end. We support the Commission's proposals to improve the process and relevance of the information requested. We would, however, request that the Commission revise the Fund of Funds definition to exclude Funds that may invest in money market funds in excess of the amounts permitted under Section 12(d)(1) of the Investment Company Act in reliance on Rule 12d1-1. We believe that this would provide a more appropriate definition of Fund of Funds.

IV. Proposed Rule 30e-3: Shareholder Report Delivery

The Commission is proposing new Rule 30e-3 under the Investment Company Act, which would permit a Fund to deliver its reports to shareholders by making them accessible on the Fund's website. To rely on the proposed rule, the Fund would have to satisfy certain conditions, including (i) obtain implied consent from shareholders; (ii) provide notice to shareholders regarding the availability of each report on the website; and (iii) deliver a printed shareholder report to shareholders upon request.

We agree with the Commission that this option has the potential to modernize the way in which report information is delivered to shareholders and improve the accessibility of the information while reducing costs borne by Funds, and ultimately by shareholders.⁹ CSIM agrees that the option provides potential benefits to shareholders and Funds, but to realize the full potential of the proposal, we believe that certain enhancements should be adopted.

First, we believe a Fund should have the option to incorporate the consent elements of the Initial Statement into its summary and statutory prospectus. That is, in lieu of providing the Initial Statement under proposed Rule 30e-3(c), a Fund should be deemed to have obtained implied consent of its shareholders if its summary and statutory prospectus discloses (i) the Fund's intent to make future shareholder reports available on the Fund's website; (ii) that future shareholder reports will be accessible free of charge at its website; and (iii) a toll-free telephone number through which shareholders can obtain mailed printed copies upon request within 30 days.¹⁰

We understand the Commission's desire that shareholders be informed of the provision of electronic shareholder reports, and recognize that the Initial Statement is intended to serve that very purpose. But if a Fund can similarly provide that information in the summary and statutory prospectus—upon which investors and the Commission rely upon to communicate key and essential information about the Fund itself, such as investment objective and strategies, fund

⁹ The annual printing and mailing costs to deliver the annual and semi-annual shareholders reports to shareholders of all Schwab Funds, Schwab ETFs and Laudus Funds (hereafter, all referred to as the "Schwab Funds") are approximately \$4 Million. The annual costs of sending the required Notices under Proposed Rule 30e-3(d) would be approximately \$2.3 Million. This would result in annual cost savings complex wide of about \$1.7 Million.

¹⁰ The disclosure item could, for example, be incorporated into Form N1-A as new Item 8.

expenses and investment risks, and which a Fund is mandated to already provide—then it makes the additional mailing of the Initial Statement redundant and unnecessary.

CSIM estimates that the cost savings of not mailing the Initial Statement to Schwab Funds' shareholders in the first year would be approximately \$1.1 Million, and annually thereafter would be a percentage of that amount depending on the number of new shareholders to the fund complex.¹¹ But in addition to that sum, the Schwab Funds would gain additional cost savings because the Funds would not always have to mail a printed shareholder report to at least some subset of their shareholder base. Under the rule as proposed, there would always be a segment of shareholders who purchased the Fund after delivery of an Initial Statement but before publication of the shareholder report, and for whom the Funds have not obtained implied consent.¹² These shareholders must always receive a printed shareholder report by mail, notwithstanding the preference of most to receive or access the report electronically.¹³ By permitting Funds to capture implied consent in the summary and statutory prospectus, all shareholders purchasing the Fund will have been notified and have consented, pursuant to the terms of the summary and statutory prospectus, to electronic transmission of the Funds shareholder reports. So, in addition to the cost savings of not mailing the Initial Statement, the Fund would also save costs by not having to mail hard copy shareholder reports to those that most likely would not elect to receive a paper copy.¹⁴

¹¹ The ICI recommends that the Commission also consider a similar implied consent approach for delivery of summary and statutory prospectuses. CSIM supports this idea in concept and agrees that Funds should have that option (assuming appropriate implied consent requirements are fulfilled). We believe that given the ever increasing access to the internet and our Funds current e-delivery percentages that many shareholders would prefer to receive not only their shareholder reports through the internet but also the summary and statutory prospectus. Notwithstanding our general support of the ICI's recommendation, CSIM believes Funds should still have the option to obtain the implied consent of shareholders through delivery of a printed summary and statutory prospectus. Should the Commission adopt the ICI's recommendation, some Funds may choose not to rely on the rule but rather may elect to continue to send a printed summary or statutory prospectus; in such a case, significant savings are gained from leveraging the summary and statutory prospectus rather than sending a separate Initial Statement. Funds that choose to rely on the rule would still need to send some subset of new shareholders a printed prospectus, and would save the costs of subsequently having to send an Initial Statement to those same shareholders to rely on their implied consent in the future.

¹² Assuming the Initial Statement is delivered to current shareholders once annually 60 days prior to publication of the latest shareholder report (e.g., a Fund's annual shareholder report), this segment of shareholders would comprise all shareholders who purchased the Fund between transmission of the Initial Statement and publication of the next two shareholder reports (i.e., both the Fund's annual and semi-annual reports)—which amounts to approximately a 2 month period for delivery of the annual shareholder report and an 8 month period for the semi-annual shareholder report that next follows. The period of time can be limited to a 2 month period for each shareholder report, but only if the Fund mails an Initial Statement twice a year, 60 days before publication of both the annual and semi-annual report. This second mailing would, of course, result in an additional expenditures for printing and mailing.

¹³ Unless the Fund has otherwise obtained the shareholder's affirmative consent to electronic delivery and/or web delivery as permitted under current Commission guidance.

¹⁴ We note that under our recommendation, to realize the full cost savings of not having to mail an Initial Statement, a Fund would need to begin its reliance on the proposed rule 60 days after transmission of an

Note, that under this proposal, those who purchased shares of the Fund for which the implied consent requirements were included in the summary and statutory prospectus, as we recommend, would have no less an opportunity to request a mailed paper copy, should they prefer.

In addition to the foregoing, CSIM supports the positions articulated by the ICI and SIFMA in their comments letters to modify and clarify the proposal, and would draw the Commission's attention specifically to the following:

- *Clarify the role of intermediaries:* The majority of the Schwab Funds are sold through intermediaries; therefore, it is crucial that the Commission make clear that intermediaries would be able to fulfill the obligations under Rule 30e-3 on behalf of the Funds.¹⁵
- *Allow consolidated consent to cover multiple funds:* To the extent that a Fund must or chooses to seek to obtain implied consent in accordance with proposed Rule 30e-3(c)(1), the Commission should permit the implied consent under an Initial Statement to cover all current and futures Funds that a shareholder may invest directly with any particular fund complex. Similarly, a shareholder's consent should cover all Funds, held or subsequently purchased, through a particular intermediary. Shareholders would have the ability at any time to request a printed shareholder report for any particular Fund.¹⁶
- *Retain existing e-delivery guidance:* The Commission should retain existing e-delivery guidance to permit Funds to deliver shareholder reports by email to shareholders who affirmatively consent to e-delivery. In addition, the Commission should clarify that for shareholders who have affirmatively consented to e-delivery, the Fund may deliver the Initial Statement and Notice by email.
- *Permit other important accompanying materials:* To the extent that a Fund must or chooses to seek to obtain implied consent in accordance with proposed Rule 30e-3(c)(1) and to send out notices under Rule 30e-3(c)(4), the Commission should permit Initial Statements and Notices to be accompanied by other important account information, including account statements. Further, all Funds in a fund complex with

annual summary or statutory prospectus that includes the implied consent disclosure. Otherwise, it would need to mail an Initial Statement to capture the implied consent of existing shareholders when first transitioning to reliance upon the proposed rule. Even in this scenario, however, the Fund realizes cost savings because it would not need to mail the Initial Statement to its new shareholders annually thereafter.

¹⁵ Further, if the Commission adopts our recommendation to allow Funds the option to obtain implied consent through the summary and statutory prospectus, the Commission should clarify that intermediaries can rely on that implied consent.

¹⁶ Note, if the Commission adopts our recommendation to allow Funds the option to obtain implied consent through the summary and statutory prospectus, the purchase of one Fund would not be deemed implied consent for electronic delivery of any other Fund's shareholder reports, which would need to be separately obtained with respect to that Fund.

the same fiscal year end should be permitted to send a consolidated Notice or all such Notices in a single mailing.

VI. Proposed Amendments to Form ADV and Adviser Act Rules

We support the recommendations made by the ICI and SIFMA in their comments letters to clarify items in the Adviser Reporting Proposal.

VII. Conclusion

CSIM appreciates the opportunity to comment on the Proposals. If you have any questions about this letter, please contact the undersigned at [REDACTED] or Mark Fischer at [REDACTED].

Sincerely yours,

/s/ David J. Lekich

David J. Lekich
Senior Vice President and Chief Counsel
Charles Schwab Investment Management, Inc.