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10 June 2016
Mr. Brent J. Fields
Secretary
United States Securities and Exchange Commission
100 F Street, NE
Washington, DC 02059-1090

VIA E-MAIL: rule-comments@sec.gov

Re: **Open-End Fund Liquidity Risk Management Programs; Swing Pricing**
File No. S7-16-15 (the "Proposal")
Supplemental Comments

Dear Mr. Fields:

This letter supplements our original comments regarding the Proposal in order to highlight our concerns about the herding risk posed by the Proposal. We believe that requiring funds to adopt liquidity-based investment restrictions tied to the proposed liquidity classifications will result in behavior similar to the behavior surrounding credit ratings issued by Nationally Recognized Statistical Rating Organizations ("**NRSROs**"). To avoid promoting herding behavior, we recommend that the SEC either: (i) adopt a less prescriptive liquidity risk program requirement, as suggested in our initial letter; or (ii) remove the requirement that funds establish a minimum amount of fund assets to be maintained in the most liquid classifications.

The Risk of Herding Behavior Created by the Proposal

The risk of herding rises when large groups of market participants are subject to similar investment restrictions triggered by the same objective events, such as a determination made by one of a small number of independent service providers. This phenomenon is most clearly evident in the case of credit quality ratings issued by NRSROs. Institutional bond portfolios often include rating-based investment restrictions that limit their ability to invest in securities with lower credit ratings. As a result, investors who would otherwise act independently of one another tend to sell downgraded bonds around the same time. This concentrated selling creates volume spikes and price volatility for issuers around the time of the rating change. [1]

We believe the Proposal creates a similar scenario relating to liquidity classifications. Proposed Rule 22e-4 would require funds to classify their positions into liquidity categories based on the number of days the fund expects it to take to convert a position to cash. At the same time, fund boards would be required to establish a minimum amount of fund assets that would be invested in the most liquid classifications (i.e., convertible to cash within three business days) ("three-day liquid asset minimum"). While funds would be permitted to use in-house systems to classify their positions into the liquidity classifications, we believe that most would use third-party vendors instead. Smaller fund

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1 Index reconstitution offers another example of herding behavior. Many investors circumscribe their investible universe to the issuers included in a specific index. When securities are added to or removed from an index these investors also tend to transact accordingly, again creating volume spikes and price volatility.

complexes may lack the resources to develop in-house systems. Other funds may outsource to streamline business processes. For example, funds employing multiple sub-advisers could apply a consistent methodology for liquidity classifications by using third-party vendors. Finally, funds could use third-party vendors to avoid both the appearance of being an outlier and the conflicts of interest stemming from the fund manager's exercise of subjective judgment in the classification process.[2]

If enough funds outsource liquidity classifications to third-party vendors, the three-day liquid asset minimum would induce herding behavior among funds.[3] Just like investors who must respond to NRSRO rating changes, funds would transact in response to changes from their liquidity classification vendors to maintain compliance with their three-day liquid asset minimum. Funds would, as a group, tend to avoid (or attempt to sell) investments that are subject to a liquidity "downgrade". This concerted market activity by funds would create volume spikes and price volatility, and would exacerbate the liquidity stratification of the fixed income markets. Funds would tend to favor the securities most likely to be determined to be most liquid, which are, in the case of fixed income securities, generally the extremely large issuances by frequent issuers. Issuers who are unable to assemble larger deals would face increased costs of capital and less access to capital markets.

We believe the SEC can avoid unintentionally promoting herding behavior by adopting a less prescriptive liquidity risk management program requirement as outlined in our initial letter. Alternatively, the SEC could significantly mitigate the risk of herding behavior by eliminating the requirement that fund boards establish three-day liquid asset minimums and thus eliminate the need for funds to purchase or sell individual securities based on the determination of a third-party vendor, significantly mitigating the risk of herding behavior.

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We appreciate the opportunity to comment on the Proposal. If you have any questions about our comments or would like any additional information, please contact me or Lance Dial at the number above.

Very truly yours,

Cynthia M. Clarke

Cynthia M. Clarke
General Counsel
Wellington Management Company LLP

CC:
The Honorable Mary Jo White, Chair
The Honorable Kara M. Stein, Commissioner
The Honorable Michael S. Piwowar, Commissioner
David Grim, Director, Division of Investment Management

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2 The SEC also notes that funds whose reported classifications are outliers versus other funds would be subject to "further inquiry" from SEC staff. This would further incentivize funds to rely on a small group of common third-party vendors.

3 Funds currently rely on third-party vendors in other contexts without giving rise to herding behavior, for example portfolio security valuation. Herding does not arise in these contexts because the third-party vendor is not informing compliance with an investment restriction, e.g., changes in a security's valuation do not trigger common investment restrictions across a large swathe of market participants.