OppenheimerFunds®
The Right Way
to Invest

January 13, 2016

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-9303

Re: **Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release – Comments on Proposal to Require Liquidity Risk Management Programs and Related Disclosures**
Release No.: IC-31835; ***File Nos.:*** S7-16-15 and S7-08-15

Dear Mr. Fields:

OppenheimerFunds[1] appreciates the opportunity to comment on the Securities and Exchange Commission's ("SEC" or "Commission") proposed rulemaking on Open End Fund Liquidity Risk Management Programs and Swing Pricing (the "Proposal")[2]. OppenheimerFunds shares the SEC's concern that investors in open-end registered investment companies (excluding money market funds) ("funds") not be exposed to the potential for disproportionate loss through failures by funds and their fiduciaries to effectively manage liquidity risk. Prudent, fiduciary stewardship of fund assets should include management of risks, including liquidity risk, in a manner consistent with funds' disclosures and regulatory frameworks. OppenheimerFunds supports the SEC's objective of ensuring that funds, acting through their investment advisers and officers, adopt and implement appropriate programs for liquidity risk management. Over the last ten years, OppenheimerFunds has developed and implemented for its managed funds sophisticated risk management protocols that include liquidity risk management programs and liquidity stress testing, and has acquired multiple lines of credit covering our entire fund complex, from standalone, fund-specific lines of credit for certain funds to broad, shared lines of credit for other funds, to enhance fund liquidity. As the investment adviser to a loan fund and an emerging markets equity fund that are each among the industry's largest in their respective asset

---

[1] OppenheimerFunds is a registered investment adviser, providing investment management and transfer agent services to approximately 100 registered investment companies. OppenheimerFunds has been in the investment advisory business since 1960, and with its subsidiaries, has more than $216 billion in assets under management as of December 31, 2015.

[2] Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release, Release Nos. 33-9922, IC-31835 (Sept. 22, 2015), 80 Fed. Reg. 62274 (Oct. 15, 2015) (the "Proposing Release"). This comment letter addresses the liquidity risk management program portion of the Proposal.

class[3], we have distinct views on the considerations for liquidity risk management and the Proposal.

1. Introduction

The several aspects of the Proposal are the subject of thoughtful analysis, observations and commentary from the Asset Management Group of the Securities Industry and Financial Markets Association ("AMG") and the Investment Company Institute ("ICI") (collectively, the "Trade Organizations")[4]. We endorse the analysis, observations, commentary and suggestions set forth in the AMG and ICI comment letters as they relate to liquidity risk management programs. Specifically, in Section 3 below we discuss in detail certain comments made by AMG and ICI, offering our own views in support thereof. In Section 2 below, we discuss the important role played by lines of credit in effectively managing settlement liquidity and provide comments on the Proposal's treatment of lines of credit.

Although we support the SEC's goal that funds manage liquidity risk so that they can meet redemptions and do so without adversely affecting remaining shareholders, OppenheimerFunds is concerned that several of the Proposal's requirements are unnecessarily prescriptive and will impede the professional portfolio management judgment of investment advisers. Rather than requiring funds to develop their own liquidity risk management programs guided by principles-based regulation, the Commission has proposed a single, untested, sweeping set of substantive, prescriptive parameters on every fund, regardless of asset class. We believe that the Proposal's requirements that every fund, in every asset class, (i) assess the liquidity of each asset held by it using nine mandatory factors, (ii) allocate each asset (or relevant portion thereof) to one of six specified liquidity categories based on the number of days required to convert such asset to cash, (iii) assess and periodically review its liquidity risk by considering four mandatory factors and (iv) manage its liquidity risk by, among other things, maintaining a minimum amount of its net assets in a three-day liquidity bucket composed of cash and assets convertible to cash in three business days will be extraordinarily challenging and expensive to implement, negatively impact fund portfolios and ultimately limit investor choice.

Moreover, as discussed in detail in Section 3 below, we do not believe that the Proposal's asset-by-asset, bottom-up approach to liquidity assessment will actually achieve the Commission's objectives. However well executed, such an approach ignores (i) the cumulative liquidity of assets held across several funds simultaneously, (ii) the lack of evidence that detailed analysis of the nuances of asset liquidity in normal market conditions provides a meaningful indication of liquidity under periods of severe market stress and (iii) the reality that funds cannot assess asset liquidity with the level of precision assumed by the proposed approach. Additionally, we are concerned that publication of funds' liquidity profiles, through the required identification in proposed Form N-PORT of assets in each specified liquidity category, will be

[3] Oppenheimer Senior Floating Rate Fund and Oppenheimer Developing Markets Fund, with net assets as of the date of this letter of approximately $12.7 billion and $25.9 billion, respectively.

[4] Letter from Timothy W. Cameron, Head, and Lindsey Weber Keljo, Vice President & Assistant General Counsel, AMG, to Brent J. Fields, Secretary, SEC (January 13, 2016). Letter from David W. Blass, General Counsel, ICI, to Brent J. Fields, Secretary, SEC (January 13, 2016).

confusing and misleading to investors and likely to spawn a cottage industry of interpretive and comparative publications that will be similarly misleading, rather than enlightening, to investors.

The specter of a widespread redemption crisis – a specter not based on actual historic occurrences – has generated a Proposal that we believe will force fund investors into a more homogenous group of lower risk funds with lower return profiles for their investments. The millions of Americans who invest in funds for their retirement and other savings goals derive important benefits from well-constructed portfolios that provide access to less liquid assets and the concomitant diversification and potential for enhanced returns. The Proposal will add costs to investors, either directly through reduced returns if funds restructure their portfolios to hold a greater proportion of their assets in cash or highly liquid but low return securities than is truly warranted, or indirectly through higher fees on future products as advisers' costs of compliance are passed on. Although more sophisticated, larger investors may have access to alternative vehicles to avoid these costs, the mutual fund remains the investing vehicle of choice for many smaller investors. The SEC has not demonstrated the kind of urgent, remedial regulatory need that should be demonstrated before mandating liquidity risk management programs that may reduce fund returns and reduce diversification, thereby threatening investors' ability to achieve their financial goals.

The Commission has determined that fund regulation is in need of dramatic change in the form of a regulatory fiat that overrides investment advisers' professional portfolio management judgment and requires funds to conform to an industry-wide liquidity risk management paradigm. Although this first set of requirements is confined to liquidity risk, it establishes a precedent for mandating other forms of risk management frameworks for funds. It is reasonable to expect that the SEC may impose limits on a variety of other risk parameters in the name of protecting fund investors from loss, rather than allowing investors to choose from a range of funds to meet their diverse risk appetites. OppenheimerFunds believes that the SEC's efforts are best deployed to establish a requirement that funds adopt, employ and disclose liquidity risk management programs that meet guiding principles, not in replacing the judgment of experienced industry professionals in creating and managing funds with diverse risk profiles.

OppenheimerFunds understands the importance of fund liquidity risk management, and we are strong proponents of a thoughtful framework for the industry. The concerns that we and our peers in the industry have over the particulars of the Proposal are expressed in the utmost good faith. It is not our goal to prevent the adoption of regulation. Rather, it is our hope to engage the Commission in a collaborative process that will produce regulation that will achieve its policy goals without unduly sacrificing fund investor choice, dampening fund returns and creating avoidable operational complexity and portfolio strictures for fund managers.

We hope that the SEC will give serious consideration to the concerns of the industry, and to suggestions to make the Proposal more flexible, practical and ultimately better for investors.

2. Acknowledgement of the Role of Lines of Credit in Managing Settlement Liquidity; Filing of Lines of Credit as Exhibit to Form N-1A

As noted in the introductory section above, to enhance the liquidity of our managed funds, OppenheimerFunds has acquired multiple lines of credit covering our entire fund complex, including both standalone, fund-specific lines of credit for certain funds and broad, shared lines of credit for other funds. OppenheimerFunds has successfully employed lines of credit as a key tool in managing liquidity risks in funds, particularly in funds whose assets may be readily saleable yet take an extended period to settle (such as loan funds), and we commend the SEC for taking lines of credit into consideration in the Proposal, specifically as a factor to be considered and evaluated by funds in assessing their liquidity risks. However, we believe that the Proposal's treatment of lines of credit is incomplete. Funds can use lines of credit to address two distinct types of liquidity risk – (i) the risk that arises from the fund's ability to sell its assets and (ii) the risk that arises from the time it takes for sales of assets to settle and for the fund to receive cash. We believe that particularly with respect to this second risk, the Proposal significantly underweights the effectiveness of a line of credit as a liquidity risk management tool. For example, a loan fund holding loans that trade regularly in an active market and which has a line of credit that it uses to meet redemptions while waiting for loan sales to settle has a very different liquidity profile from an identical fund with no line of credit. With a line of credit, such a fund with readily saleable assets having long settlement times can meet redemptions immediately. The Proposal does not acknowledge this distinction, and in fact specifically rejects the consideration of lines of credit in assessing three day liquidity.

A fund's ability both to sell assets and to receive proceeds of those sales in a timely manner (which we sometimes separately refer to as "trading liquidity" and "settlement liquidity") in order to meet redemptions is of course of vital importance to the assessment of the fund's liquidity profile and the management of its liquidity risk[5]. However, it is important to understand how a line of credit plays different roles as a tool in managing the risks of trading liquidity and settlement liquidity. In managing the timing of asset sales – for instance by allowing a fund to borrow to meet a period of substantial redemptions while it subsequently sources trading liquidity and sells assets over several days – a line of credit can be a useful tool, but one that must be used with great care. If subsequent redemptions persist, because the fund is now leveraged, additional asset sales are required both to meet these subsequent redemptions and to repay that borrowing. In this circumstance, the borrowing might be regarded as creating liquidity risk with respect to these subsequent redemptions.

In contrast, the use of a line of credit to in effect accelerate settlement of previously sold assets does not display any such negative effects. In this instance, once an asset is sold, the fund uses a borrowing to pay redemptions while awaiting receipt of sales proceeds (which, upon receipt, are used to repay the borrowing), and the fund does not incur incremental leverage because its investment exposure to the asset has terminated at or before the time of the borrowing. Instead, the line has the effect of transforming liquidity and ensuring that the availability of funds to pay redeeming shareholders reflects timing to transact sales rather than

[5] Proposed Rule 22e-4(b)(2)'s liquidity classification requirement and the definition of "three-day liquid asset" each uses a "convertible into cash" concept, which incorporates both an asset's trading liquidity and settlement liquidity.

time taken to settle sales. Additionally, because funds are regarded as extremely creditworthy borrowers, the fees paid both to maintain and borrow under a line of credit used for this purpose will often be substantially less than the opportunity cost the fund would incur by instead holding an amount of highly liquid, lower yielding assets equal to the line's credit capacity.

Yet the Proposal appears not to acknowledge the important role played by lines of credit in effectively managing settlement liquidity. In the Proposing Release's discussion of the requirement that funds maintain minimum investments in three-day liquid assets, an example cited by the SEC of a hypothetical bank loan fund[6] explicitly suggests that the presence of a line of credit should <u>not</u> be considered by a fund when establishing its level of three-day liquid assets (or be regarding as increasing the three-day liquidity of the fund), irrespective of the ease of sale of the fund's assets and that the fund might have obtained the line to achieve immediate liquidity to meet redemptions while awaiting settlement of previously sold assets[7]. We believe that the existence of such lines of credit in transforming liquidity and, in effect, providing shorter settlement times (rather than adding leverage) is of material benefit to fund shareholders and that any final rule should more specifically acknowledge this benefit than does the Proposal. Of course, settlement liquidity alone does not create trading liquidity. But the Commission should allow funds to assess the two forms of liquidity separately, and apply available lines of credit to liquid assets with longer settlement times in assessing the liquidity of the fund's assets and allocating them to their respective liquidity categories and consider lines of credit in establishing a minimum (or target, as we support in Section 3 below) amount of highly liquid assets.

Moreover, it is essential for investors evaluating the liquidity profile of a fund to know whether the fund has a line of credit to manage settlement liquidity. Without such disclosure, investors will not have complete information in assessing the liquidity of two otherwise similar funds. Consequently, as we discuss in more detail in Section 3 below, if the SEC decides to require funds to disclose their liquidity profiles on Form N-PORT, funds should also be permitted to include supplementary information, including information regarding available lines of credit.

OppenheimerFunds opposes the Proposal's requirement that funds that have obtained a line of credit file the related agreements as an Exhibit to Form N-1A. Based on our experience, lines of credit are often composed of several transaction agreements (including credit agreements, security agreements, control agreements and fee letters), all of which are highly negotiated with relevant bank providers. We note that fees paid in connection with lines of credit are not the only terms regarded as confidential by funds, their investment advisers and bank providers. In addition, representations and warranties, affirmative and negative covenants imposed on funds, events of default and terms governing borrowing base calculations (in the case of secured lines of credit) are all generally regarded as sensitive information and subject to confidentiality obligations under the transaction agreements. Because these other sensitive terms

---

6 Proposing Release, supra note 2, at 62313-14.

7 The example is also seemingly inconsistent with proposed Rule 22e-4(b)(2)(iii)(D) and (iv)(A), which require a fund to consider its borrowing arrangements when assessing its liquidity risk and then to determine its three-day liquid asset minimum considering, among other factors, those arrangements.

and provisions run throughout the transaction agreements, they are not as easily “redacted” from the documents as is fee information.

Because lines of credit are complex arrangements represented by several transaction agreements, we believe that investors will gain limited benefit from availability of these agreements as an exhibit to Form N-1A but that funds will suffer disadvantages from such disclosure. Public disclosure of all fund line of credit agreements will provide funds, their investment advisers and their legal counsels with the ability to compare legal and credit terms across all such lines, with a concomitant loss of bargaining power by bank providers, as they are requested to incorporate perceived advantageous terms in a particular fund line of credit into all fund lines of credit in which they participate. But because banks must have robust risk management in their lending practices, it is unreasonable to expect that banks will relax their underwriting standards to accommodate these requests. Instead, the more likely result will be less willingness on the part of bank providers to flexibly negotiate fund lines of credit, tailoring the terms of a particular line of credit to accommodate the investment style and needs of the relevant fund(s). Diminished ability for funds to tailor lines of credit to suit their particular needs will result in lines generally being less effective tools for managing liquidity risk.

We note that the Proposal would require that funds make certain disclosures regarding lines of credit, their size, their bank providers and their usage in Form N-CEN and in Form N-1A (assuming that a fund that obtains a line of credit to manage its liquidity risk would disclose the line of credit as a method that the fund uses to meet redemption requests in its prospectus or statement of additional information). We further note that, even today, funds with access to lines of credit often disclose their existence in prospectuses/statements of additional information and in financial statement footnotes. We believe that these disclosures will provide both investors and the Commission with sufficient, relevant information regarding fund lines of credit so as to make filing with Form N-1A unnecessary.

3. <u>Support for Trade Organization Comments</u>

The AMG and ICI comment letters set forth important analysis, observations and comments about the Proposal, along with certain alternative approaches to liquidity risk management, crafted with input from numerous investment advisory firms. OppenheimerFunds supports the AMG and ICI comments. In particular, we believe the Commission should pay particular attention to the following comments reflected in their letters.

Classification of Fund Assets Based on Number of Days to Convert to Cash

Like AMG and ICI, we note that there is no precedent for proposed Rule 22e-4(b)(2)’s requirement that a fund classify each portfolio asset (or portion thereof) into one of six liquidity categories based on the number of days that the fund reasonably determines that such asset could be converted to cash (the “Liquidity Classification”). We do not use, and we are unaware of other investment advisers that employ, such a classification system as part of existing liquidity risk management practices applied to funds. We are also unaware of any similar liquidity classification system that is currently imposed on other regulated entities in the financial services industry. Consequently, the usefulness of the Liquidity Classification and its effectiveness in protecting investors from liquidity risk is untested. Because the Liquidity Classification is not rooted in industry best practices, OppenheimerFunds and other investment advisers are unlikely to replace their existing methodologies for measuring fund liquidity with the Liquidity Classification and, as a result, the Liquidity Classification is likely to be a prescriptive regulatory requirement that exists alongside industry best practices.

Further echoing AMG and ICI, we have concerns regarding whether the Liquidity Classification is feasible to implement and will actually achieve the Commission's objectives. The requirement assumes that an assessment of an asset's liquidity, measured as "days to convert to cash" without a material impact on value, is a scientific, quantitative determination, as evidenced by the fine distinctions between the various proposed liquidity categories (for example, categories two and three are distinguished by whether an asset can be converted to cash in 2-3 business days or 4-7 calendar days; the distinction between these two categories is so fine that the proposed rule includes guidance addressing weekends and holidays). However, except perhaps with respect to exchange traded instruments and certain highly liquid assets, liquidity determinations cannot be made with such precision. As a result, funds might be required to make extremely subjective, projective determinations when ascribing assets to liquidity categories so as to be compliant with the regulatory requirement. Both the impracticality of obtaining the bottom-up data and of conducting the bottom-up analysis required for the Liquidity Classification is well-summarized in the DERA study cited in the Proposing Release[8]:

> "…for mutual funds with significant investments in assets other than U.S. equities, the bottom-up approach is difficult to implement…the bottom-up approach requires a common measure of liquidity for all securities in a fund's portfolio…liquidity measures for fixed-income securities are typically more complex and tailored to the data available for each class. Further, if the liquidity measure we use varies between fixed-income classes, then it is not possible to calculate average portfolio liquidity for funds that invest in multiple fixed-income classes. In addition, the infrequent trading of many fixed-income securities can introduce both stale and inaccurate measures of liquidity into the calculation of a fund's bottom-up liquidity."

We agree with ICI's comment that, while the Liquidity Classification might be merely difficult, imprecise and potentially misleading for exchange traded instruments, it would be nearly impossible for assets that trade over-the-counter. In the face of the tremendous operational challenges and burdens that funds would experience trying to comply with the Liquidity Classification requirement, we also agree with ICI that the Liquidity Classification would regrettably become the *de facto* focal point of liquidity risk management programs, diverting funds and their investment advisers from broader assessments of liquidity risk.

While the Commission suggests in the Proposal that vendors might be able to provide data and analysis to funds to assist them with the Liquidity Classification requirement and ease the operational burden, we concur with AMG that no vendor currently has the necessary

---

[8] Paul Hanouna, Jon Novak, Tim Riley, Christof Stahel, Div. of Econ. & Risk Analysis, SEC, Liquidity and Flows of U.S. Mutual Funds 31, (September 2015), available at: https://www.sec.gov/dera/staff-papers/white-papers/liquidity-white-paper-09-2015.pdf.

analytical capabilities and product offerings. More importantly, we agree with the Trade Organizations that the emergence of a small number of vendors that sell proprietary liquidity classification information to funds and their investment advisers who rely on that information to facilitate compliance with a prescriptive liquidity classification regime would be a negative development for fund liquidity risk management, reminiscent of the role that credit rating agencies formerly played in certain federal securities laws.

The reality that many funds cannot assess liquidity for all of their assets with the level of precision assumed by the Liquidity Classification also means that funds will be unable to monitor their liquidity real-time (as the Proposal suggests might be required) with such precision, adjusting asset classifications among the various categories to reflect market conditions that are changing moment to moment and responding with changes to portfolio construction. Further, even assuming that funds in normal market conditions could assess the nuances of asset liquidity as required by the Liquidity Classification, we do not believe that this analysis would provide a meaningful indication of liquidity under periods of severe market stress, such as the financial crisis of 2008, which periods (and the market dislocations experienced in them) cannot be accurately predicted. This suggests that the Liquidity Classification will not prove to be more useful in assisting funds predict or prepare for market-based liquidity crises of the kind that put timely redemptions in peril than are the existing, more top-down liquidity measurement methodologies currently employed as industry best practices.

The Liquidity Classification also does not account for the cumulative liquidity of a particular asset that is held across several funds simultaneously. Because a fund must only consider the size of its position in the asset in assessing its liquidity, multiple smaller funds holding a given asset will inevitably appear more liquid than a smaller number of larger funds holding the same asset in the same aggregate amount. This will be the case even if the smaller and larger funds are affiliates in the same fund complex, the investor bases in the funds (and hence the aggregate propensity to redeem) are the same and all such funds must access liquidity in the asset simultaneously. Accordingly, we agree with ICI that the Liquidity Classification requirement, combined with the requirement that funds identify their Liquidity Classifications in proposed Form N-PORT, is inherently biased against larger funds. Although a larger fund typically has a diversified, stable shareholder base (resulting in relatively less liquidity risk than a smaller peer fund with a more concentrated shareholder base), the Proposal's requirement that each fund consider the position size of its assets will inevitably result in the larger fund classifying some assets (or portions thereof) in less liquid categories than the smaller fund classifies those same (or similar) assets. Liquidity Classification disclosures on Form N-PORT by these two funds might suggest that the liquidity profile of the large fund is "worse," notwithstanding that its more diversified, stable shareholder base actually gives rise to less liquidity risk.

Additionally, as AMG notes, the Liquidity Classification and its emphasis on prescriptive determinations does not account for the experience and expertise of portfolio managers and traders in managing fund liquidity. As experts in the securities and markets in which they invest funds, portfolio managers and traders often have qualitative insights and judgments on liquidity, including venues and counterparties from which liquidity can be sourced in stressed market conditions. Under an overly prescriptive liquidity risk management regime that includes a requirement that funds maintain a minimum percentage of highly liquid assets that is informed considerably by the Liquidity Classification, investors would be denied the benefits of these skills, forced instead into more homogenous, lower risk funds with lower return profiles resulting from increased holdings of lower yielding investments.

For these reasons, OppenheimerFunds supports ICI's proposed alternative that funds, as part of their liquidity risk management programs, be required to formulate policies and procedures regarding how they will assess, classify and monitor the liquidity of their assets. We agree with ICI that this approach is superior to the Liquidity Classification requirement because it would allow a fund to adopt a liquidity classification system that (i) is risk based and tailored to that fund and the asset classes in which it invests, (ii) is less dependent on subjective, projective determinations of asset level liquidity and (iii) properly emphasizes asset level liquidity assessments within the broader context of portfolio level liquidity assessment. Under such an approach, we would expect a fund to specify in its policies and procedures the various liquidity categories into which its assets are to be classified for liquidity assessment purposes. Depending on the fund, its investment strategy and the asset classes in which it invests, those categories might be defined more quantitatively ("bottom-up") or more qualitatively ("top-down"). However, categories would be required to be defined with sufficient granularity to be meaningful. In classifying assets into the specified categories, the fund would consider and weigh those factors that it reasonably determines are most relevant for those assets and the liquidity categories. Additionally, the fund's policies and procedures would be required to include a monitoring obligation, necessitating that the fund conduct periodic re-assessments of its asset classifications to address any changed market conditions.

However, should the SEC determine that the final rule must include specific liquidity categories into which all funds classify their assets, OppenheimerFunds supports AMG's proposed alternative liquidity classification system in which fund assets would be classified into one of four liquidity categories, using a good faith estimate of asset liquidity based on current market conditions (and recommending an assumption of no fire-sale discounting if the Commission believes that an outer boundary on price impact must be a component of a liquidity classification requirement). Category 1, which includes cash and cash equivalents and other highly liquid assets that a fund reasonably believes it can convert to cash (i.e., trade and settle) within three business days in the context of normal trading, would require funds to make a determination regarding the amount of their assets that can be converted to cash within three business days, which is a critical determination for the Proposal's requirement that funds manage their liquidity risks (as well as for the alternative liquid asset target that we discuss and support below). Where an asset's liquidity can be more precisely evaluated (such as because it is exchanged traded or otherwise has a deep and resilient trading market, even during periods of market stress), a fund would be required to make a more precise determination in concluding that the asset can be converted to cash within three business days and classified in Category 1. Consideration of a fund's position size in these assets might often be irrelevant to their liquidity assessment and classification given their characteristics and/or the fact that they have deep markets that can accommodate substantial trading. At the same time, through its inclusion of Categories 2, 3 and 4, AMG's proposed classification system better recognizes that liquidity assessments of other assets are more qualitative and top-down and incompatible with the fine distinctions required by the Proposal's Liquidity Classification. Consideration of a fund's position size might be relevant to the liquidity assessment of assets in these three categories, and we would expect that a fund might need to classify some portion of certain substantial holdings in less liquid categories to reflect concentrated positions.

Finally, liquidity classifications of fund assets should not include a "materially affecting the value" concept. Measuring the market impact of a particular fund's selling activity on the value of an asset is difficult even in retrospect, such that attempts to predict market impact and its "materiality" pre-sale will be extremely challenging and subjective. Because consideration of a fund's position size in a particular asset will, in many cases, be relevant to the classification of that asset's liquidity, we expect that under either of the proposed alternative liquidity classification systems that we support above a fund might need to classify concentrated positions in less liquid categories (as we describe in the preceding paragraph in connection with AMG's proposed alternative liquidity classification system). Moreover, it is a fact of financial markets and asset valuation that asset prices are likely to be trending down when a fund is selling. The price movement is a function of investor sentiment on the desirability of owning the asset, and in most cases it will be difficult and impractical for a fund to accurately conclude whether its selling activity has the effect of contributing to (or accelerating) that downward price movement. The fact that a fund is selling into a declining market is not necessarily a badge of illiquidity, nor should a fund be forced to classify an asset as more illiquid solely because its market value is declining when the fund is selling.[9]

Factors for Determining Asset Liquidity

We agree with AMG and ICI that proposed Rule 22e-4(b)(2)'s requirement that a fund consider nine factors when classifying and reviewing the liquidity of a portfolio asset should be eliminated and that the SEC should instead provide these factors as guidelines in the adopting release for any final rule. Regardless of whether a final rule will require a fund to classify the liquidity of assets as set forth in the Proposal or as we alternatively support above, these nine factors are overly prescriptive and not relevant to a liquidity assessment of many assets (though the nine factors may indeed be "applicable" to many assets and thus required to be considered under the Proposal).

As an example, a fund that invests solely in equity securities of large capitalization issuers that are traded on U.S. exchanges might reasonably determine that the frequency of trades in those equity securities and their average daily trading volumes are sufficient factors to determine their liquidity, and that consideration of factors such as bid-ask spread and volatility of trading prices are not useful or informative in a liquidity assessment. However, because these securities have observable bid-ask spreads and volatility, the fund would nonetheless be required to obtain and consider such data.

---

[9] This same issue with respect to market impact arises with the Proposal's definition of "liquidity risk" and its focus on the ability of a fund to meet redemptions in normal or reasonably foreseeable stressed conditions "*without materially affecting the fund's net asset value*." On this definition, we note in particular our support for AMG's recommendation that the qualifying language be deleted and the arguments provided in support thereof.

Further, there might be several other factors not among the nine set forth in the Proposal that are relevant for assessing the liquidity of a particular asset. As an example, for loan assets the credit quality of the borrower, the loan's spread to maturity and whether the loan is trading as "par" or "distressed" might all impact the liquidity of the loan, both with respect to the loan's trading liquidity and settlement liquidity. As noted above, if a particular asset is held in a fund and in one or more affiliated funds in the same fund complex that have similar liquidity risks, assessment of the asset's liquidity might require that the fund additionally consider the possibility that all such funds might need to simultaneously access liquidity in that asset. Although the Proposal does not prohibit a fund from considering additional factors such as these, the fact that the Proposal sets forth a list of nine factors that must be considered will require funds to expend resources evaluating these mandatory factors that might be better deployed considering non-mandatory factors that are more relevant to the particular asset.[10]

For these reasons, we believe that any final rule should require that a fund, when classifying and reviewing the liquidity of a portfolio asset, take into account those factors that are reasonably determined by the fund to be most relevant with respect to the asset and the fund's ownership position in the asset. Commission guidance in the adopting release for any final rule should identify the nine factors as guidelines for consideration by funds, but make clear that funds retain flexibility to identify and weight, and to exclude, any factors in their reasonable determination.

Three-Day Liquid Asset Minimum

We agree with AMG and ICI that several portfolio management problems would result from Rule 22e-4(b)(2)'s requirement that each fund (i) be required to determine a "three-day liquid asset minimum" and (ii) be prohibited from acquiring less liquid assets at any time that its investments in "three-day liquid assets" are less than its three-day liquid asset minimum. For actively managed funds, these problems include a fund's inability to fully pursue and implement its stated investment objectives and strategies and reduced returns for shareholders resulting from the fund's carrying of "extra liquidity". For passive funds and funds pursuing "smart beta"

---

[10] We note that the proposed factor set forth in Rule 22e-4(b)(2)(ii)(I) (relationship of the asset to another portfolio asset) would significantly exacerbate the operational challenges and burdens of the Liquidity Classification requirement that are discussed above. While fund policies and procedures generally require that a specified amount of liquid assets be segregated against particular derivative instruments, a fund will typically sum the asset segregation requirement in respect of each derivative instrument in its portfolio on a daily basis to calculate an aggregate asset segregation requirement for that day. Liquid assets are then segregated against the aggregate requirement. Similarly, hedging derivatives are often entered into to hedge an aggregate portfolio exposure, not a particular security (for example, a fund might enter into one or more foreign currency forward contracts to hedge a portion of its foreign currency risk arising from securities denominated in the relevant foreign currency). In both cases, it would be impossible for the fund to "link" the relevant asset to another asset that it "covers" or hedges as this proposed factor would require. Additionally, even if a fund could establish such a "link", we believe that disclosure of the effect of this linkage on Form N-PORT would be extremely confusing and misleading to investors. For example, a fund that has segregated cash and money market fund shares against a single, less liquid derivative instrument would seemingly be required to disclose the liquidity of the money market fund in a category other than "convertible to cash within 1 business day", but without any ability to explain the "linkage" of the money market fund to the less liquid derivative instrument that it covers (we note that whether the segregated cash would also need to be disclosed in a less liquid category is unclear). For these reasons, we agree with ICI that the Commission should eliminate any requirement that funds determine the liquidity classification of assets based on related assets.

strategies, the most significant problem would be a fund's inability to adhere to its index. Additionally, as we note above, the determination of whether an asset constitutes a three-day liquid asset can be challenging and impractical, particularly for certain asset classes. Nonetheless, implementation of the proposed three-day liquid asset minimum would require any fund that is below its minimum to conduct a prospective liquidity analysis of all potential purchases to ensure that only three-day liquid assets are acquired. Particularly for fixed income and alternative funds, we are concerned that the most practical course of action for a fund to ensure compliance and avoid violation would be to sell less liquid assets for cash to replenish its three-day liquid assets. By taking such action, the three-day liquid asset minimum would have the unintended consequence of exacerbating a risk in that fund that the Proposal seeks to address – namely, the fund's excessive sale of less liquid assets during times of market stress in a manner that affects the fund's net asset value.

For all these reasons, we support as an alternative AMG's proposal to require funds to determine whether to establish a "target" amount of highly liquid assets (in AMG's proposed alternative liquidity classification system, such assets would be those classified in Category 1), considering a fund's liquidity risk and all of the liquidity tools available to the fund (which might include lines of credit and interfund lending facilities, among others). When below its target, a fund would be permitted to acquire less liquid assets only if determined to be prudent (based on relevant circumstances, including the fund's redemption activity at the time and whether other effective liquidity tools remain available to the fund) and consistent with the fund's stated investment objectives and strategies. The determination of whether to establish such a target and its amount would be based on a fund's evaluation of the factors set forth in proposed Rule 22e-4(b)(2)(iii), which we, like AMG and ICI, believe the Commission should articulate as a non-exhaustive list of factors that a fund may consider and weight as it deems appropriate and relevant when assessing its liquidity risk. We would similarly support a requirement that funds periodically review whether to establish or adjust a liquid asset target, semi-annually or on an ad-hoc basis, based on any changes to the previously considered factors or market events. To ensure that any target is reasonably established by a fund (or that a decision not to have a target is reasonable), we would support board oversight of the target, including a requirement that a fund disclose to its board its determination to establish (or not to establish or to suspend) a target and the amount of the target and any material changes thereto, as well as the factors regarded as relevant by the fund in making such determinations. A fund would also be required to disclose to its board any instances where it falls below its target and provide an explanation of the circumstances of such occurrence and its impact on the fund's liquidity risk.

We believe that a target amount of highly liquid assets, unlike the proposed three-day liquid asset minimum, would allow funds the flexibility to continue pursuing their investment objectives and strategies (and consequently to continue providing investors with the benefits of well-constructed portfolios and the potential for enhanced returns), even during periods in which market events or redemption activity put the fund temporarily below its target, but only if acquisitions of less liquid assets are determined to be prudent and consistent with those investment objectives and strategies. The requirement that a fund's board oversee the establishment of any target and changes thereto, and also monitor the fund's compliance with any target, would obligate funds and their investment advisers to regard the target with appropriate importance, ensuring that portfolio management decisions to acquire less liquid assets when the fund is below its target are made subject to appropriate review. Finally, we believe that a target amount of highly liquid assets, because of the increased flexibility that it provides as compared to the three-day liquid asset minimum, does not carry the same risk of incentivizing procyclical activity in which less liquid assets are sold by a fund to build cash during periods when the fund is below its three-day liquid asset minimum.

Disclosure of Asset Liquidity Classifications on Proposed Form N-PORT

OppenheimerFunds is concerned, as are the Trade Organizations and others in the industry, with the Proposal's requirement that funds disclose their liquidity profiles by identifying their Liquidity Classifications in proposed Form N-PORT. We note that, in commenting generally on proposed Form N-PORT as part of the SEC's proposal for modernizing investment company reporting and disclosure, we urged the SEC not to require public disclosure of certain information proposed to be included in Form N-PORT that we believe will be confusing to investors and potentially harmful to funds[11]. We comment that Liquidity Classifications should be added to that list of items proposed to be reported on Form N-PORT that should be kept confidential.

We believe that disclosure of a fund's Liquidity Classifications on Form N-PORT will not be useful to fund investors and is more likely to be misleading and confusing. Because the information on Form N-PORT would be made publicly available only for the last month of a fund's fiscal quarter and with a 60-day delay (with no obligation (or means) for a fund to update to reflect changed circumstances), information regarding Liquidity Classifications would be infrequent, static and outdated. Consequently, the information will not be useful to even the most sophisticated investors in assessing the liquidity risk of funds, including during times of market stress, because a user of the information will have no insight as to whether a fund has changed its liquidity profile since the last reporting date. Further, as we note above, because the Proposal assumes a level of precision in assessing asset liquidity that simply does not universally exist, Liquidity Classifications will in some cases be highly subjective determinations that are susceptible to second guessing with the benefit of hindsight. Consequently, disclosure of Liquidity Classifications will give fund investors a false sense of precision in evaluating and comparing the liquidity and liquidity risks of funds. Indeed, out of fear of being regarded as an outlier and second guessed, funds may simply copy the Liquidity Classifications of similarly sized funds pursuing similar investment strategies and/or holding equivalent or similar assets, further detracting from the usefulness of public disclosure of this information[12]. Worse yet, as ICI notes, public disclosure of Liquidity Classifications might also lead funds to invest in assets that are regarded as more liquid (but that are also lower yielding), particularly around the last month of their fiscal quarters, to improve the perception of their liquidity profiles, or to otherwise restructure their portfolios to be similar to peer funds in terms of their liquidity

[11] Letter from Ari Gabinet, Executive Vice President and General Counsel, OFI Global Asset Management, Inc., to Brent J. Fields, Secretary, SEC (August 10, 2015).

[12] We note that, although the SEC would have access to the Liquidity Classifications of funds more frequently (on a monthly basis), the SEC's ability to accurately assess and compare fund liquidity and liquidity risks would be impeded by these same issues.

profiles. Any such "herding" by funds out of less liquid assets into more liquid assets or into a more homogeneous group of securities within a particular asset class solely to bolster the perception of their liquidity would be detrimental to shareholders and limit investor choice.

We also think it is likely that a cottage industry of information vendors will develop, who purport to compile and analyze public disclosure of funds' Liquidity Classifications on Form N-PORT and provide interpretive and comparative information regarding fund liquidity. Unlike the more objective fund data that such information vendors today compile, analyze, report and compare for investors (including fund performance, expense ratios and portfolio holdings), we believe that the inherent limitations in the Liquidity Classification information that we and the Trade Organizations highlight make it more likely that any summary, interpretive or comparative information published by these vendors will mislead, rather than enlighten, investors.

We further note that, for certain funds that invest in relatively less liquid asset classes, public disclosure of Liquidity Classifications on proposed Form N-PORT in an isolated, structured format will be particularly detrimental to both the funds and investors. For example, a fund investing in bank loans would be likely to disclose a substantial amount of its assets in less liquid categories (8-15 calendar days or greater), reflecting the longer settlement period for loans as compared to other assets. If that fund has taken affirmative steps to mitigate the risks posed by the settlement liquidity of the loans in which it invests, such as obtaining a line of credit with a credit capacity equal to 10% of its net assets, investors would be required to review information in the fund's Form N-CEN and Form N-1A (as the SEC has proposed to amend these forms to provide information about lines of credit and the methods that the fund uses to meet redemptions) to obtain a holistic view of the fund's management of its liquidity risk. An investor's review of Form N-PORT alone would misleadingly suggest to that investor that the fund is relatively illiquid.[13] Consequently, we request, if the SEC determines to require any public disclosure of a fund's liquidity profile in Form N-PORT, that the fund be permitted to include explanatory disclosure or supplementary information, such as information regarding available lines of credit, to provide a more holistic view of the fund's liquidity profile.

Our comments above address issues and concerns with the public disclosure of funds' Liquidity Classifications on Form N-PORT, a requirement of the Proposal that we strongly oppose for the reasons discussed above. Although either of ICI's or AMG's recommended alternative liquidity classification systems would better support reporting of liquidity classification information at the portfolio level (the percentage of fund total assets in each liquidity category) than would the Liquidity Classification (which would require asset-by-asset liquidity classification information), we believe that public disclosure of even such portfolio level information would give rise to several of the same issues and concerns highlighted above (infrequent, static and outdated information, suggestion of a false sense of precision, lack of

---

[13] We further note that a fund with such a line of credit might reasonably determine under the Proposal's framework that its liquidity risk is substantially less than it would be without the line of credit and therefore conclude that it is appropriate to maintain fewer three-day liquid assets. As a result, Form N-PORT would disclose that this fund holds a relatively larger percentage of its assets in loans, and has a lower three-day liquid asset minimum, than a loan fund with a smaller line of credit, magnifying the suggestion that the fund is illiquid and exposed to greater liquidity risk.

comparability and lack of explanatory information to provide context). Consequently, we oppose any requirement for funds to publicly disclose their liquidity profiles on Form N-PORT.

* * *

OppenheimerFunds appreciates the opportunity to comment on this important proposed rulemaking by the SEC, as well as the Commission's consideration of our comments and views shared in this letter. We are available to provide any additional information or assistance that the SEC might find useful. Please do not hesitate to contact Ari Gabinet at [redacted] or [redacted].

Sincerely,

/s/ Arthur S. Gabinet

Arthur S. Gabinet, Esq.
Executive Vice President & General Counsel
OppenheimerFunds

/s/ Geoffrey J. Craddock

Geoffrey J. Craddock
Executive Vice President & Chief Risk Officer
OppenheimerFunds