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Submitted electronically through http://www.regulations.gov

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: **Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release**
File No. S7-16-15

Dear Mr. Fields,

Fidelity Investments ("Fidelity")[1] appreciates the opportunity to provide comments to the Securities and Exchange Commission ("SEC" or "Commission") on its proposal to require open-end funds, other than money market mutual funds, to establish liquidity risk management programs and its proposal to establish swing pricing as an elective tool for certain funds (the "Proposals").[2]

We fully support the SEC in its examination of liquidity management practices in the asset management industry and in its efforts to promulgate rules that it deems are necessary and appropriate in the interests of shareholder protection and risk monitoring. We support the Proposals as a critical component of the SEC's broader agenda to examine and enhance its regulatory oversight regime[3] and we agree that the Commission's review of its liquidity regulations is timely given the growth and changes in the industry since the last time it provided guidance on liquidity.

We strongly support a requirement for funds to adopt written liquidity risk management programs to promote more effective and consistent liquidity risk management across the asset management industry. In the Release, the SEC states an objective "to create a regulatory framework that would reduce the risk that a fund will be unable to meet its redemption

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[1] Fidelity and its affiliates are leading providers of mutual fund management and distribution, securities brokerage, and retirement recordkeeping services, among other businesses.
[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. 62275 (Oct. 15, 2015) (the "Release"). Throughout this letter, our comments relating to mutual funds exclude money market mutual funds.
[3] Speech by Chair Mary Jo White, "Enhancing Risk Monitoring and Regulatory Safeguards for the Asset Management Industry," available at http://www.sec.gov/News/Speech/Detail/Speech/1370543677722.

obligations and minimize dilution of shareholder interests by promoting stronger and more effective liquidity risk management across open-end funds."[4] We agree with this objective and we suggest modifications to the Proposals that take into account existing sound liquidity management practices.

Another of the SEC's stated objectives is to "…give the Commission better information with which to conduct comprehensive monitoring and oversight of an ever-evolving fund industry."[5] We fully support this objective. As the asset management industry's primary regulator, the SEC should conduct this oversight based on relevant and current information provided to it by funds. In the Release, the SEC proposes categories of liquidity information that it believes will assist it in the performance of its oversight function. While we support reporting relevant data to the SEC, we suggest modifications to the information requested which we believe will enhance the SEC's ability to perform its monitoring and risk oversight responsibilities.

Our suggested enhancements to the Proposals acknowledge that like capital markets, liquidity is dynamic, and effective fund liquidity risk management requirements must provide flexibility for funds to be able to take on investment risk according to their mandates and investors' expectations, for investors to have access to investments with a range of risk/return profiles, and for funds to play the important role of supporting capital formation for the development of businesses and the economy.

I. EXECUTIVE SUMMARY

Our comments that follow include the following points:

1. We strongly support the requirement for funds to adopt written liquidity risk management programs. We offer suggestions to enhance the effectiveness of such programs in promoting flexible liquidity risk management practices across the industry.

2. We support a fund's board having responsibility for approving and overseeing the fund's liquidity risk management program, but believe that the board's role should be consistent with its governance and oversight activities in other contexts.

3. We support codifying existing SEC guidance on illiquid assets.

4. We support a requirement to classify assets into one of three liquidity categories as opposed to the six categories set forth by the SEC. Our suggested categories are: highly liquid assets; liquid assets; and illiquid assets. Six liquidity categories would be unworkable and because liquidity is dynamic, a higher number of categories would lead to a false sense of precision in liquidity determinations. Finally, six liquidity

[4] Release at 62275.
[5] Release at 62276.

categories would not give the SEC helpful information about a fund's overall liquidity profile.

5. We do not support asset-level liquidity classifications based on the number of days in which an asset would be convertible to cash at a price that does not materially affect the value of that asset immediately prior to sale, because we do not believe that standard informs a proper assessment of fund liquidity. We suggest that classification of assets as highly liquid be based on a determination of what a fund can convert to cash within three business days "within the context of normal trading." This standard would be uniformly applicable across asset classes and would better inform fund liquidity risk management. To classify assets as illiquid, we support using the Proposal's guidance on illiquid assets.

6. As part of its liquidity risk management program, a fund should periodically review with its board the fund's existing liquidity profile compared to the fund's liquidity needs, both in current market conditions and reasonably foreseeable stressed market conditions, in order to inform the fund's liquidity risk. This approach would provide a fund with the flexibility to adapt its liquidity management to changing market conditions without an artificial restriction on security purchases. A minimum liquid assets requirement is not appropriate for mutual funds or ETFs. Restricting funds from purchasing certain assets has the potential to be harmful to funds, investors, the markets and the economy.

7. We support reporting to the SEC the aggregate percentage of a fund's assets in each of three liquidity categories on a monthly basis. We do not support reporting asset level liquidity classifications to the SEC because such disclosure would provide little useful information to the SEC. We do not support public disclosure of liquidity metrics because such disclosure would be misleading to investors. Before any public disclosure of liquidity data is considered, the SEC should evaluate the information it is requesting for a period of time to determine whether the information can be helpful to investors seeking to compare liquidity across funds.

8. We support measures intended to protect shareholders from dilutive effects of excessive purchases and redemptions. Swing pricing could be helpful in this regard, but as proposed, presents operational hurdles that would be problematic for the industry. We also strongly recommend an implementation delay, which would begin only after the industry is operationally prepared for swing pricing.

The asset management industry has a strong track record of meeting shareholder redemptions through a variety of market conditions.[6] Responsible fund managers focus on the

[6] The SEC's issuance in December 2015 of a temporary order to allow a mutual fund to suspend redemptions was indeed a rare event – the rarity of such which emphasizes the low magnitude of liquidity risk, as defined by the SEC, in the asset management industry. *See* SEC Release No. IC-31943 (Third Avenue Trust and Third Avenue

liquidity needs of their funds as an integral part of portfolio construction and fund structure, taking into account both normal and stressed market conditions.[7] Additional liquidity requirements should incorporate existing best practices and encourage prudent liquidity management practices for all funds. In doing so the Proposals should account for the dynamic nature of liquidity across asset classes, within various market conditions, and among different types of funds.

We believe our suggested enhancements to the Proposals are more consistent with existing best practices and would better meet the objective of ensuring that funds are able to adequately meet shareholder redemption obligations. We also believe our suggested enhancements will result in more useful information for the SEC to use to monitor for risk in the industry.

II. OPEN-END FUND LIQUIDITY RISK MANAGEMENT PROGRAMS

Proposed Rule 22e-4 would require each registered open-end fund, including open-end ETFs but not including money market mutual funds, to adopt a written liquidity risk management program that incorporates specified elements.[8] We strongly support this requirement and believe it will promote stronger and more effective liquidity risk management practices. Such a requirement would make each fund accountable for informing its board on how its liquidity management practices support the fund's ability to meet redemptions. Board oversight also may highlight deficiencies or vulnerabilities in a fund's liquidity management practices.

We suggest modifications to the Proposals below to strengthen the written liquidity risk management program requirement. Our suggested modifications allow funds the flexibility to manage their liquidity risk based on their investment universe, the markets they trade in, and each fund's unique liquidity needs.

<u>Board Oversight</u>

Board oversight of a fund's liquidity risk management program is the most effective way for the SEC to accomplish its objectives.

Under the Proposals, a fund's board would have a number of responsibilities including approval of a fund's liquidity risk management program, approval of material changes, periodic review of the adequacy of the program and designation of responsibility for administering the program.[9] We support board responsibility for approving a fund's liquidity risk management

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Management LLC; Notice of application and temporary order under Section 22(e)(3) of the Investment Company Act) (Dec. 16, 2015).

[7] Funds use a variety of approaches to meet redemptions; the assumption that funds only sell the most liquid assets to meet redemptions is not consistent with how we manage portfolios at Fidelity, particularly because we are always seeking to keep our funds in line with investor expectations.

[8] Release at 62287.

[9] Release at 62324.

program and for determining the adequacy of a fund's liquidity risk management program. A fund's board plays an important oversight role and is in the best position, as a fiduciary to the fund, to oversee the manager's determinations that a fund's liquidity management practices are sufficient in light of the attributes of the fund, market conditions and shareholder flows. These factors are unique to each fund and change over time. For these reasons, effective liquidity risk management does not lend itself to a single, prescriptive formulation. Each fund's board can best oversee the application of flexible requirements to the fund's needs.

The board's responsibilities for liquidity risk management should be consistent with its governance and oversight responsibilities in other contexts. A fund's liquidity risk management program should be subject to the same review as Rule 38a-1 policies and not be subject to board approval each time the program changes.

We do not support the proposed designation of a fund officer – who is not the portfolio manager – to be responsible for administering the fund's liquidity risk management program. Because liquidity risk management is an integral part of responsible portfolio construction and management, we believe that the fund's portfolio manager is the most appropriate individual to manage the risk of a fund, including its liquidity risk. The SEC suggests that funds for which liquidity risk management is overseen by non-investment professionals may perform better,[10] but offers no evidence to support that assertion. The SEC also asserts that there is an inherent conflict between a portfolio manager's desire to optimize performance and manage liquidity risk.[11] We do not agree – the failure to manage liquidity risk could itself negatively impact performance. We believe that the responsibility for managing a fund's liquidity risk should reside with the fund's portfolio manager and, like the fund's Rule 38a-1 policies, responsibility for administering the program should reside with the fund's chief compliance officer.

<u>Illiquid Assets</u>

Existing guidance regarding the classification of illiquid assets should be codified as proposed by the SEC.

We support, as proposed, codifying existing guidance on illiquid assets into a formal rule. We also support requiring a fund to report the assets classified as "15% standard assets" to the SEC.[12] We recommend changing how this category of assets is monitored from an acquisition test to a maintenance test.[13] Enhancing board oversight of a fund's liquidity risk management,

[10] Release at 62285.
[11] Release at 62304.
[12] We suggest changing the name of these assets from "15% standard assets" to "illiquid assets." The term "15% standard assets" is confusing and potentially misleading. There is nothing "standard" about these types of assets. Standard assets that a fund might invest in are better described as the assets that are not considered illiquid. Using a numerical value in the name of the category is also confusing and misleading because it implies that a fund actually holds 15 percent of its portfolio in those assets.
[13] An acquisition test, sometimes referred to as a time of purchase test, allows a fund to passively exceed a portfolio limit based on shareholder flows or changes in market value. A maintenance test requires a fund to adjust its portfolio when it exceeds a limit.

combined with enhanced monitoring of the securities in the illiquid basket, would strengthen fund liquidity management practices.

Liquidity Classifications

Classifying fund assets into one of three liquidity categories on a monthly basis, as opposed to the SEC's six categories, is a more practical and effective liquidity risk management framework.

The Proposals include a requirement for funds to classify each fund asset into one of six liquidity categories on an ongoing basis.[14] We support categorizing assets based on liquidity but believe that three categories, instead of six, on a monthly basis is a more effective liquidity risk management framework. Asset liquidity is dynamic and it is unrealistic to believe that assets could be precisely mapped and maintained in six categories, however defined.

Classification of assets into six categories would not promote better liquidity management and would not help to ensure that funds have adequate liquidity levels to meet redemptions. The classification system that the SEC proposes is not consistent with current liquidity management practices in our funds nor do we believe it is consistent with industry best practices. The Proposals would force funds to undertake a classification approach with onerous ongoing maintenance requirements that is not useful for effective liquidity management.

In addition, we do not believe that classification of fund assets into six liquidity categories would assist the SEC in its objective to better monitor risk in the industry. The proposed six categories would yield volumes of imprecise, subjective assessments that would create illusions of liquidity/illiquidity across funds and fund complexes. The proposed classification system may misrepresent the relative liquidity of certain assets or funds (e.g., conservative classifications would indicate a less liquid fund, particularly as compared to a fund with similar or identical holdings but using more aggressive classification methodologies).

Classifying assets into six categories is overly burdensome and near-impossible to manage. Fidelity funds collectively hold hundreds of thousands of individual securities. To evaluate and classify each security initially, and then to reevaluate each security with a level of precision to properly classify it within one of six buckets would be an extraordinary task even on a monthly basis. Finally, the subjective nature of these classifications would severely restrict a fund's or fund complex's ability to automate liquidity classification.

To enhance the Proposals, we recommend that a fund classify its assets into the following three categories on a monthly basis:

- *Highly Liquid Assets*: Any cash held by a fund and assets (or portions of assets) that the fund believes are convertible into cash within three business days within the context of normal trading.

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[14] Release at 62293.

- *Liquid Assets*: Assets (or portions of such assets) that are not classified as either highly liquid assets or illiquid assets.
- *Illiquid Assets*: Assets that are considered "15% standard assets," as defined in the Proposals.

Liquidity Classification Process

Classification of assets should not be informed by the potential for a trade to materially affect the value of an asset immediately prior to its sale.

The SEC proposes a standard to determine the liquidity of a portfolio asset that hinges on how quickly it would be converted to cash at a price that does not materially affect the value of that asset immediately prior to sale.[15] This is not an appropriate standard to use to evaluate the liquidity of portfolio assets. Tying liquidity evaluations to the potential price impact of an asset sale is inconsistent with a key objective of the Proposals – to reduce the risk that funds will be unable to meet redemptions. Asset prices fluctuate and every sale of an asset impacts value in the market. In certain markets, merely inquiring about an asset sale may cause its price to move. In addition, other factors also impact the asset's value including other sales of the same or similar assets and broader market conditions.

A key objective of the Proposals is to ensure that funds will be able to meet redemptions. Classification of an asset as "liquid" should not be dependent on the ability to sell the asset without materially affecting its price. The time within which an asset can be sold and converted to cash is the more appropriate measure of liquidity in this context. For example, an asset may be sold in seven days at one price, but can be sold in two days at a different price. Though the asset is liquid in both cases, the speed with which an asset can be made liquid is the more appropriate measure of its liquidity.

Estimating the materiality of potential asset price impacts is also problematic. Price impact may depend on a number of factors including the type of asset and the current market environment for that asset. The potential price impact from trading portfolio assets varies with market conditions and, as the basis for liquidity classifications, would create inconsistent or arbitrary distinctions among portfolio assets. Such assessments would be speculative, at best.

Classification of assets should be based on a combination of both quantitative and qualitative considerations, including some of the nine factors proposed by the SEC.

We believe that classifying portfolio assets into the highly liquid, liquid, and illiquid categories described above is a better way to achieve the Commission's objective to reduce the risk that funds will be unable to meet redemptions. The Release includes nine factors that a fund would be required to consider in its assessment of an asset's liquidity.[16] The nine factors are logical considerations to use when evaluating asset liquidity, but are not relevant to all asset

[15] Release at 62292.
[16] Release at 62297.

types and should not be required for every asset in a fund's portfolio. For example, certain asset types may trade infrequently yet constitute some of the most liquid assets in fund portfolios. Indeed, a bond with a high coupon may trade infrequently simply because it is a highly desirable asset to hold.

Of the three categories we suggest, the highly liquid assets category is the key to determining whether a fund will be able to meet redemptions, and therefore the most critical to define. Classification of assets into the highly liquid assets category should be based on a determination of what a fund can convert to cash within three business days "within the context of normal trading." This standard can be applied across asset classes and varying market conditions. In applying this standard a fund could consider quantitative and qualitative factors including trading volume, asset type, credit quality, market capitalization, market conditions, and the firm's experience trading the assets. For exchange traded securities, classifications also may be informed by a participation rate commensurate with normal trading activities for the fund. For assets traded over-the-counter, a fund could determine that specific asset types, such as U.S. Treasury securities, are highly liquid based upon their structure, status and settlement periods, and periodically review this determination as market conditions change.

Classification of assets into the illiquid assets category should be based on SEC guidance on illiquid assets, as codified by the Proposals. Those assets that are not classified as either highly liquid or illiquid would be classified as liquid assets.

Highly Liquid Assets Minimum

A pre-established level of highly liquid assets, enforced through a time of purchase test, is not appropriate for funds.

The SEC proposes that each fund determine a level of three-day liquid assets, which it must maintain in its portfolio at the time it purchases an asset.[17] While we support funds maintaining adequate liquidity to meet shareholder redemptions, we do not support a limitation on purchasing assets if fund holdings of highly liquid assets fall below a pre-established level.

A required minimum of highly liquid assets is not an effective method for funds to ensure appropriate portfolio liquidity. Even though funds would be allowed to set their own levels, asset and fund liquidity changes constantly. A pre-established minimum may require a fund to be overly conservative during normal market conditions and could limit a fund's ability to take advantage of buying opportunities when they present themselves. A fund's ability to purchase out-of-favor assets is valuable to facilitate liquid and orderly markets and can enhance shareholder returns over the long-term.

A requirement to maintain a specified level of highly liquid assets could distort portfolio construction and potentially put a fund at odds with other regulatory requirements. A restrictive requirement may prevent a fund from fully investing according to its investment objective and

[17] Release at 62311.

strategies. For example, many funds have investment strategies and objectives that require them to concentrate in certain investment types (e.g. sector or industry focused funds). A market dislocation affecting a specific industry may require a change in the fund's highly liquid classification of those securities. Because the value of those securities may drop as well, the fund could passively fall below its name-test or concentration-test requirements. Yet because those same securities are no longer designated as highly liquid, the fund is in the position of needing its next acquisition to be in those same securities to meet its name-test /concentration requirements, and yet it may not purchase those securities because they are not deemed highly liquid assets. In these circumstances, the fund would not acquire anything until market conditions improve, even though the fund would remain well-positioned to meet shareholder redemption requests.[18]

A minimum highly liquid assets requirement could be detrimental to long-term investors. If funds are required to hold a set level of highly liquid assets, certain funds will be forced to manage their portfolios in a way that is potentially more conservative than they would otherwise – and counter to investor expectations for those funds to be fully invested according to their investment mandates. This constraint could impact fund performance significantly over time without improving fund liquidity.

To ensure adequate liquidity to meet shareholder redemptions, a fund's board should examine the fund's current portfolio liquidity, its current liquidity needs and its potential liquidity needs under stressed conditions.

A better approach to ensuring sufficient fund liquidity is to estimate a fund's liquidity needs both in current market conditions and reasonably foreseeable stressed market conditions. The fund's liquidity needs should be reviewed with the board on a periodic basis and be compared to its existing level of highly liquid assets to inform the fund's liquidity risk. This approach would provide a fund with the flexibility to adapt its liquidity management to changing market conditions without an artificial restriction on security purchases.

A fund should periodically demonstrate to its board why its current level of highly liquid assets is adequate by comparing this level to the fund's current liquidity needs, based on historical shareholder flows. A fund could determine a portfolio liquidity ratio that would indicate the sufficiency of the fund's liquidity profile. Such a ratio, based on current shareholder redemption levels, could be used to indicate a need for enhanced monitoring of a fund's liquidity risk over time.

A fund should also determine an appropriate level of liquidity to cover estimated redemptions under reasonably foreseeable under stressed conditions (the "Redemption Test Level") and demonstrate to its board how it would satisfy redemptions at that level. It is

[18] A required minimum could also be problematic for index funds, including index ETFs. In certain circumstances, a passive fund would have to choose between violating a minimum liquid asset requirement and purchasing securities consistent with its objective to track an index. Significant tracking error could be created to the extent an index mutual fund or ETF is required to deviate from the index to meet a minimum requirement. Additionally, certain sectors of the market could be impacted if funds are restricted from providing liquidity, particularly in stressed markets when the asset management industry has historically been a market-stabilizing force.

important for a fund's board to be informed of what a stressed redemption level could be, but it is not appropriate for a fund to manage its liquidity to that level if the fund is not experiencing or expecting redemptions at this level. Day-to-day liquidity management should reflect current liquidity needs.

Assessment of Liquidity Risk

We support, as proposed, the requirement for a fund to assess its liquidity risk as part of its liquidity risk management program.

We support periodic review of a fund's liquidity risk, the frequency of which should be determined by the fund and its board on a fund-by-fund basis. We propose removing the requirement to assess liquidity risk in relation to a material impact to a fund's NAV. Fund NAVs fluctuate with underlying asset values regardless of shareholder redemptions. Therefore, a fund should assess its liquidity risk based upon its ability to meet redemptions that are reasonably foreseeable under normal and stressed conditions, not based on a potential impact to the fund's NAV.

Reporting and Disclosure of Liquidity Assessments

Liquidity assessments and certain other information should be reported to the SEC to enhance its risk oversight and monitoring but should not be publicly disclosed.

The SEC proposes asset-level reporting to the SEC.[19] We do not support reporting asset-level liquidity classifications to the SEC because the cost of such reporting outweighs the potential benefits. In addition, asset-level classifications require false precision and, therefore, would not assist the SEC in monitoring fund liquidity. We believe that the Commission would better meet the objectives of the Proposals by requiring fund-level reporting designed to demonstrate how funds are applying liquidity classifications to their fund assets. A fund would report the percentage of its assets held in each liquidity category. Fund-level data would allow the Commission to focus on fund liquidity trends that may merit further attention.

The SEC also proposes to require public disclosure of liquidity metrics on a periodic basis.[20] We do not support public disclosure of either the percentage of a fund's assets in each of the three liquidity categories or the underlying asset-level liquidity classifications because such disclosure would be misleading to investors and may lead to imprudent investment behavior.[21] Paradoxically, those funds employing a conservative approach to liquidity classifications could appear less liquid than their less conservative peers, which may introduce a competitive disadvantage for these funds seeking to manage liquidity risk in a prudent manner. Therefore, we

[19] Release at 62346.
[20] *Id*.
[21] If an investor is inclined to base an investment decision on liquidity information, the information without context would not meaningfully or accurately portray the value of the fund to the investor's portfolio. Such context would include: (i) flows analysis reflecting the funds' current liquidity needs, (ii) liquidity tools available to the fund, and (iii) the risk/return profile of the fund.

believe that the SEC should evaluate the information it is requesting for a period of time to determine whether the information can help investors seeking to compare liquidity across funds before any public disclosure of liquidity data is required.

III. SWING PRICING

The SEC proposes amendments to Rule 22c-1[22] under the Investment Company Act of 1940, which currently requires funds to sell or redeem fund shares at a price based on the net asset value ("NAV") of the fund next computed after receipt of an order to purchase or redeem. The amendments would permit, but not require, funds to implement swing pricing, which in theory would allow a fund to pass on the costs it incurs from large net purchases or redemptions to the shareholders associated with that activity. Swing pricing aims to protect the fund's non-transacting shareholders from being diluted by these costs.

We agree that, from time-to-time, large shareholder flows can be disruptive to a fund and its existing shareholders. The need to raise or spend significant cash balances can impose some costs on funds, which are borne by all of the fund's shareholders. For example, a shareholder redeeming a large amount of shares may cause the fund to incur trading and other costs to enable the fund to honor that redemption in a timely manner, but the full impact of these costs will not be borne by that redeeming shareholder because some of them will be incurred after the redeeming shareholder receives his or her proceeds. Instead, the remaining shareholders may see a decline in the value of their investments when these costs are incurred by the fund.

Swing pricing appears to present a method of allocating the costs of large shareholder activity on the responsible shareholders. We believe, however, that further study is needed on a host of issues, including investor fairness, the impact of swing pricing on the market for mutual funds, the ability of an advisor to accurately calculate the amount of near-term costs when determining a swing factor, and whether the amount of dilution caused by shareholder activity warrants such a solution. As a threshold matter, however, the existing operational systems supporting the mutual fund industry will not support effective swing pricing.

Operations

Swing pricing is predicated on measuring shareholder flows against a fund-determined threshold. The fund's advisor would determine whether that threshold had been crossed each business day by analyzing purchase and redemption activity across each of the different channels through which the fund is available. The most significant issue with the implementation of swing pricing as proposed, is the inability of fund complexes to receive and review complete daily shareholder flow information in sufficient time to determine if a fund's NAV should be swung.

A typical U.S. mutual fund calculates its NAV as of the close of the New York Stock Exchange, normally 4:00 pm Eastern Time. In accordance with SEC rules and guidance, the fund or its designated agents, including intermediaries, accept trades that are in proper order until 4:00

[22] Release at 62326.

pm. Further, it is standard industry practice for fund complexes to disseminate the NAVs of the funds they manage to various transfer agents, intermediaries and other fund complexes by 6:00 pm. Doing so allows these parties to process individual shareholder transactions and to determine cash payments, which are typically made the following day.

While broker-dealer intermediaries may accept orders until 4:00 pm, these intermediaries do not transmit the orders to the fund company until after 4:00 pm. In the U.S., a significant percentage of shareholder transactions through intermediaries are not transmitted to the fund company until after the fund's NAV is calculated. The primary mechanism for these intermediaries to submit trades is through the National Securities Clearing Corporation, which allows intermediaries to transmit the amount of shares until 8:30 pm for orders that met the proper order cutoff of 4:00 pm. To implement swing pricing, accurate shareholder transaction information would need to be communicated to a fund company in time for the fund to determine whether its swing threshold has been crossed and publish its NAV.

In light of these operational challenges, we encourage the SEC not to adopt the swing pricing proposal at this time. Rather, the SEC should seek industry input on the most effective solutions to the operational impediments to effective swing pricing methodologies in the United States.

Compliance Period

The SEC did not specify an implementation date for swing pricing, suggesting that one was unnecessary because swing pricing would be voluntary. This could result in the adoption of swing pricing on an inconsistent basis across the industry, creating confusion and uncertainty for fund shareholders. For this reason, if the SEC elects to proceed with the swing pricing proposal prior to identifying practical, industry-wide solutions to the issues discussed above, we strongly encourage the SEC to adopt a mandatory compliance period of 30 months after an industry-wide solution has been implemented.

IV. REPORTING AND DISCLOSURE REQUIREMENTS

Agreements Related to Lines of Credit

We do not support the proposed requirement for line of credit agreements to be included as exhibits to Form N-1A.[23] Unlike custodian agreements and transfer agent agreements, which are currently required to be included as exhibits to a fund's N-1A, committed lines of credit are not ubiquitous or standardized: some fund complexes do not have them, and even for those that do, not all mutual funds in the complex are party to the agreement. Providing a copy of a fund's committed line of credit and uncommitted line of credit agreements would compromise a fund's ability to negotiate agreement terms necessary to meet its specific needs. Making all terms public will cause other borrowers, even non-mutual fund borrowers, to demand the same terms. It will

[23] Release at 62344.

also discourage the lending banks from granting those terms to mutual funds out of a concern that any terms granted will become standard in their other agreements.

Proposed Form N-1A Item 11

The SEC proposes that a fund disclose the number of days following receipt of shareholder redemption requests in which the fund will pay redemption proceeds to redeeming shareholders.[24] The requirement also asks if the number of days differs by distribution channel, that a fund disclose the number of days for each channel. This requirement is problematic for several reasons.

The granularity of this requirement may lead to shareholder confusion. A single shareholder may be invested in the same fund through different classes with different payment methods (e.g., ACH (3 days), check (3-5 days), wire (next day), etc.). Most importantly, however, funds often do not have transparency into the distribution channels that act as the conduit between a fund and a shareholder. The Commission acknowledged this in its December 2015 Advance Notice of Proposed Rulemaking, Concept Release, and Request for Comment on Transfer Agent Regulations.[25] The concept release explains the various types of financial institutions that perform services similar to those performed by a transfer agent but that are not required to register as transfer agents. The Commission states "[a]lthough transfer agents provide critical recordkeeping and transfer services to registered owners, they generally do not have visibility beyond the master securityholder file and therefore rarely provide recordkeeping and transfer services to beneficial owners who hold in street name. Instead, recordkeeping and transfer services usually are provided to beneficial owners by the intermediary through whom the beneficial owner purchased the securities, usually a broker-dealer or bank."[26]

Fidelity's concerns with respect to the proposed Form N-1A disclosure requirement are based on the issue articulated by the Commission: a mutual fund does not always have a direct contractual relationship with the ultimate beneficial owners of its shares, as there are often multiple intermediaries between the mutual fund and its shareholder. Therefore, a mutual fund is not in the best position to disclose to its shareholders a precise timeframe in which an intermediary will transmit the proceeds of a shareholder's redemption.

V. OTHER CONSIDERATIONS

Request for Comment on Additional Guidance on Cross-Trades

The Proposals acknowledge that funds currently are permitted to engage in cross-trading of securities in accordance with the requirements of Rule 17a-7 of the Investment Company Act of 1940 or pursuant to exemptive relief obtained from the SEC.[27] Rule 17a-7 allows funds to cross-trade securities that have an independent current market price, which may include readily

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[24] *Id*.
[25] Transfer Agent Regulations, Release No. 34-76743 (Dec. 22, 2015), 80 Fed. Reg. 81948 (Dec. 31, 2015).
[26] *Id*. at 81989.
[27] Release at 62322.

available market quotations or the average of the highest current independent bid and lowest current independent offer. The SEC recognizes that "cross-trading can benefit funds and their shareholders" [28] and that some funds may seek to use cross-trading as an additional liquidity risk management tool.[29]

In the Proposals, however, the SEC states that the less liquid a security is, the more likely that it may not satisfy Rule 17a-7.[30] We do not agree. A less actively traded security may be less liquid, but nonetheless have readily available market quotations, and a fund may determine that independent bid and offer prices are available in the market. The relative illiquidity of the security itself will not alone be determinative of whether prices are available for Rule 17a-7 purposes. Therefore, we do not recommend any guidance that imposes liquidity requirements for cross-trading in addition to the existing conditions, including the independent current market price condition, in Rule 17a-7. We believe that funds are protected adequately in cross-trading transactions under existing SEC guidance and we see no benefit to extending the SEC's guidance on this matter.

ETFs: Flexibility in Redemption Basket

Based on exemptive relief that the SEC previously provided to some, but not all, ETF sponsors, ETFs are required to provide an Authorized Participant in-kind redemptions that represent a pro-rata slice of the ETF. The SEC requested comment on whether ETFs should be allowed more flexibility in constructing their creation/redemption baskets. Increased flexibility would allow ETFs to better manage their liquidity and potentially improve investment results. The SEC should consider adopting a rule to codify exemptive relief that would allow all ETF sponsors flexibility in constructing their baskets.

Cap on ETF Transaction Fees

The Proposals would exclude ETFs from the swing pricing option because ETFs currently impose transaction fees for the same purpose (i.e., to pass along the costs stemming from creation or redemption activity to the shareholders responsible for the activity). There is currently a two percent limit on ETF redemption transaction fees.

In its comments on swing pricing, the SEC states that "[w]e are not proposing to require an upper limit on the swing factor that a fund would be permitted to use, on account of the difficulty of establishing an appropriate across-the-board limit that would permit funds with different investment strategies, under all market conditions, to determine a swing factor that reflects the costs associated with the potential shareholder purchase or redemption activity. These costs could vary widely across funds and under different market conditions and we do not wish to limit the extent to which swing pricing could mitigate the dilution of existing shareholders."[31] This philosophy should be applied equally to ETF transaction fees. Whether or

[28] *Id*.
[29] Release at 62323.
[30] *Id.*
[31] Release at 62337.

not the swing pricing option is adopted, we recommend that this limitation on transaction fees be eliminated to allow all ETFs to pass along all costs of creation and redemption transactions.

VI. COMPLIANCE PERIODS

Liquidity Risk Management Program

The SEC proposes that smaller fund complexes have 30 months to comply with a final rule and larger complexes would have an 18 month compliance period. A tiered compliance period approach for any liquidity risk management program final rule is not appropriate. We suggest all funds have at least a 30 month period to comply with a final rule. It is paramount that all funds have liquidity risk management programs in place, and both large and small fund complexes[32] have the potential to impact financial stability should liquidity risk be mismanaged. Larger fund complexes will likely have more funds for which to implement the requirements and a greater number and variety of assets to classify. We strongly recommend a uniform compliance period of at least 30 months across all fund complexes.

Swing Pricing

As discussed in Section III above, we recommend a mandatory 30 month delay in a fund's ability to implement swing pricing. This delay should not begin until after the operational issues have been fully addressed.

Reporting and Disclosure Requirements

We appreciate and support the Commission moving forward as efficiently as possible with changes to proposed Forms N-PORT and N-CEN. We continue to view the operational changes that will be necessary to implement these new forms as significant. As a consequence, we recommend that the compliance periods for implementation of these forms be extended to 30 months.

[32] *See* Release at 62353, recognizing the potential for smaller funds to demonstrate greater liquidity risk: "To the extent that a fund invests in portfolio assets that are relatively less liquid, the fund may experience greater liquidity risk than a fund that invests in portfolio assets that are highly liquid. Based in part on our empirical analysis, we have decided not to propose any modification of or exclusion from the proposed liquidity requirements for smaller funds, since smaller funds tend to demonstrate relatively high flow volatility (and thus possibly greater liquidity risk)."

* * *

Fidelity would be pleased to provide further information, participate in any direct outreach efforts the Commission undertakes, or respond to questions the Commission may have about our comments.

Sincerely,

cc: The Honorable Mary Jo White, Chair
The Honorable Michael S. Piwowar, Commissioner
The Honorable Kara M. Stein, Commissioner

David W. Grim, Director, Division of Investment Management

Fidelity
INVESTMENTS