Federated Investors, Inc.
Federated Investors Tower
1001 Liberty Avenue
Pittsburgh, PA 15222-3779
412-288-1900 Phone
FederatedInvestors.com

January 13, 2016

VIA E-MAIL RULE-COMMENTS@SEC.GOV

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

Re: Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release (File Nos. S7-16-15; S7-08-15)

Dear Mr. Fields:

This letter presents the comments of Federated Investors, Inc. and its subsidiaries ("Federated") with respect to the recent issuance by the Securities and Exchange Commission (the "Commission") of a release proposing (i) to require all registered open-end funds other than money market funds (collectively, "Covered Funds") to establish a liquidity risk management program; (ii) to permit registered open-end funds (other than exchange traded funds) to use "swing pricing" in some circumstances and to create new requirements related thereto; and (iii) to amend Form N-PORT and Form N-CEN to require disclosure of certain information regarding the liquidity of a fund's holdings and the fund's liquidity risk management practices; and reopening the comment period with respect to the Investment Company Reporting Modernization proposal, which originally proposed Form N-PORT and Form N-CEN (the "Reporting Rule").[1] The proposed amendments and the Reporting Rule are collectively referred to herein as the "Proposed Amendments."[2] Federated is one of the largest investment management firms in the United States (the "U.S."), managing $221 billion in registered money market fund assets and $360 billion in total assets as of December 31, 2015. With 122 mutual funds and a variety of separately managed account options, Federated provides comprehensive investment management to more than 8,400 institutions and intermediaries including corporations, government entities, insurance companies, foundations and endowments, banks and broker/dealers.

[1] The Reporting Rules were originally published for comment in Investment Company Reporting Modernization, Investment Company Act Release Nos. 33–9776; 34–75002; IC–31610, 80 Fed. Reg. 33590 (June 12, 2015).
[2] The Proposed Amendments were published for comment in Open-End Funds Liquidity Risk Management Program, Investment Company Act Release Nos. 33–9922; IC–31835, 80 Fed. Reg. 62274 (Oct. 15, 2015) [hereinafter Release].

TABLE OF CONTENTS

I. EXECUTIVE SUMMARY

Federated understands that the Proposed Amendments are a consequence of investors' reliance on investments in open-end funds to meet their financial needs and to access the capital markets, coupled with the Commission's finding of disparate degrees of liquidity risk management programs among Covered Funds. Federated, however, strongly opposes the Proposed Amendments in their current form.

a. The proposal to classify each security holding into six liquidity classifications, and to disclose these classifications to shareholders, will be burdensome to investment advisers while creating a misleading presumption of accuracy that provides no material benefit to shareholders. Federated instead

proposes that funds develop and disclose portfolio level liquidity estimates using three liquidity classifications. Federated does not oppose the concept that funds should periodically assess and disclose a portfolio level liquidity measure, but disagrees with the three-day liquid asset minimum test as proposed.

Federated recognizes the need for Covered Funds to effectively manage their liquidity risk and does not object to a requirement that Covered Funds develop and implement a written liquidity risk management program with targeted liquidity levels. We also agree with other elements of the proposal, such as the codification of the fifteen percent illiquid asset rule as codified in proposed Rule 22e-4(b)(2)(iv)(D).[3] However, Federated believes that certain of the requirements for the liquidity risk management program included in proposed Rule 22e-4 are unnecessary and may create new, or exacerbate existing risks for Covered Funds in ways that have not been fully considered by the Commission. Specifically, it is Federated's view that the requirement to classify each Covered Fund's individual holdings into one of six specified categories implies a false degree of precision and does not take into account important factors including the liquidity of comparable securities or the positions of other funds in the fund complex. The Release also appears to concur with vendor assertions that the data necessary to comply with the proposal is readily available and that fund complexes may rely on vendors to perform security-level liquidity analysis. In our opinion, the available data does not support these conclusions and such reliance could lead to the dissemination of misleading information, especially if multiple fund complexes engage the same vendors. Such vendor concentration could cause a false perception of liquidity in the market as a result of flawed assumptions or calculations made by a single vendor.[4] Additionally, the disclosure of liquidity classifications at an individual security-level on Form N-PORT would be both harmful and misleading to shareholders, because such disclosures could not be made in a manner that would provide shareholders with an understanding of the many factors, including estimates and other subjective judgments by the investment adviser, that necessarily will be used to generate the classifications and make comparisons across fund families impossible.

Federated believes that a better approach would be to make liquidity classifications at a portfolio-level and using fewer categories. Portfolio-level disclosure would be both more realistic and more accurate, as it would allow portfolio managers and traders to devote necessary time to development of estimates. For these reasons and as discussed further herein, Federated suggests that the Commission revise proposed Rule 22e-4 to: (i) provide for portfolio-level, as opposed to individual security, categorization of liquidity; and (ii) reduce the number of liquidity categories to three in order to provide more meaningful and understandable reporting to investors. Federated also believes that: (i) the three-day liquid asset minimum requirement as proposed (the "Three-Day Liquid Asset Minimum Test") will unduly distort fund management practices; and instead proposes that (ii) the requirement be stated as a target and that the fund and the investment adviser adopt, and the board of directors of the fund approve, procedures

[3] We note that Federated does not object to the retention of the fifteen percent illiquid asset rule as codified in the proposed Rule 22e-4(b)(2)(iv)(D); however we recommend that the Commission revise the nomenclature associated with the rule to avoid shareholder confusion with the other elements of the proposed liquidity classification program.
[4] We note that in recent years the Commission has removed references and requirements related to credit rating agencies in a number of rules as result of similar issues.

reasonably designed to achieve the target while simultaneously implementing the fund's investment strategy.

b. Swing pricing will be far more difficult to implement in the U.S. and has materially greater deficiencies than presumed in the Release, either on a standalone basis or in comparison to less onerous but effective alternative approaches. The cost/benefit analysis has not been performed to justify the necessity or net benefit of swing pricing, after adoption of the other elements of the rule, or that swing pricing is preferred to other alternatives. Moreover, due to the likelihood that, under the liquidity program requirements of the rule, larger funds will be perceived as riskier and thus forced to adopt swing pricing, smaller funds may be forced to as well due to competitive pressure. If, despite these considerable deficiencies, swing pricing were to be "optionally" permitted, a lengthy transition period would be required to allow for investor education and build out of the required infrastructure by investment advisers and intermediaries prior to allowed adoption. Immediate adoption by some could be disruptive and damaging to the industry and individual shareholders as it could: (i) be confusing to shareholders and generate chaotic fund flows; (ii) cause some investment advisers to rush to adopt if it were perceived that the larger investment advisers were gaining advantage by early adoption; or (iii) create an unfair advantage for firms with experience from European operations.

Federated agrees that anecdotal evidence suggests that implementing a version of swing pricing in the U.S. fund space could enhance shareholder protections and improve fund performance. However, we believe that the implementation of the swing pricing mechanism contained in proposed Rule 22c-1(a)(3) would present a number of issues and concerns that have not been fully considered by the Commission. Among these issues are: (i) the potential for abuse by investors who could attempt to reverse engineer swing thresholds and factors; (ii) the potential for abuse when some investors seek to identify the trading intentions of other shareholders, which data would represent a new class of material non-public information not addressed in the Release; (iii) the randomness of fund performance that individual investors would experience (depending on their entry or exit points) and for published performance, particularly where the price of a fund is swung on a month or a quarter end; (iv) the likely confusion among investors and impairment of mutual funds as a convenient investment vehicle resulting in reduced usage; and (v) the inevitability that swing pricing as proposed would inappropriately enrich some shareholders at the expense of others (depending the direction of a shareholder's transactions relative to whether the fund is in a state of net redemption or subscription), thus reducing the perceived fairness and transparency of fund vehicles. Additionally, while swing pricing in general is perceived to reduce systemic risk, partial swing pricing, which is the version most likely to be adopted by funds in the U.S., it could have the adverse effect of creating a first mover advantage by encouraging shareholders to redeem ahead of the others in the hope of avoiding the swing factor. Such an effect would not exist under full swing pricing.

Furthermore, current rules already direct fund boards to craft redemption fee programs that account for a fund's specific circumstances while offering investor protection against the systemic risk presented by large-scale redemptions that underlies the Commission's concerns. Specifically, Rule 22(c)-2 states: "The fund's board of directors, including a majority of directors who are not interested persons of the fund, must either: (i) Approve a redemption fee, in an amount (but no more than two percent of the value of shares redeemed) and on shares redeemed within a time period (but no less than seven calendar days), that in its judgment is necessary or appropriate to recoup for the fund the costs it may incur as a result of those redemptions or to otherwise eliminate or reduce so far as practicable any dilution of the value of the outstanding securities issued by the fund, the proceeds of which fee will be retained by the fund; or (ii) Determine that imposition of a redemption fee is either not necessary or not appropriate." Note that the implementation of redemption fees under this rule does not create conditionality that would allow first-mover effects.

If the Commission deems it necessary to implement a pricing mechanism to supplement the Rule 22(c)-2 protections, we suggest that the Commission consider dual pricing or T+1 pricing as alternatives to swing pricing. For the reasons discussed herein, we believe that either alternative could offer more clarity and fairness to shareholders. Given the potential issues with the implementation of swing pricing and the availability of less onerous alternatives, Federated suggests that the Commission engage in a more thorough study of the potential impacts of the implementation of swing pricing in the U.S. open end fund markets, and that such study should include a consideration of whether dual pricing or T+1 pricing in combination with the implementation of redemption fees contemplated by Rule 22(c)-2 may be a more effective means of protecting investors. Such an evaluation should be made in light of the enhanced investor protection that will exist post-adoption of the other requirements of the proposed rule. In this regard, any evidence of improved performance resulting from swing pricing should be carefully scrutinized. In the case of European Undertakings for Collective Investments in Transferable Securities (i.e. "UCITS"), improved performance may only reflect the absence of frequent trade monitoring or other anti-dilution requirements such as the obligations that U.S. funds have under Rule 22(c)-2. A more relevant measure of the potential benefits of swing pricing for U.S. registered funds could be the estimated performance improvement, if any, that swing pricing may allow in funds that already have a redemption fee.

c. A motivation for the Commission to collect granular security level risk or liquidity data (in the Reporting Modernization and Liquidity rule proposals, respectively) may be to fulfill a perceived systemic risk oversight obligation.[5] However, the form in which the data requirements are posed, and the means and frequency of data collection, are inappropriate to that objective and conflate investor protection and systemic risk assessment. Absent a statutory mandate, granular data collection that imposes significant cost on investment advisers while creating no benefit for shareholders and failing to fulfill any implied systemic oversight obligation would be arbitrary and capricious.

Even the most sophisticated investors have not, in our experience, solicited the type of granular security-level duration risk or liquidity data as required by the Commission in the proposed Reporting Rules and liquidity rules. However, we believe investors would benefit from enhanced portfolio-level disclosures. Conversely, the Commission would have limited

[5] *See* proposed rule 22e-4(b)(2).

ability in employing the proposed data collection for systemic risk oversight because of delays in reporting, differing models and differing assumptions across investment advisers regarding the definition of "stressed market" conditions that will make data aggregation difficult. The Commission should therefore require enhanced portfolio level risk and liquidity disclosure for investor protection, but (as further developed in Section IV) defer collection of data for systemic risk assessment to the forthcoming stress test rule where: (i) investment advisers may be asked to respond to specific market-wide stress scenarios as outlined by the rule; and (ii) the Commission may further mandate streamlined and more timely (daily) data collection directly from fund custodians and transfer agents. This will enable the Commission to better fulfill any systemic risk oversight role and strengthen its insights through its own analysis of fund holdings using any scenarios it wishes. Such a framework would better position the Commission to employ its own experts to rapidly evaluate market events and inform Financial Stability Oversight Council ("FSOC") evaluation of the systemic risk consequences of our securities laws and regulations.

Set forth below is a summary of our specific comments and suggestions with respect to the Proposed Amendments.

II. CLASSIFICATION OF THE LIQUIDITY OF A FUND'S PORTFOLIO POSITIONS AND ASSESSING AND MANAGING LIQUIDITY RISK UNDER PROPOSED RULE 22E-4

a. The requirement to manage liquidity risk under "reasonably foreseeable" stressed market conditions is vague and unrealistic.

Proposed Rule 22e-4 requires that each Covered Fund adopt and implement a written liquidity risk management program that is "reasonably designed to assess and manage the fund's liquidity risk." "Liquidity risk" is defined as "the risk that the fund could not meet requests to redeem shares issued by the fund that are expected under normal conditions, or are reasonably foreseeable under stressed conditions, without materially affecting the fund's net asset value." Under general fiduciary obligations, portfolio managers seek to manage their portfolios prudently under prevailing market conditions balancing a goal of maximizing shareholder returns and managing the risks (including liquidity risk) in the fund. Such portfolio management processes generally include efforts to manage funds during reasonably foreseeable conditions. However, for the purpose of a specific requirement against which investment advisers will be measured and examined, historical redemptions and market reactions during past stress events are the only realistic basis for defining what is "reasonably foreseeable." Any more expansive definition would create an unrealistic standard that: (i) requires portfolio managers to speculate and manage liquidity relative to unknowable future events while (ii) subjecting investment advisers to potential private litigation or regulatory challenges based on second guessing for failing to have accounted for some market scenario that others determine should have been "reasonably foreseeable."

b. The proposed categorization of individual security holdings is illogical in its conception and misleading in its execution.

Proposed rule 22e-4 would require each Covered Fund to establish a liquidity risk management program incorporating elements specified in the rule. Among the primary components of the liquidity risk management program required by the proposed rule is a requirement for each fund to classify and monitor the liquidity of each individual portfolio security. For purposes of the proposed Rule 22e-4, a fund would assess liquidity based on the number of days within which each security holding, or portion thereof, would be convertible to cash at a price that would not materially affect the value of that asset immediately prior to sale.[6] Under the proposed rule a fund would classify each of its positions into one of six liquidity categories specified in the proposed rule, based on whether a position is convertible into cash within (i) one business day, (ii) two to three business days, (iii) four to seven calendar days, (iv) eight to fifteen calendar days, (v) sixteen to thirty calendar days, or (vi) more than thirty calendar days. Federated believes that the components of the proposed rule requiring the categorization of individual security positions is onerous, illogical and may, if executed, be misleading to shareholders.

1. *The concept of categorizing each security within a fund in isolation from events in other funds in the complex or market is inherently flawed.*

The objective of the Proposed Amendments is to improve liquidity risk management where liquidity risk is defined as "the risk that the fund could not meet requests to redeem shares issued by the fund that are expected under normal conditions, or are reasonably foreseeable under stressed conditions, without materially affecting the fund's net asset value." When this definition is carried over to the security classification requirements of proposed Rule 22e-4, the proposal becomes contradictory and ill-defined. A fund may reasonably classify its liquidity profile under normal market conditions by taking into account only its own holdings. However, under stressed market conditions, it could be necessary for the liquidity of a particular security to be judged in the context of the investment adviser's entire position in that security under the assumption that the stress event would be impacting the entire complex and the market as a whole. Failure by the investment adviser to view stress events in this broader context suggests the flawed notion that stress events affect one fund at a time. Indeed, we believe that estimating security liquidity without this broader context could give shareholders a false and misleading assessment of an individual fund's liquidity and furthermore imply that fund investment advisers are providing responses at a fund level that are in likely violation of the investment adviser's trade allocation policies in the stressed environment envisioned.[7] The Commission must establish clear and unambiguous assumptions to underlie its request for creation and collection of the data.

2. *The categorization of individual security holdings into six liquidity categories for each fund implies a false degree of precision.*

It is our view that the classification of individual security positions into the proposed six liquidity categories is impractical, unrealistic and unjustified. Under proposed Rule 22e-4, a Covered Fund would be required to classify each security into one of six categories no less

---

[6] In numerous instances the Release describes the new requirement as classifying the "relative liquidity" of portfolio securities. In fact the classification into specific categories defined by days-to-liquidate is an absolute liquidity classification.

[7] In the case of small holdings of the same security across multiple funds in a complex, for example, aggregation to round trading lots for liquidity analysis under the proposed classification system may actually improve the reported liquidity of the security being classified.

frequently than monthly in order to comply with the proposed reporting requirements on Form N-PORT. Notwithstanding the Release's statement that investment advisers use "information obtained after reasonable inquiry" the processes necessary to make and review such classifications will be time and labor intensive; and liquidity conditions for many fixed-income securities imply that fine-grain liquidity classification would produce results that are, at best, speculative and therefore likely to be misleading to investors.

The classification system in the proposed rule fails to include important criteria in the evaluation process, and the rule's apparent rigidity limits the ability of portfolio managers and professional traders to rely on industry expertise when making determinations. It is critical that a fund classifying liquidity take into consideration not only available trading data but also factors such as liquidity of comparable securities. This more holistic process fundamentally requires the judgment of experienced portfolio managers and traders. Professional traders possess unique experience and expertise to understand liquidity characteristics of the assets in which they invest fund assets. Similarly, portfolio managers have unique expertise in selecting and managing security exposure of their funds so as to maximize shareholder returns and minimize liquidity risk. Given this expertise and experience, the input and judgment of portfolio managers and traders are essential to accurate assessment of liquidity characteristics of individual securities and portfolios, notwithstanding a review of the factors articulated in the proposed rule.

The characteristics of certain asset classes also do not lend themselves to highly granular time-to-liquidate estimates. For example, fixed-income securities often do not trade with a depth, regularity, or transparency level that is comparable to that of many equity securities. In certain asset classes, it is common for securities to be considered liquid but have no or little trading history; therefore, potentially appearing illiquid when judged solely by historical data. For instance, a small issue of a high quality large issuer (having many securities in the market) may be bought by a single fund and held to maturity. Additionally, in cases where the holder of a security does not wish to sell the security, it is common for such securities to have little or no trading volume but still to have active bids.[8] As a result, each fund or fund complex could very well treat such securities differently.

The resource commitment necessary to maintain classifications in the proposed categories is not justified by the minimal benefit in liquidity management that may be achieved. Market events may change on a daily or intra-day basis causing previously determined liquidity classifications for a security to be stale almost immediately after they are determined. As a result, each fund and fund complex will be required to invest an inordinate amount of time and expense towards maintaining its liquidity categorizations.[9] As result traders and portfolio managers could be forced to spend an excessive amount of time evaluating and providing

[8] For example, a municipal obligor may be well known in the market, highly rated, and have multiple issues outstanding. A single fund, complex, or other investor who either does not trade or does so infrequently, however, may purchase an entire individual issue. Though such an investor may never trade the security, it could be sold readily at or near its evaluation, which is derived by examination of comparable securities - in terms of quality, structure, obligor, or sector - that have observable trades. A similar issue exists with respect to many corporate securities, many of which are not Trade Reporting and Compliance Engine eligible, so that historical trading data for these securities is not available.

[9] The Release's presumption to the contrary may be evidence of relying on the input from a small group of large investment advisers for an assessment of industry practices.

estimates of the liquidity characteristics of each holding. Ultimately, the effort needed to classify and maintain the classifications of individual securities would be excessive and produce little value for investors.

3. *The design of the proposed classification scheme beyond 7 days itself is logically flawed.*

As a practical matter, the investment adviser is asked to classify securities into trading horizons at which the entire position could be sold at approximately the time-T security price. However, the fund is also required to meet time-T redemptions within 7 days. Therefore, security settlements at day T+8 and beyond will, by definition, be funding redemptions made at time-T+1 or beyond, which must be judged against security valuations at time-T+1 or beyond – not against time-T prices. Consequently, the portions of a holding that could be settled beyond 7 days at approximately the time-T price is a theoretical question that has no regulatory or practical relevance while representing the most uncertain, speculative and costly component of the proposed rule.[10]

4. *The disclosure of individual security categorizations in Form N-PORT could be misleading to shareholders and could result in potential liability for funds.*

Each liquidity categorization will be subject to a number of estimates by portfolio management and trading staff, along with assessments of the various factors specified in the proposed rule by compliance and administrative staff. Such estimates and assessments will be the result of the subjective judgment of the personnel making the estimate or assessment, and as discussed above, may become stale due to market events almost immediately after determination of the classification. As a result any comparison of the liquidity profile across funds or fund families would be difficult and misleading, and could result in shareholders making decisions based on unreliable information. Requiring funds to publicly disclose subjective determinations of individual security liquidity would be a novel concept, as there is no other reporting regime currently requiring funds or their investment advisers to disclose information that is so inherently speculative to the investor. Such disclosure could open up a fund complex to litigation risk if investors were to allege harm from investing based on liquidity classifications disclosed by a fund. Even if a safe harbor provision were established that protected funds and their directors from Commission enforcement action based on liquidity classifications, funds and directors could still be subject to private litigation.

c. The Three-Day Liquid Asset Minimum Test presents investment and operational difficulties.

Proposed Rule 22e-4 requires that each fund's written liquidity management program establish the minimum percentage of the fund's assets that will at all times be held in three-day liquid assets. Under the proposed rule, "three-day liquid asset" is defined to be "any cash held

[10] While we appreciate the Commission's objective of assuring that funds have adequate liquidity to protect remaining shareholders from the potential dilution from redemptions, defining the liquidity of an individual security in terms of its ability to be sold long after a time-T redemption, and in a potentially stressed market, but at a price not materially different from the time-T price, is problematic, particularly beyond 1-3 days.

by a fund and any position of a fund in an asset (or portion of the fund's position in an asset) that the fund believes is convertible into cash within three business days at a price that does not materially affect the value of that asset immediately prior to sale." The proposed rule further requires that in determining whether a position or portion of a position in an asset is a "three-day liquid asset," a fund must take into account certain factors specified in the rule. The proposed Three-Day Liquid Asset Minimum Test is similar to other compliance requirements that require daily monitoring, including a prohibition on acquiring securities that are outside the 3-day liquidity range if a fund is below the prescribed minimum. To accurately monitor this limitation a fund's trade order management system would need to maintain the liquidity classification for each security, which may present significant operational and technological challenges.

Beyond the compliance and systems requirements of the Three-Day Liquid Asset Minimum test as proposed, the requirement would create significant challenges in managing portfolios on a day-to-day basis. The requirement that a fund below its three day requirement may only purchase securities in fulfillment of the requirement will create unintended limitations on the ability of the portfolio manager to implement the fund's investment strategy. For instance, the portfolio manager may not be able to add to existing positions if the interpretation is that the amounts added contribute to the longer-to-liquidate portion of the overall holdings. Similarly, an entirely new purchase may be determined to only partially be saleable within 3 days. It is possible that the only securities that would fulfill the requirement would be actual cash and cash equivalents, which could force a material change in investment strategy and considerable reduction in performance for shareholders. Federated would instead recommend that the Three-Day Liquid Asset Minimum Test be a target percentage of the fund and that the investment adviser adopt, and the board approve, procedures reasonably designed to achieve the target while simultaneously implementing the fund's investment strategy.

d. Reliance on vendors to perform liquidity analysis and reporting would lead to both dissemination of misleading information to shareholders and harmful systemic effects.

In the proposing Release, the Commission recognizes that funds may rely on data from third-party providers when making liquidity management and categorization decisions. Such providers could, for example, create liquidity scores for a fund's portfolio holdings or provide models reflecting how the liquidity of a portfolio holding is expected to be affected under different market conditions. Reliance on such vendor data, however, could have negative effects on the market as a whole, and could result in misleading information being disclosed to shareholders. As described in Section II.b.2 above, basing liquidity assessments solely on recent trading data is inaccurate because data may not be available for certain securities (and may be misleading where it is available). It would also be difficult for portfolio managers to derive insight from third-party comparisons of their funds' classifications to those of other funds without first knowing what standards other funds use to make their classifications. Without such knowledge, it is unlikely that a portfolio manager would change a fund's classification simply because another portfolio manager shows different results.

Further, there is ample evidence that overreliance on third-party providers can have damaging systemic effects.[11] In the present case, extensive use of third-party providers for liquidity analysis and reporting who are not regulated by the Commission could generate false perceptions of liquidity at the systemic level and, among other things, defeat the objectives the Commission seeks to accomplish with the Proposed Amendments. Unless there is some limitation imposed by the Commission on the ability of service providers to perform liquidity analysis and reporting for funds it is likely that a small number of vendors will provide liquidity services to funds. This concentration among a small number of vendors providing liquidity services is likely to result in the same or similar classifications of securities across a broad selection of funds, and could exacerbate the impact of an issue should such vendors processes be revealed to be flawed. It should be noted that such vendor models are limited to use of historical data and will rarely envision "reasonably foreseeable" events that are not predicted by history.

e. The collection of granular individual security risk or liquidity data cannot be justified on the basis of the role played by third party fund evaluation services.

To provide further justification for the security-level data collection of the Proposed Amendments, the Release states that the proposed data collection "would result in investor protection benefits, because we believe the proposed requirements would permit investors (particularly institutional investors), as well as academic researchers, financial analysts, and economic research firms, to use the liquidity-related data reported on Form N-PORT to evaluate fund portfolios and related risks."[12]

Under current regulation, funds report holdings with a sixty-day delay, and large institutions and evaluation services may use this data to employ their own risk or liquidity analytics on fund holdings to evaluate detailed security characteristics or more specialized measures of portfolio risk. Analysis performed in this way, as opposed to the manner the Commission contemplates under the proposed rule, would improve the comparability of data and require that such service providers clearly state their assumptions for analyzing and comparing funds. It is furthermore not the role of public policy to promote reliance on vendors or to

[11] Overreliance on credit-rating agencies contributed to the 2008 financial crisis. *See* Press Release, Dep't of Justice, Justice Department and State Partners Secure $1.375 Billion Settlement with S&P for Defrauding Investors in the Lead Up to the Financial Crisis (Feb. 3, 2015) (available at http://www.justice.gov/opa/pr/justice-department-and-state-partners-secure-1375-billion-settlement-sp-defrauding-investors) (quoting Attorney General Eric Holder as saying of Standard & Poor's, "[o]n more than one occasion, the company's leadership ignored senior analysts who warned that the company had given top ratings to financial products that were failing to perform as advertised"). This in turn led to a congressional mandate removing references to such agencies from the 1940 Act. SEC, 17 C.F.R. §§ 239, 270, 274 (2014) ("The amendments we are adopting today replace [a] reference to credit ratings with an alternative standard designed to retain a similar degree of credit quality to that in current rule 5b-3. The Commission is also adopting amendments to Forms N-1A, N-2, and N-3 under the Investment Company Act and Securities Act to eliminate the required use of NRSRO credit ratings when a fund chooses to depict its portfolio holdings by credit quality."). Similarly, overreliance on proxy voting investment advisers has led the Commission to clarify an investment adviser's fiduciary obligation to its clients when the investment adviser has authority to vote their proxies. *See* SEC, Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms, Staff Legal Bulletin No. 20 (IM/CF) (June 30, 2014) (available at http://www.sec.gov/interps/legal/cfslb20.htm); *see also* SEC, 17 C.F.R. § 275 (2003).

[12] Release, *supra* note 2, at 62294.

facilitate the business of vendors in producing the more relevant fund level data that the Proposed Amendments should have required.

f. If the Commission elects to implement liquidity classifications, it should do so at the portfolio-level.

As stated herein, Federated does not believe that the proposed individual security liquidity classification requirements offer any tangible benefit to investors but present significant costs, implementation challenges and risks to the mutual fund industry. We strongly recommend that the Commission modify the proposal to: (i) require that liquidity classifications be done at the portfolio-level, rather than individual security-level; and (ii) that portfolio-level liquidity classifications should be made in a reduced number of liquidity categories. Specifically, we recommend that portfolio-level liquidity classifications be split into the following three classes: (i) one to three days, (ii) four to seven days, and (iii) more than seven days. This level of disclosure would improve the usefulness and reliability of the data for investors[13] and reduce the complexity and compliance costs of the rule for the industry.

Our proposal is not drastically different than what is included in proposed Rule 22e-4. In fact, the classification system as currently proposed implies that one-day and two- to three-day liquidity categories would already reflect portfolio-level analysis and judgment. If a fund were to sum the one-day and two- to three-day categories of the individual securities held in its portfolio, the result would imply a false level of liquidity, because taken literally, the sum of the one-day and two- to three-day categories as a measure of liquidity would imply that more liquid holdings are sold within three days, potentially in their entirety. This approach, however, would harm remaining shareholders by leaving the portfolio unbalanced and more illiquid. Thus, a portfolio-level one-to-three-day category disclosed and maintained according to a fund's liquidity-risk management plan must be less than the sum of the security-level one-day and two- to three-day categories to reflect the fact that a portfolio manager would not simply sell the most liquid holdings to meet a redemption, but rather would seek to retain the overall characteristics of the fund for remaining shareholders.

Our recommended "more-than-seven-day" liquidity category, which would consolidate the three longest-term categories under the proposed rule, would also allow portfolio managers to use systems and processes already in place associated with the fifteen percent illiquid asset rule.[14] Further, we note that portfolio managers currently report portfolio-level data on an ad hoc basis when investors inquire in accordance with applicable rules. In many cases, institutional shareholders request, and the funds provide, information about portfolio-level liquidity of funds,

---

[13] For example, the mandated classification criteria under the proposed rule may require portfolio managers of larger funds with historically excellent liquidity risk management practices and shareholder protection track records to classify their security holdings as relatively less liquid - and therefore riskier - than those of smaller funds. This result however, would not reflect reality, and may cause investors to invest in securities in funds that are, in fact, relatively riskier than these larger funds. This illogical outcome would be the most pronounced with respect to large bond index funds, which are generally liquid.

[14] *See* SEC, Revisions of Guidelines to Form N-1A, 57 Fed. Reg. 9828 (Mar. 20, 1992) (available at https://www.sec.gov/rules/other/1992/33-6927.pdf) ("The Commission is publishing revisions to the Guidelines to Form N-1A to permit open-end management investment companies to increase from 10% to 15% the amount of illiquid assets they may hold. Revising the Guidelines will permit investment companies more flexibility to make investments in the illiquid securities in small businesses.").

including the percentage of the fund's holdings that are deemed illiquid at a specified point in time. An increasing number of such institutional investors also inquire about the time necessary for a fund to liquidate varying portions of a portfolio or the maximum percentage that the fund could liquidate in a single day. By contrast, we have not received requests for individual security-level data from institutional investors, consultants, or evaluation services. If the Commission enacts proposed Rule 22e-4 in its current form, it is our expectation that fund complexes will continue to receive requests from institutional investors to provide portfolio-level liquidity information in addition to the security-level disclosure required by the rule. By comparison, a rule that governed disclosure of portfolio-level liquidity information would be in line with current fund and industry practices, and reduce risk of uneven disclosure of potentially material facts.

g. The Commission should encourage or require improved data collection protocols and standardized conventions for funds' use of such data in their liquidity risk disclosures.

In addition to any rule adopted by the Commission with respect to liquidity management and disclosure, we recommend that the Commission take steps to improve the data infrastructure in fixed-income markets and assist in developing industry-standard conventions for calculating and reporting liquidity, such that the same security held by different funds is treated in a similar fashion. Doing so could significantly reduce the cost and complexity of reporting and compliance, and would provide shareholders with an improved ability to compare securities across funds. When developing such standards, we recommend that the Commission consider the following:

1. The Commission should not require funds to report security-level liquidity, but could direct portfolio managers to consider, among other factors, individual security analyses appropriate to the asset class at issue, and could require fund investment advisers to maintain books and records of security-level data used to develop and maintain their portfolio-level estimates;

2. A central feature of the proposed rule is that a portfolio holding should be classified based on when the portfolio holding could be sold at a price that does not "materially" affect the value of the portfolio holding immediately prior to sale. The proposed rule does not, however, define the concept of "materiality." As a result, what constitutes "materiality" is left to the judgment of the funds and their service providers. Differences in how funds define "materiality" will necessarily lead to potentially significant disparity in the way they classify security positions. This variance would, in turn, reduce shareholders' ability to compare liquidity classifications across funds or fund families.

3. The Commission should consider permitting a fund complex to classify each security at the complex level, because a stress event would likely impact the entire complex-wide position and the market simultaneously. This approach would be a more relevant for portfolio managers and traders charged with performing the liquidity analysis.

4. The Commission should require omnibus accounts and intermediaries to provide improved subaccount information. The proposed rule directs portfolio managers to consider client concentration within each fund as they determine their liquidity risk

management programs. However, portfolio managers do not necessarily know or have access to client concentration data at the subaccount level for such omnibus accounts. This is in part because the Commission's current rules only mandate that omnibus accounts provide such detail for use in connection frequent trade monitoring. Accordingly, the Commission should require that omnibus account holders provide funds a simplified codification of the underlying detail for assessing concentration.

5. The Commission should consider either requiring by rule, or encouraging in another format, investors to provide advance notice to funds for large subscriptions and redemptions; for example, those in excess of $250,000 that are likely to be institutional. Though it is common for institutional clients to provide advance notice of such transactions, it is not required. It would be helpful for liquidity management if the Commission either encouraged clients to provide such notice, or included in a final rule a provision that provided funds with a means to mandate such notice themselves.

h. The Commission should consider mandating redemption policies to better align the payment of settlement proceeds with the perceived liquidity of particular asset classes.

The Release requires that fund directors and investment advisers consider redemption policies as part of a fund's overall liquidity management plan. Presumably, funds must be judicious in adopting T+1 redemption policies when the underlying securities of funds are less liquid or when the underlying securities settle in a longer time frame. It may be advisable for the Commission to mandate a different redemption policy for asset classes having longer security settlement characteristics unless fund boards specifically determine that an alternative policy is in the best interest of shareholders. This may encourage the industry to adopt a more cautious standard and help avoid instances in which stressed environments lead to investor harm. Anecdotal evidence from industry forums suggests that investment advisers would not oppose such a position from the Commission as long as the industry overall adopts a given standard.[15]

i. Conclusion

As currently drafted, proposed Rule 22e-4 contains security-level liquidity categorization requirements that are difficult to implement, illogical and likely to confuse more than aid investors. The proposed rule's focus on categorizing an individual security under both normal and "reasonably foreseeable" stressed conditions presents inherently contradictory guidance for actual classification. Categorizing individual securities into one of six classifications, moreover, suggests a higher degree of accuracy than can reasonably be expected. Further, overreliance on vendors to perform liquidity analysis and reporting may lead to publication of inaccurate information. We recognize the Commission's desire to take affirmative steps to provide a mechanism for funds to manage and report with respect to the liquidity of their portfolio; however, we do not believe that the current proposed rule will have the desired effects. If the Commission chooses to pursue its proposal, we strongly recommend that liquidity classifications, if any, should be required at the portfolio-level in a manner consistent with the recommendations we have made above.

---

[15] The Commission may also wish to encourage the industry to shorten the settlement times for transactions currently settling over longer periods.

III. Implementation of Swing Pricing Under Proposed Rule 22c-1(a)(3)

Under proposed rule 22c-1(a)(3), a registered open-end management investment company (other than money market funds and exchange traded funds) would be permitted to establish and implement policies and procedures enabling the fund to adjust its current net asset value ("NAV") to mitigate dilution of the value of its outstanding redeemable securities as a result of shareholder purchase and redemption activity.[16] More specifically, a fund would be permitted to establish and implement swing pricing policies and procedures requiring a fund to adjust its NAV under certain circumstances, provided that the fund's board and a majority of non-interested directors approve these policies and procedures, which include certain specified elements. Under the proposed rule, a fund's swing pricing policies and procedures must provide that the fund will adjust its NAV by an amount designated as the "swing factor" once the level of net purchases into or net redemptions from the fund has exceeded a specified percentage of the fund's net asset value known as the "swing threshold." A fund would be required to adopt policies and procedures for determining and periodically reviewing its swing threshold. A fund's swing pricing policies and procedures also would be required to include policies and procedures for determining a swing factor that would be used to adjust the fund's NAV when the fund's swing threshold is breached. While the swing factor could vary depending on the facts and circumstances, a fund's policies and procedures for determining its swing factor must take certain specified factors into account. A fund's board must approve the swing pricing policies and procedures (including the fund's swing threshold), as well as any material change thereto, and the board would be required to designate the fund's investment adviser or officers responsible for administering the policies and procedures. A fund would be required to abide by certain recordkeeping requirements relating to its swing pricing policies and procedures and any NAV adjustments made pursuant to these policies and procedures. The Commission believes that proposed Rule 22c-1(a)(3) will provide funds with a tool to mitigate the potentially dilutive effects of shareholder purchase and redemption activity.

Funds would be able to adopt swing pricing policies and procedures at their discretion. When a fund that has adopted swing pricing experiences net purchases exceeding the swing threshold, it would adjust its NAV upward, which would effectively require purchasing shareholders to cover transaction costs associated with the fund investing in additional portfolio assets. Conversely, when a fund that has adopted swing pricing experiences net redemptions exceeding the swing threshold, it would adjust its NAV downward, which would effectively require redeeming shareholders to cover transaction costs associated with the fund selling portfolio assets. In both cases, swing pricing would result in the costs of trading portfolio assets (transaction fees and charges relating to these trades) being passed on to purchasing and redeeming shareholders.

a. The impact of implementing swing pricing in the U.S. has not been fully studied and the potential costs are not adequately understood.

[16] It should be noted that current regulation requires that fund investment advisers and boards employ the available tools granted by the Commission to reduce dilution "to the extent practicable." Federated advocates that this standard be maintained when reformulating and adopting the current rule proposal.

We agree with the Commission that anecdotal evidence suggests that implementing a version of swing pricing in the U.S. mutual fund space could enhance shareholder protection and improve fund performance.[17] However, we believe that the implementation of the swing pricing mechanism contained in proposed Rule 22c-1(a)(3) is highly flawed and we present below a number of issues and concerns that have not been fully considered by the Commission.

Furthermore, the Release fails to adequately address the fact that current Commission rules, including Rule 22(c)-2 under the 1940 Act, already directs fund boards to craft redemption fee programs that account for a fund's specific circumstances while offering investor protection against the dilutive effect and systemic risk presented by large-scale redemptions that underlie the Commission's concerns. If after further study, including a determination that the liquidity program component of the Proposed Amendments in combination with current Rule 22(c)-2 is in adequate, the Commission deems it necessary to implement a pricing mechanism to supplement these protections, we suggest that the Commission should also consider dual pricing or T+1 pricing as alternatives to swing pricing. For the reasons discussed herein, we believe that either alternative would offer more clarity to and fairness for shareholders. Given the potential issues with the implementation of swing pricing and the availability of less troublesome alternatives, Federated suggests that the Commission should engage in a more thorough study of the potential impacts of the implementation of swing pricing in the U.S. open-end fund markets post adoption of the other new protections included in the Proposed Amendments; and that such study should include a consideration of whether the range of alternatives including, dual pricing or T+1 pricing, in combination with a careful evaluation of redemption fee options allowed by Rule 22(c)-2, may be a more effective means of protecting investors.[18] Further, the Commission has not conducted a full cost/benefit analysis to determine that swing pricing is preferred over the other alternatives (*i.e.*, dual pricing, T+1 pricing or via current 22(c)-2), or to determine that swing pricing should be allowed but not the other alternatives. The Commission cannot avoid the obligation to perform cost/benefit analysis simply by making swing pricing optional – thus forcing cost/benefit obligations on to fund boards.

1. *Swing pricing may not have a beneficial impact on systemic risk.*

It is our understanding based on anecdotal evidence obtained from speaking with others in the industry, that most funds choosing to employ swing pricing will do so under a "partial

[17] We stress anecdotal. These findings are limited to a very small number of funds and have not been subjected to rigorous analysis. Furthermore, these findings may only be a reflection of the failure of some funds to implement other anti-dilution protections already provided for in Rule 22(c)-2 for U.S. funds.

[18] For instance, we discuss below a form of redemption fee in which boards could disclose the assessment of a redemption fee equal to expected transaction costs (but no more than 2%) for any individual redemption in excess of $250,000 that exceeds (x) % of fund assets when at least (y) day advance notice is not provided. This would amount to giving shareholders making large redemptions a choice between: (i) a redemption fee; or (ii) T + y pricing on settlement. It is already common for large investors to give notice so that this would not be burdensome to the industry. Such a fee could be designed to avoid impacting small ("retail") investors, but cause larger redemptions to either be spaced out to avoid the fee, or cause these investors to provide adequate advance notice (which is currently the case for most large clients). This structure protects remaining shareholders while addressing FSOC's concern that redemption rights in open end funds create systemic risk. Large sudden redemptions would be subject to transaction fees, but shareholders that are averse to such fees can avoid them by simply giving advance notice. This redemption fee structure would be almost identical in effect to certain swing pricing variations and build on existing infrastructure, while not requiring expensive reworking of fund pricing methodologies based on predicted fund flows.

swing" method. In this regard, funds will only impose a transaction fee only after a predetermined percentage of the fund's assets have redeemed (or subscribed). As a result, there could be an incentive to be the first to redeem (creating a first-mover advantage) under the belief that earlier redemptions will not be subject to the (lower) swung price. This effect would not exist under: (i) a full swing methodology when the fee is always in effect; or (ii) under the current regulatory regime where redemption fees allowed by Rule 22(c)-2 do not have this form of conditionality; or (iii) under several other alternatives discussed below. This effect may be particularly prevalent in stressed markets.

2. *Swing pricing could improperly enrich some investors at the expense of others.*

The implementation of swing pricing by a fund may result in the enrichment of one shareholder to the detriment of another. For example, when there are net subscriptions above the swing threshold, redeeming investors would receive an unexpected windfall by receiving the unadjusted NAV plus the swing factor. Conversely for subscribing investors, when there are net redemptions that are above the swing threshold, the subscriber will receive shares at the downward-adjusted NAV. These outcomes may be contrary to the objectives of investor protection and the perceptions of market fairness.[19]

3. *Swing pricing could lead to increased volatility in fund performance and unnecessary randomness in both reported performance and in realized fund returns for individual investors.*

It is expected that swing pricing could increase the volatility of a fund's NAV in the short term, because NAV adjustments would occur when the fund's net purchases or net redemptions pass the fund's swing threshold. Thus, the fund's NAV would show greater fluctuation than would be the case in the absence of swing pricing. This volatility could result in an increased tracking error (*i.e.*, the difference in return based on the swung NAV compared to the fund's benchmark) during the period of NAV adjustment, and could make a fund's short-term performance deviate from the fund's benchmark to a greater degree than if swing pricing had not been used. Increased volatility and tracking error resulting from swing pricing could, therefore, result in investors incorrectly perceiving the risk-adjusted performance of a fund relative to its benchmark or that of its peers. Investor aversion to this risk could generally reduce the demand for fund products. Moreover, volatility and tracking error resulting from swing pricing could activate alerts in monitoring systems that follow fund performance, which could in turn trigger purchases or redemptions in automated fund advisory services whose algorithms are driven by fund performance.

In addition to the impact on volatility, a fund's reported returns would be impacted, particularly when the price is swung on month or quarter ends. This will distort the fund's apparent attractiveness in performance ranking services where a relatively small return deviation can cause a large change in rankings.

[19] For instance, this could result in arbitrary and unexpected results for investors purchasing or redeeming through automated programs such as 401(k) contributions or periodic withdrawal programs.

Additionally, realized investor returns would be impacted when investors transact on days when the price is swung. Thus, a lucky investor might receive an unexpectedly low purchase price and an unexpectedly high sale price. An unlucky investor would experience an unexpectedly high purchase price and an unexpectedly low sale price. Furthermore, large transactions occurring in just one share class would impact all share classes. These are examples of pure distortions that impair the fairness of the market, reduce the attractiveness of mutual funds and are a detriment to allocational efficiency and capital formation.

In order to mitigate some of these adverse outcomes, it could be necessary for investment advisers to publish both the adjusted and unadjusted NAV so that the markets and individual shareholders better understand the reported performance and individual performance outcomes.

4. *Swing pricing could inevitably lead to efforts to game trading in a manner that would harm investors and the integrity of mutual funds generally.*

In the current environment, investors in mutual funds transact at the current NAV. Upon the implementation of swing pricing for a fund, having knowledge of the intentions of other investors will become valuable in determining how to time trades. Data relating to swing factors may need to be published by reasoning outlined above. In any case however, bad actors would have an incentive to learn and benefit from the trading plans of others. Investors, market data services or bad actors could be able to reverse engineer the swing threshold and factors considered of a fund based on prior experience, even though such information is not published. The availability of knowledge of swing thresholds and factors could lead some investors to attempt to time transactions to avoid paying the swing factor, or to receive the swing factor at the expense of other investors, resulting in unfair trading practices. Based on these effects, swing pricing would create a new type of material non-public information (*i.e.*, the trading intent of other shareholders). Historically there has not been such a significant benefit to having this information. Consideration must therefore be given to developing adequate investor protection against this risk. This concern was not identified in the rule proposal; however, it should be evaluated, and ample safeguards, including necessary compliance programs, put in place before implementation of a final rule.

5. *Although "optional," the adoption of the proposed rule will effectively force larger funds to adopt swing pricing. Other funds may then be pressured to adopt if it were perceived that early adopters gained a business advantage.*

Although the proposed rule makes the adoption of swing pricing optional at the fund level, we believe that the effect of the proposed rule will be to drive the industry towards the implementation of swing pricing because of, among other things, factors impacting larger funds. Under the liquidity reporting requirements of the proposed rule, larger funds may be deemed less liquid under the new rule because of the size of their positions inevitably implies longer times-to-liquidate. Bond index funds could be particularly impacted because of the prevalence of smaller issues necessary to fully replicate the indices, notwithstanding the fact that bond index funds have historically shown minimal adverse dilutive impact from shareholder redemptions. Therefore, boards of directors of these funds may be forced to adopt swing pricing to protect against allegations of greater risk. This in turn could force swing pricing to become the industry norm as the absence of swing pricing could be seen as an unknown liability for directors and investment advisers of smaller funds.

6. *There are significant operational hurdles in implementing swing pricing.*

The implementation of swing pricing in the U.S. mutual fund market poses significant operational and technological hurdles. In other jurisdictions where swing pricing has been implemented, funds generally receive net flow information by the pricing cutoff time. By contrast, in the US, intermediaries act as agents for shareholders and provide net flow information well after pricing cutoff times, and funds strike NAVs by early evening in order to facilitate industry operations. Despite this, National Securities Clearing Corporation flows as well as flows from many platforms are not known until much later in the evening. Consequently, many funds would not have the net flow information necessary to apply swing procedures in the requisite time. In order to synchronize trade flow reporting and NAV computation and publication, funds and the industry would have to implement significant and costly operational changes. It should be noted that, if swing pricing was optionally adopted without an adequate mandated phase-in period, the risks to shareholders and investment advisers from operational shortfalls would be significant if some investment advisers rushed to adopt because early adopters with the benefit of European experience were perceived as gaining any advantage.

7. *The Commission's proposed requirement that funds may base swing procedures on information developed from "reasonable inquiry" is naïve and provides an inadequate standard for fund valuation practices. The "reasonable inquiry" standard tells the transacting shareholder that they can only be "reasonably confident" that they received the correct price, as opposed to one that improperly enriched other shareholders or penalized their account.*

In order to address the problem that funds would have to implement significant and costly operational and technological changes, the proposed rule includes a provision permitting funds to base swing pricing procedures on information developed from and after "reasonable inquiry." We believe that this standard is naïve because funds employ rigorous valuation procedures to establish a daily NAV and do not base such material decisions on "reasonable inquiry." The proposed rule also does not define the term "reasonable inquiry" leaving it open to interpretation by funds with the likely result that each fund complex will develop its own standard for what level of inquiry is deemed reasonable. Under such a vague standard, funds and directors could become subject to significant liability if swing pricing factors are mistakenly applied, or fail to be applied, due to data inadequacies or errors. Even under perfect and timely flow information, the potential operational complexity could lead to damaging NAV errors. At a minimum, any final rule permitting funds to implement swing pricing upon some standard of inquiry prior to having full pricing or NAV information available should include provisions providing funds and their directors with a safe harbor from litigation or Commission enforcement action resulting from errors due to less than perfect data or speculative judgments made in accordance with the rules and the fund's swing pricing policies. We believe that adopting swing pricing rules that cannot be rigorously followed using carefully vetted data inputs, or that require speculation by valuation committees based on imperfect data, should not be promulgated as they will lead to confusion, inconsistent practices and undue risk for the fund.

8. *Without adequate investor education, swing pricing could lead to investor confusion and impair mutual funds as an investment vehicle.*

Although swing pricing has been in use in other jurisdictions, the proposed form of "optional" implementation contained in the proposed rule would represent a major change in the U.S. mutual fund market that would cause investor confusion and, based on numerous disadvantages, could be expected to impair investor use of mutual funds as an investment vehicle. This is contrary to the Commission's mandates of market efficiency capital formation.

9. *Summary of concerns relating to swing pricing.*

The presumed advantage of swing pricing lies primarily in the unproven assumption that investors are better protected than under the various less onerous alternatives, or under such alternatives in combination with an effective implementation of Rule 22(c)-2, and that investment advisers prefer such a mechanism over a rules-based approach. Furthermore, the Release fails to adequately weigh the disadvantages of swing pricing that include: (i) a possible increase in systemic risk; (ii) significant operational costs to implement; (iii) lack of investor protection as compared with alternative approaches; (iv) potential damage to shareholders by impairing the transparency of the market and introducing new forms of market abuse; (v) increased performance volatility and tracking error (as discussed above); (vi) reduced perceptions of the underlying fairness of fund vehicles; (vii) risks arising from inadequate investor education; and (viii) the pressure for smaller funds to adopt because of the likely adoption by larger funds (due to larger funds having greater perceived risk under the liquidity component of the Proposed Amendments).

b. Proposed alternatives

We understand the Commission's desire to provide the mutual fund industry with tools to protect investors and to mitigate the impact of trading costs associated with subscriptions and redemptions on investors remaining in the fund; however, it is our view that the implementation of a significant change in the manner in which mutual funds are priced without further study of the need for such changes and the range of alternatives, along with the costs and benefits of such changes, is unwarranted and imprudent. Furthermore, current Commission rules, including Rule 22(c)-2 under the 1940 Act, already permit fund boards to craft redemption fee programs that account for a fund's specific circumstances while offering investor protection against dilution. If the Commission deems it necessary to implement a pricing mechanism to supplement the Rule 22(c)-2 protections, we suggest that the Commission should consider dual pricing or T+1 pricing as alternatives to swing pricing.

1. *Implementation of redemption fees under Rule 22c-2*

Rule 22(c)-2 under the 1940 Act directs funds, subject to compliance with the provisions of the rule, to implement redemption fees of up to 2% unless such fees are not deemed to be in the best interest of shareholders by the board of directors. Reliance on current Rule 22(c)-2 enables boards of directors to assess a transaction fee that would be similar in effect to the proposed swing pricing rule.[20] The need for any additional regulation such as swing pricing should be considered in light of existing regulations and methods of achieving the same results.[21]

Moreover, we believe that redemption fees under Rule 22c-2 may be implemented in a manner that minimizes the systemic risks created by swing pricing, and that offers certain investor protections that are not present in connection with swing pricing. We believe that prior to creating additional regulation the Commission should evaluate and determine whether the current tools available to funds are sufficient to achieve the Commission's regulatory aims. In this regard, we note that the additional protections created by swing pricing or the other alternatives are "in addition to" not "instead of" the other liquidity risk management requirements of the Proposed Amendments. Consequently, the Commission should determine that the current means available to directors, in combination with the proposed liquidity risk management requirements, are inadequate before introducing costly or uncertain new alternatives such as swing pricing, dual pricing or T+1 pricing.

With this in mind, current Section 22(c)-2 enables boards to adopt the following (illustrative) redemption fee structure to address any investor protection or residual systemic risk concerns: Boards could disclose the assessment of a redemption fee equal to expected transaction costs (but no more than 2%) for any individual redemption in excess of $250,000 that exceeds (x) % of fund assets when at least (y) day advance notice is not provided. Such a fee could be designed to avoid impacting small ("retail") investors, but cause larger redemptions to either be spaced out to avoid the fee, or cause these investors to provide adequate advance notice (which is currently the case for most large clients). This structure protects remaining shareholders while addressing FSOC's unsubstantiated concern that redemption rights in open end funds create systemic risk. Large sudden redemptions would be subject to transaction fees, but shareholders that are averse to such fees can avoid them by simply giving advance notice. This redemption fee structure would be almost identical in effect to certain swing pricing variations and build on existing infrastructure, while not requiring expensive reworking of fund pricing methodologies based on predicted fund flows.[22]

2. *Dual pricing may present many benefits in comparison to swing pricing.*

Certain foreign funds use dual pricing as an alternative means of mitigating potential dilution arising from shareholder transaction activity. A fund using dual pricing would not adjust the fund's NAV by a swing factor when it faces high levels of net purchases or net redemptions, but instead would quote two prices—one for incoming shareholders (reflecting the cost of buying portfolio securities at the ask price in the market), and one for outgoing shareholders (reflecting the proceeds the fund would receive from selling portfolio securities at the bid price in the market). The Release notes that the Commission considered dual pricing but

---

[20] Funds that have implemented redemption fees generally employ them to deter short term holding periods or momentum trading.

[21] The Commission could also consider updating its guidance with respect to redemption fees.

[22] As a practical matter, the redemption fee approach described above has the effect of giving large redeeming shareholders a choice between: (i) a redemption fee of up to 2%; or (ii) T + y pricing (under the view that the effect of giving a y-day notice on day T means that the redemption shares will be priced on day T + y with the proceeds then paid on day T + y + z where z is the stated redemption settlement policy of the fund).

determined swing pricing is preferable because it would be simpler to implement and for investors to understand. Given the challenges in implementing swing pricing that we have identified, we do not necessarily agree with such statements and believe that there should be further study done with respect to the potential use of dual pricing by U.S. mutual funds. We perceive there to be many advantages to dual pricing, including: (i) no first-mover advantage because every investor knows he/she will bear their own transaction costs; (ii) no gaming/insider information issues; (iii) no randomness in outcomes; (iv) no issues with timing of flows; and (v) clarity and fairness leading to improved investor acceptance and confidence in the industry. Therefore, dual pricing may be preferable to swing pricing.

i. Dual pricing does have different system/operational challenges.

There are, however, systems and operational challenges associated with a dual pricing regime. For instance, funds adopting dual pricing would be required to maintain two NAVs, which is not currently supported in today's operating environment and would entail costly operational, technological and infrastructure enhancements. Additionally, many intermediaries could elect to not perform this work and not allow dual NAV funds on their platforms unless mandated to do so by the Commission. Funds would also need to publish unadjusted NAVs for performance.

Further, dual pricing has a structural feature in which there is a putative over-collection of transaction cost payments compared with swing pricing. This is because there is no netting – every shareholder pays the transaction cost fee entering or leaving. However, any such payments accrue to the benefit of fund shareholders which would cause this form of mutualization to create *higher* performance rather than the alleged *lower* performance of today's system (that is claimed by some).

ii. Dual pricing in mutual funds would create a clear and favorable market-making distinction to exchange traded funds that should be made available to investors to promote efficiency.

In dual pricing, the bid-ask spread compensation is internalized within the fund to pay actual transaction costs and any "over-collection" is retained by the fund to the benefit of shareholders. In exchange traded funds, the ability to trade at any time is paid for as a bid-ask spread paid to market-makers. Any excess is not internalized by the fund, but lost as an economic rent (commission) paid to the broker involved in the transaction.

3. *An alternate approach to swing or dual pricing is to adopt T+1 pricing.*

An alternative to swing pricing or dual pricing that should also be considered is T+1 (*i.e.*, trade date plus 1 day). T+1 pricing has multiple advantages over both swing pricing and dual pricing, including that under T+1 pricing investors redeeming or subscribing bear their own transaction costs since T+1 pricing reflects the costs of transactions made on T+1 to implement the trades. T+1 pricing would eliminate the systemic risk concern of shareholders believing that they can avoid their own transaction costs. In fact, T+1 pricing does so more effectively than other means because investors cannot avoid transaction costs **or** any market move anticipated for day T+1 that the redemption might have sought to avoid. T+1 pricing also avoids issues associated with the maintenance of multiple NAVs or investors purchasing or redeeming at an adjusted NAV. Implementation of T+1 pricing would not be without its own challenges, as funds would be required to move to T+2 settlement, and there would be other operational changes necessary to accommodate T+1 pricing. The redemption fee framework described in Section III.b.1 above is an illustration of how the Commission may combine current Rule 22(c)-2 with a T + y pricing concept.

4. *An additional option that the SEC should consider is swing pricing only for redemptions.*

A primary motivation for introducing swing pricing as a pricing methodology for U.S. registered open-end funds is presumably to address the FSOC's unsubstantiated allegation that the redemption rights in these funds pose systemic risk. Under this view, subscriptions do not contribute to systemic risk. Therefore limiting the application of swing pricing to redemptions would arguably address FSOC's systemic risk concerns while reducing the frequency of unintended adverse consequences that the Commission's proposed application would entail.

c. Conclusion

In conclusion, the Proposed Rule 22c-1(a)(3) has various disadvantages that the Release did not fully address. These include, among others, (i) the potential for swing pricing to create a first-mover advantage for a redeeming shareholder; (ii) improper enrichment of some investors at the expense of others; (iv) randomness in reported and realized fund returns; (iv) operational hurdles in implementing swing pricing; (v) a vague "reasonable inquiry" standard; and (vi) investor confusion leading to reduced investor use of mutual funds as an investment vehicle. Given these problems, we believe it appropriate for the Commission to consider alternatives that have less downside, such as dual pricing and T+1 pricing, possibly in combination with redemption fees as currently provided in Rule 22(c)-2.

Finally, the current rule proposal that swing pricing could be optionally adopted by fund boards upon publication of the final rule would be irresponsible. Significant damage could be caused to investors, investment advisers and service providers if operational requirements were not met, investments were interrupted and NAV errors occurred. Investors and investment advisers would have an inadequate period for training and education. The reputation of the industry and individual firms could be needlessly damaged. Investor confidence in the industry, mutual fund products and the regulatory process could be impaired. Therefore, if notwithstanding our recommendations to the contrary, swing pricing is implemented, we recommend that it be subject to a mandatory two-year delay which would permit the necessary industry preparation and investor education.

The issues pertaining to swing pricing, dual pricing or T+1 pricing in the U.S. mutual fund space are complex and should be thoroughly evaluated before making any of the three options available for funds. We believe that the Commission should finalize and implement the liquidity features of proposed Rule 22e-4 prior to adopting any new pricing scheme. Following such implementation, the Commission should make a determination of what additional regulation, if any, may be required after evaluating the performance of the adopted liquidity measures.[23] In particular, the Commission should determine and clarify why the liquidity rule in conjunction with redemption fees under Rule 22c-2 are inadequate for shareholder protection before adopting any new pricing scheme. If the Commission deems additional regulation is required, a proper cost/benefit analysis should be conducted – with input from the industry – to evaluate the relative merits of the available methodologies including: (i) the overall impact on the industry, investor perceptions and the efficacy of mutual funds as an investment vehicle; (ii) the impact on systemic risk; (iii) the impact on investor protection; and (iv) the overall cost of implementing the necessary operational, technological and infrastructure changes to accommodate the differing solutions.

IV. PERCEIVED SYSTEMIC RISK OVERSIGHT OBLIGATION OF THE COMMISSION

While it is understandable, given today's regulatory climate, that the Commission is concerned about systemic risk, monitoring such risk is not defined with the Commission's statutory mandate. If systemic risk oversight is nonetheless the Commission's underlying objective for requiring security-level duration risk and liquidity data (in the Reporting Rules and the liquidity program components of the Proposed Amendments, respectively), we do not believe it is appropriate to require funds to publicly disclose such information in lieu of portfolio-level information. Indeed, requiring disclosure of costly-to-produce information in a way that does not fulfill a statutory mandate may be arbitrary and capricious.

Moreover, if the Commission is seeking to oversee systemic risk, there are simpler and more direct and accurate means of obtaining such data. Because of differing models and assumptions underlying reports by different fund families, it is impossible – under the proposed rules – to aggregate risk data across funds in order to arrive at market-level insights.[24] Furthermore, the assumptions underlying much of the data apply fund-by-fund and do not take into account complex-wide or industry-wide events. This makes the aggregation of such data of little use for evaluating time-to-liquidate at a fund level in a true market-wide stress event.[25]

It would be simpler, less costly, and more effective for the Commission to perform its own analyses for systemic risk oversight and to aggregate data across funds to evaluate those systemic investment and liquidity risks it deemed relevant. This approach would significantly reduce compliance costs for funds while increasing costs only modestly for the Commission. Further, it would greatly increase the timeliness, accuracy, and reliability of data available to the Commission, and would enable the Commission to consider any market or redemption scenarios it deemed relevant without being limited to portfolio manager estimates. This approach would also allow the Commission to conduct analyses for which it would be unrealistic or inefficient to seek a future rule change.

It would also reduce the reporting burden on funds for the Commission to acquire information directly from custodians and transfer agents, which are proficient in maintaining and

[23] As an example, the 2014 money market fund reforms followed the 2010 money market reforms.

[24] In particular, in the liquidity rule, funds are asked to evaluate and report time-to-liquidate estimates for individual security holdings under "reasonably foreseeable" stressed market assumptions, which are a highly subjective standard and does not allow for comparison across funds.

[25] It is noteworthy that, in other stress-test conditions, banks (for instance) are told which stress events they must consider, thus making efforts at aggregation more realistic, albeit still challenging.

reporting portfolio holdings and other information. Working directly with custodians, the Commission could obtain information on a timelier basis, including daily data, and could make more real-time assessments of fund risks, including systemic risk assessments.

The Commission has yet to propose the stress test rule mandated under the Dodd Frank Act,[26] the purpose of which will be to identify systemic risk of financial firms. Rather than employing the Proposed Amendments, the Commission should take advantage of that rule to identify and collect any investment or liquidity risk data it deems necessary for systemic risk oversight. This would enable the Commission to coordinate (i) stress tests identified in the mandated rule with portfolio-level risk assessments considered under proposed Form N-PORT or Rule 22e-4, and (ii) analyses of fund or aggregate industry or asset-class holdings to better define and execute systemic risk oversight.

It is also worth noting that many of the conclusions the Commission could draw from its proposed disclosures related to investment or systemic risk would differ only immaterially from those derivable from a simpler benchmark-level analysis. Federated's extensive experience developing portfolio analytics suggests that the aggregate systemic risk in the fund industry, when confronted with shocks, does not materially differ from results suggested by analysis of benchmarks customarily used for fund performance. Most funds have modest tracking errors against their benchmarks. The extent to which individual funds may differ from their benchmark characteristics is, therefore, properly seen as an investor protection issue better addressed by effective portfolio-level disclosures (for liquidity and investment risk) rather than by security-level information. This is another reason to defer collection of data relevant for systemic risk purposes to the stress test rule.

If the collection of security-level liquidity information is for the intended purpose of assessing a potential systemic impact of the alleged first-mover advantage[27] purportedly inherent in the redemption features of open-end funds, the Commission should give funds market-wide stress parameters against which to estimate times-to-liquidate for varying fund redemption volumes. Fund-specific security-level data, or even some portfolio-level data, created using advisers' perceptions of "reasonably foreseeable" stress events would not be relevant to answering this question.

---

[26] *See* 12 U.S.C. § 5635(i)(2)(C) (2012) ("Each Federal primary financial regulatory agency, in coordination with the Board of Governors and the Federal Insurance Office, shall issue consistent and comparable regulations to implement this paragraph that shall— (i) define the term "stress test" for purposes of this paragraph; (ii) establish methodologies for the conduct of stress tests required by this paragraph that shall provide for at least 3 different sets of conditions, including baseline, adverse, and severely adverse; (iii) establish the form and content of the report required by subparagraph (B); and (iv) require companies subject to this paragraph to publish a summary of the results of the required stress tests."); SEC, IMPLEMENTING THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT, https://www.sec.gov/spotlight/dodd-frank.shtml# (last visited Jan. 7, 2016) (indicating the Commission has yet to propose the stress-test regulations required under section 5635(i)(2)(C)).

[27] *See, e.g.*, OFFICE OF FIN. RESEARCH, ASSET MANAGEMENT AND FINANCIAL STABILITY 12 (2013) (available at http://financialresearch.gov/reports/files/ofr_asset_management_and_financial_stability.pdf) ("Any collective investment vehicle offering unrestricted redemption rights could face the risk of large redemption requests in a stressed market if investors believe that they will gain an economic advantage by being the first to redeem. Investors in mutual funds with portfolios of securities with varying levels of liquidity may have a "first-mover advantage" to sell early, if they believe cash on hand and maturing assets are insufficient to cover redemption requests and that more liquid assets may need to be sold to meet redemptions.").

V. GENERAL COMMENTS AND QUESTIONS

In addition to the foregoing discussion, Federated has set forth a number of additional questions and comments related to the Proposed Amendments on Appendix A.

VI. CONCLUSION

Federated believes that some elements of the proposal by the Commission, if modified as noted above, could serve to enhance shareholder protection and improve the mutual fund marketplace. However, the classification system for managing liquidity risk in proposed Rule 22e-4 is unworkable, it excludes important factors from consideration and suggests a higher degree of precision than would exist in practice. More practical, less costly and more informative measures are proposed. The swing pricing system in proposed Rule 22c-1(a)(3) would introduce an array of unintended and unexamined effects that require much greater study before any decision to implement can be made. Taken together, we do not believe that implementation of the proposed rules in the current form is in shareholders' best interests and, in fact, it would introduce them to additional risks. Furthermore, for the reasons outlined above, we believe that the Commission has inadequately assessed the potential protection afforded by current Rule 22(c)-2, particularly when combined with the liquidity risk measures provided in the Proposed Amendments; or whether Rule 22(c)-2, possibly with the simple adaptations suggested herein, in combination with other alternatives discussed herein, could adequately protect shareholders while being less disruptive and costly than swing pricing.

To provide additional perspective on Federated's opposition to core elements of the proposed rule, in both the liquidity classification scheme and in surmounting the operational challenges in implementing swing pricing, the Release proposes that investment advisers simplify and reduce the necessary resource requirements to comply with the rule by basing regulatory reporting, shareholder disclosure and NAV determination on data determined through "reasonable inquiry." Moreover, this simplification appears to be a material element in the Release's presumption that the benefits of the proposed rule outweigh the costs. However, such a methodology is inconsistent with the standards that investment advisers typically apply with respect to such consequential matters. With "reasonable inquiry," the Commission would appear to be introducing a new and undefined legal or regulatory standard that does not comport with other more exacting Commission requirements. As a result, Federated's responses reflect a more realistic assessment of the actual effort that would be required and the risks to shareholders, funds and investment advisers that would result from inadequate or inaccurate work.

As a general matter, the topic of fund pricing, the economics of how transaction costs are absorbed and alternative models for how such costs are internalized represent a very deep subject that goes to the heart of the mutual fund industry and its distinction from the exchange traded fund marketplace. The distinctions between swing pricing, dual pricing, T+1 pricing and redemption fees have material implications for operational efficiency, investor protection and for how investors perceive fund vehicles. Such a material change as proposed in the Release, that could impose swing pricing as a de facto standard because of the circumstances of larger funds, should not be made as a seemingly "costless bolt-on" option to defend against an FSOC allegation regarding the redemption rights in open-end funds. The Commission has an obligation to devote the time and attention to this subject that is warranted given the complexity and importance to investors and the capital markets. Federated recommends that the Commission thoroughly evaluate the costs and benefits of the available alternatives, including the highly relevant underlying distinctions for how transaction costs are paid and to whom any excess fees accrue, as part of a determination of the best course of action for shareholders and the industry. Federated further recommends that such an evaluation be performed in light of the additional protective measures that will be created by the other components of the Proposed Amendments.

Federated hopes that the Commission finds these comments helpful and constructive and is happy to provide additional information relating to our comments or discuss any questions you may have.

Yours very truly,

/s/

J. Christopher Donahue
President and Chief Executive Officer

/s/

Michael R. Granito
Chief Risk Officer

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

David Grim, Director
Division of Investment Management

Appendix A

In addition to the foregoing discussion, Federated has the following additional questions and comments with respect to specific issues not discussed in the letter that relate to the proposed liquidity classification requirements and additional proposed reporting requirements on Forms N-1A, N-PORT, and N-CEN.

Additional Questions and Comments Related to the Proposed Liquidity Classification Requirements

1. If an otherwise liquid asset is designated on the longer end of the liquidity spectrum because it is segregated against a derivative designated as illiquid, can it qualify as a liquid asset for purposes of the Three-Day Liquid Asset Minimum testy and fifteen-percent liquidity limit, or would this be double-counting illiquid levels? Classifying segregated assets, normally on the shorter -end of the liquidity spectrum, on the longer end would require an additional indicator to represent assets linked to other assets.

2. If a fund bases its disclosure on Investment Book of Record data, it needs to determine the effect of forward settling transactions on the three-day liquid category. Will this determination result in double counting and thereby impair the accuracy of the three-day liquidity classification? Should the fund exclude cash held to settle the transaction from the three-day classification because it is associated with a liability for the fund?

3. Must a fund perform the proposed monthly reevaluation of liquidity at the portfolio-level, or at both the portfolio and asset level?

4. Must a fund resubmit all changes to its board-approved three-day liquidity budget level for board approval prior to implementation? Could a portfolio manager recommend and implement certain changes that the board could ratify after the implementation?

5. The proposed factors to determine which securities fit in which liquidity classifications do not include presumptions as to which asset types are illiquid. Does a fund only need to apply the factors as stated in the Commission's Release? Do fund boards no longer need to review the liquidity of security types presumed illiquid?

6. Should funds include redemption fees associated with certain funds as part of their analysis when developing their liquidity risk programs?

7. When reviewing an asset for its continued liquidity classification, what constitutes a reasonable inquiry? How should funds document reasonable inquiry?

8. If a board must independently review the adequacy of a fund's written liquidity management program and performance, who is permitted to perform such review?

9. Should securities on the restricted list automatically be excluded from the three-day classification? How should funds classify them on the liquidity spectrum? If internal restrictions dictate such classification, should the classification be made public?

Additional Questions and Comments Related to Proposed Disclosure and Reporting Requirements

Form N-1A

1. The proposed changes to Item 11 are of uncertain benefit to shareholders and regulators. Federated currently discloses the period for "normally" funding redemption proceeds reserving the right for that period to be longer under certain conditions and as permitted by applicable rules. Removing this flexibility would run counter to the Commission's stated goal of protecting the value of funds for their remaining shareholders. Similarly, it does not further the Commission's purpose to decrease the number of days in which a fund must fund redemptions. Additionally, we believe that providing disclosure of whether the number of days within which redemptions are paid differs by distribution channel is unnecessary and could present undue complexity in prospectus if there are minor deviations.

2. With respect to the requirement in Item 11 that each fund disclose its methods for meeting redemption requests, we believe that a portfolio manager should always fund redemptions in a manner that is in the shareholders' best interests. As a result, this requires case-by-case analysis of the various methods available to fund a redemption, which may include sales of portfolio assets, holdings of cash and cash equivalents, lines of credit, inter-fund lending facilities or the ability to make redemptions in kind. We do not believe that a fund should commit to a predetermined plan to meet requests, and a description of a priority or waterfall approach to funding redemptions would likely be confusing to shareholders. Accordingly, any additional disclosure would need to be generic, and as a result, may not be of much utility to shareholders.

3. The Commission requested comment as to whether it should amend Form N-1A to require certain funds to incorporate enhanced disclosure regarding liquidity risk into their summary prospectuses. We believe that such an amendment would run counter to the Commission's previously stated position against disclosure creep. In June 2014, the Commission observed: "[t]here are a significant number of prospectuses . . . in which disclosure remains complex, technical and duplicative. Further, the staff continues to see what it believes are unnecessarily long Summary Sections. In the Adopting Release [for proposed amendments to Form N-1A], the Commission explicitly noted that it shares the concerns of some commenters that, over time, Summary Sections could get longer, undermining the usefulness of the summary."[28] The contemplated additional disclosures are precisely the type of addition that could cause the form to become "complex, technical and duplicative." Accordingly, we do not believe that the Commission should adopt such amendments.

4. We do not object to the filing of lines of credit as an exhibit to Form N-1A, and recognize that many funds already do so. However, we believe that in addition to actual fees paid there are other provisions of such agreements that are confidential. Accordingly, we

[28] SEC, Guidance Update, No. 2014-08 (June 2014) (available at https://www.sec.gov/investment/im-guidance-2014-08.pdf).

would recommend that the proposed instruction to Item 28 permitting funds to maintain the fees paid as confidential be revised to permit withholding the rate payable by the fund on any drawdowns, both because this indicates the credit quality of the fund complex and because it could lead to increased costs for investors (as it is likely a fund expense).

Form N-PORT

1. With respect to proposed Item C.13, we do not believe that security-level liquidity classifications are appropriate, nor do we believe that disclosure of such classifications would be of benefit to the market. Production of security-level classifications at the fund level will be time consuming, create significant operational difficulties, and will involve a large number of personnel that could better serve shareholders managing their portfolios. Moreover, such classifications will be inherently flawed based on, among other things, the judgments made by personnel and information obtained from a small number of third party vendors. Accordingly, we do not agree with this new requirement of the form.

2. ***The Commission asked:*** "If the liquidity classifications are kept confidential, how does the Commission achieve its goal of allowing investors to be better informed through information provided by third parties or otherwise?" The Commission may ask for more detailed and realistic liquidity risk disclosure. The Commission could also require funds to show redemption histories so shareholders can decide whether they match the portfolio composition.

3. ***The Commission asked:*** "Would public disclosure of liquidity classifications facilitate predatory trading practices or exacerbate first mover incentives?" This disclosure likely would facilitate such practices and incentives, though the trend has been towards more frequent disclosure of portfolio holdings, which also facilitates predatory trading practices.

4. ***The Commission asked:*** "Should funds be able to explain their methodologies, assumptions, or estimations in determining liquidity classifications?" If the Commission insists on making funds' security-level liquidity classifications public, it must permit funds to include disclosure about the methodologies followed in producing such classifications and the risks inherent in such methodologies to provide a higher degree of understanding on the part of the audience. Moreover, without such disclosure investors would be unable to understand why one fund may categorize a security differently from another fund.

5. To the extent that security-level liquidity classifications are required, we believe that also requiring a security is a fifteen percent standard asset will be confusing to investors. Such information may be useful to regulators; however, it makes little sense to require disclosure of this information along with public liquidity classifications. The distinction between the two would make sense to industry experts, but would be confusing, and potentially misleading, to typical investors.

Form N-CEN

1. We agree that Information about the availability of a committed line of credit for a fund would be helpful to shareholders, though the Commission should permit funds to omit confidential elements of the line of credit as is permitted in connection with the proposed modifications for Form N-1A. Disclosure regarding the availability of uncommitted lines of credit would also be beneficial, though disclosure should include a discussion regarding the circumstances that would cause such a line to not be available to the fund. In either case, the Commission should permit funds to state generically which funds have access to lines of credit, because the alternative would require a great deal of effort to keep fund names and Commission filing numbers up to date with little added benefit. We agree that the Commission's proposal to require funds to report if they engaged in interfund lending or borrowing, as well as information about such loans, would be beneficial from a regulatory perspective.

2. The Commission asked if it should require disclosure of other sources of liquidity beyond those identified in the rule. We are not aware of other relevant sources of liquidity that the Commission should require disclosure about.

General

1. A majority of the Commission's proposed amendments to Form N-1A, N-PORT, and N-CEN would require a large effort from funds while offering data that is, at best, of little utility and, at worst, misleading. Many of these deficiencies relate to flaws inherent in a security-level disclosure scheme. Such disclosure is not cost effective, and alternative means of data collection would better enable systemic risk oversight. Another alternative, that we have discussed more thoroughly in Section IV above, would be that for systemic risk oversight the Commission collect data directly from fund custodians and apply or develop its own expertise to analyze any risk questions it deems relevant. An alternative approach would be to continue with the reporting and disclosure requirements currently in effect.