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

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

Dear SEC Staff:

Morningstar, Inc. appreciates the opportunity to comment on the SEC's proposed rule on Liquidity Risk Management Programs. As the world's largest provider of mutual fund data and research, Morningstar has a long tradition of advocating for investors' interests, and welcomes the opportunity to comment on this proposal on behalf of investors. Furthermore, we recognize the SEC's role in minimizing risk to both individual investors and the broader financial system, and consider the SEC the regulator best positioned to assess and manage these risks. We believe that several portions of the SEC's proposal would be very helpful to investors, though in other cases we urge the SEC to refine its contemplated approach or engage in additional consultations with the fund industry and investor advocates.

First, we commend the SEC for considering allowing funds to implement swing pricing programs on a voluntary basis. When funds face heavy redemption requests—particularly when the markets are volatile—a swing pricing approach allows fund managers to pass along trading costs to the investors who are exiting the funds. Indeed, in other markets around the world it is relatively common for those who transact in funds to bear the costs of their trading, whether through the use of swing pricing or other less-precise measures such as buy/sell spreads.

We are aware of objections that some long-term investors may unfairly bear costs related to swing pricing because, by chance, they happen to sell fund shares on a day when swing pricing is triggered. However, we do not believe that is a reason to forgo giving funds the opportunity to implement swing pricing. When an investor sells fund shares during a time of heightened market volatility and wider bid-ask spreads for the fund's underlying holdings, selling the fund's investments to meet redemptions necessarily results in costs to the fund. Someone will bear those costs. We believe that it is fairer for those selling fund shares to bear the costs, rather than those who do not sell their shares.

However, before moving to final rulemaking on a swing-pricing proposal, we urge the SEC to engage in additional consultations with the fund industry to determine the feasibility of implementing swing pricing in the United States. At present, funds typically strike and report their NAVs before receiving cash flow reporting from many third-party intermediaries. As a result, funds might strike an NAV before realizing that net cash outflows from these omnibus accounts had triggered the need to implement swing pricing on a particular day. We believe that it will be possible to overcome these operational difficulties but urge the Commission to work with the industry to develop a swing pricing approach that can achieve widespread adoption.

We also support the SEC's proposal to require each open-end fund to establish a liquidity risk management program which includes board oversight. Managing liquidity risk is a vital element of fund management. Because of our conversations with fund managers across the globe over the past several decades, we know that high-quality investment firms devote significant resources and management time to minimizing liquidity risks. We believe that codifying each fund's approach to liquidity risk management is not only intuitively sensible but would also allow each fund to tailor a program to its unique characteristics, especially the nature of its underlying holdings.

However, we urge the SEC to revisit its proposed "six-bucket" approach to measuring the liquidity of individual portfolio holdings. First, we believe that the SEC's proposed approach requires such a large degree of subjectivity that reporting would be inconsistent across funds. As such, investors and financial advisors would find it difficult to compare the liquidity characteristics of portfolios from different fund firms. Second, we believe that the multi-bucket approach implies a false level of precision about how long it would take to sell various individual holdings with a minimal market impact. Given that it would be difficult to report holdings' liquidity characteristics with this level of precision—and that funds might face liability if they are unable to sell holdings as quickly as they had indicated—we believe that funds would have incentives to be excessively conservative in their liquidity classifications, reducing the benefit of this information to investors. Third, we believe that this information would receive the greatest level of investor attention during periods of market turbulence, when trading conditions can change very rapidly. Given that the SEC proposes releasing this liquidity breakdown relatively infrequently, the information might well be very out of date when an investor reviews it.

Rather than establishing a prescriptive liquidity reporting regime, we urge the SEC to finalize work on its proposal to modernize investment company reporting. We believe that a standardized reporting regime, including monthly reporting of portfolio holdings, would deliver meaningful informational benefits to investors and would allow the SEC to enhance its monitoring of funds' liquidity risks. In particular, improved disclosure relating to bond funds and derivatives would permit the SEC to better monitor risks to investors and the overall financial system. Moreover, the provision of frequently updated, high-quality, standardized portfolio information to the investment community would allow consultants, analysts, and investors to assist the SEC in monitoring portfolio risks, including liquidity risks. At present, disclosure related to certain esoteric securities, leverage, and credit quality is simply inadequate to meet the needs of market participants, including investors. We therefore applaud the SEC's initiatives to improve portfolio reporting.

As a final note, although we recognize the SEC's important role in monitoring and reducing global systemic risks, we do wish to note that the mutual fund industry poses a very low risk to the stability of the global financial system. Indeed, we believe that in the 2008 financial crisis, the fund industry performed admirably and provided needed stability to the global financial system. Fund investors did not engage in panicked selling; to the contrary, most investors stuck to their predetermined investment plans. Funds themselves do not pose meaningful risks to the financial system--given that they have little or no leverage, funds are contributors to financial stability, not to instability. In the 2008 market crisis, with the exception of one institutional money market fund, the mutual fund industry easily met the redemption requests that did arrive from investors. (And we note that the SEC has already taken actions to minimize the risk of an additional money market fund failure.) Moreover, the fund industry was typically a source of support for the global financial system. To take just one example, when Barclays—like many highly leveraged banks—needed to raise capital in 2008, it was able to sell its investment management business to raise funds. In general, we therefore urge regulators to view the mutual fund industry as a source of stability for the global

financial system, and to continue to focus their efforts on managing risks at the highly leveraged financial institutions that caused the 2008 financial crisis—and which are much more likely than the mutual fund industry to cause the next financial crisis.

Again, we thank the SEC for providing Morningstar with an opportunity to comment on this proposal. We very much value our strong working relationship with the Commission and would be delighted to provide additional feedback if that would be helpful.

Sincerely yours

Scott Cooley
Director of Policy Research
Morningstar, Inc.