Statement at Open Meeting on Investment Company Liquidity Disclosure

Commissioner Michael S. Piwowar

March 14, 2018

I would first like to thank the Director of the Division of Investment Management, Dalia Blass, for moving this proposal forward. Also, thank you to the staff who worked so hard devising and drafting its contents.

I support this recommendation to improve the reporting and disclosure of liquidity information by investment companies. Nevertheless, I am disappointed that the Commission is missing a golden opportunity.

Seventeen months ago, the Commission adopted rules aiming to promote effective liquidity risk management throughout the fund industry and to provide investors with information to help them understand a mutual fund's or exchange-traded fund's ("ETF") liquidity and redemption practices.[1] I supported the final rule, because it reflected the staff's thoughtful consideration and incorporation of the public comments received on the proposal.[2]

However, since we adopted these rules, it has become clear that they do not benefit investors as we had intended. Today's proposing release acknowledges that—rather than assisting investors to make informed investment decisions, as we had hoped—the required disclosure of a fund's aggregate liquidity classification likely has a *negative* effect on investors' decision-making, because the information is misleading and does not provide necessary context. On a day when we commemorate the life and work of the great Stephen Hawking, it would be fitting to allow the data to lead our inquiry.

Hawking once wrote that "any physical theory is always provisional, in the sense that it is only a hypothesis: you can never prove it. No matter how many times the results of experiments agree with some theory, you can never be sure that the next time the result will not contradict the theory."[3] If a mind like Stephen Hawking's can recognize its limitations in observing the physical world, surely we can strive for the same humility in considering, reconsidering, and refining our own rules and regulations. I have spoken many times about the important role of retrospective rule review in ensuring that the rules and policies we implement are actually achieving their intended objectives. I am happy that a majority of the Commission supports the staff's efforts to make our disclosure work better for retail investors.

However, this retrospective review has been cut short. In our Interim Final Rule delaying the compliance date for Rule 22e-4, we acknowledged that the one-size-fits-all "bucketing" methodology has already turned out to be more costly and complex than anticipated and that the role for service providers is going to be more extensive than we had originally understood.[4] Industry participants have found the prescriptive bucketing approach to be suboptimal for its intended purpose, and funds are finding more effective ways to manage their liquidity risk.[5]

In October 2017, the Treasury Department issued a report on asset management and insurance[6] in response to President Trump's executive order calling for the identification of current laws and regulations that are inconsistent with seven "Core Principles" of financial regulation.[7] Among other findings, the Treasury Department observed that funds are using their own in-house liquidity risk methodologies alongside the costly Commission-mandated bucketing methodology.[8] In other words, our current rule is creating costly make-work for compliance departments and not improving funds' management of their liquidity risk. As former Commissioner Dan Gallagher pointed out when the Commission proposed the liquidity risk management rules in 2015, "the Commission must be mindful of the effect of these regulatory costs as it considers any rulemaking initiatives—not only because we are required by law to do so, but because these costs directly impact the bottom line for the many Americans who rely on funds to save for retirement, college, and other important financial goals."[9] The Treasury Report "reject[ed] any highly prescriptive regulatory approach to liquidity risk management"—explicitly calling out our bucketing requirement—and recommended that the Commission consider a more principles-based approach to liquidity risk management rulemaking.[10]

Thus, we are presented today with a perfect opportunity for meaningful retrospective review. Unfortunately, a majority of the Commission has decided to pass up the opportunity, as well as ignore the Administration's recommendation, to the detriment of investors and the investment companies that serve them. I encourage industry participants and service providers to continue to provide us with feedback on your experiences as you soldier forward in implementing these rules.[11] While this proposal fails to put forward a specific plan for scaling back Rule 22e-4, additional public comment on the operation of this rule—building on the substantial record we have accumulated so far and on the Treasury Report's conclusions—would help to provide an evidentiary basis for the Commission to consider more investor-friendly amendments to Rule 22e-4 in any future final rule.

Thank you. I have no questions.

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[1] Press Release, Securities and Exchange Commission, *SEC Adopts Rules to Modernize Information Reported by Funds, Require Liquidity Risk Management Programs, and Permit Swing Pricing* (Oct. 13, 2016), https://www.sec.gov/news/pressrelease/2016-215.html.

[2] Commissioner Michael S. Piwowar, "Statement at Open Meeting on Investment Company Liquidity Risk Management Programs, Investment Company Swing Pricing, and Investment Company Reporting Modernization Releases" (Oct. 13, 2016), https://www.sec.gov/news/statement/piwowar-statement-open-meeting-101316.html.

[3] Stephen Hawking, *A Brief History of Time* 10 (1988).

[4] Securities and Exchange Commission, Investment Company Liquidity Risk Management Programs; Commission Guidance for In-Kind ETFs, Release No. IC-33010, https://www.sec.gov/rules/interim/2018/ic-33010.pdf.

[5] *See*,*e.g.*, Letter from the Investment Company Institute to The Honorable Jay Clayton (July 20, 2017), https://www.ici.org/pdf/liquidity_sec_clayton_ltr.pdf .

[6] U.S. Department of the Treasury, "A Financial System that Creates Economic Opportunities: Asset Management and Insurance" (Oct. 2017), https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-That-Creates-Economic-Opportunities-Asset_Management-Insurance.pdf (the "Treasury Report").

[7] Presidential Executive Order on Core Principles for Regulating the United States Financial System (Feb. 3, 2017), https://www.whitehouse.gov/presidential-actions/presidential-executive-order-core-principles-regulating-united-states-financial-system/.

[8] Treasury Report at 34.

[9] Daniel M. Gallagher, "Statement on Open-End Fund Liquidity Risk Management Programs and Swing Pricing" (Sep. 22, 2015), https://www.sec.gov/news/statement/gallagher-liquidity-risk-management.html.

[10] Treasury Report at 34 ("Treasury rejects any highly prescriptive regulatory approach to liquidity risk management, such as the bucketing requirement. Instead, Treasury supports the SEC adopting a principles-based approach to liquidity risk management rulemaking and any associated bucketing requirements.")

[11] Securities and Exchange Commission, Investment Company Liquidity Disclosure, Release No. 33046 , at 20, https://www.sec.gov/rules/proposed/2018/ic-33046.pdf ("We note that market participants will continue to gather insights as liquidity risk management programs are implemented, and can provide comments to the Commission as they do so. The staff will monitor the information received and report to the Commission what steps, if any, the staff recommends in light of commenter experiences.").