Statement on Proposed Amendments to Public Reporting of Fund Liquidity Information

Commissioner Hester M. Peirce

March 14, 2018

Thank you, Chairman Clayton.

I am honored to be here for Dalia Blass's first open meeting as Director of Investment Management. Dalia has already shown herself to be a fantastic fit for the job. I greatly appreciate the staff's work on this release. Having sat in your seats during my last stint at the Commission, I know how much work goes into getting a recommendation ready for an open meeting. I am particularly grateful for your efforts to keep the release short—in a relative sense anyway.

Today, we are considering a proposal to amend Forms N-PORT and N-1A to rescind the requirement that certain open-end funds disclose aggregate liquidity classification information about their portfolios. We are considering replacing that disclosure with a new requirement to disclose information about the operation and effectiveness of funds' liquidity risk management programs in their annual report to shareholders. The proposed amendments also would allow funds to classify the liquidity of their investments pursuant to their liquidity risk management programs required by rule 22e-4 in multiple liquidity classification categories for a single position. Finally, we are considering amendments to Form N-PORT to require reporting of holdings of cash and cash equivalents.

Recently, we adopted an interim final rule extending by six months the compliance date for rule 22e-4's requirements, the compliance date for the classification and highly liquid investment minimum reporting requirements on Forms N-PORT and N-LIQUID, and related recordkeeping requirements.

While I support the proposed amendments, today's proposal represents a missed opportunity for investors and takes an inconsistent approach to public dissemination of classification information. For the most part, I agree with this proposal—as far as it goes. It does not, however, go far enough. Funds' aggregate liquidity classification information should not be disclosed to the public, and funds should be able to classify a single position in multiple liquidity classification categories. Nevertheless, by not also proposing to rescind rule 22e-4's classification requirement—or even inviting comment on the possibility of doing so—we are not acting in the interests of investors.

As noted in the interim final rule release, since the liquidity classification requirement was adopted, Commission staff has engaged with funds and third-party service providers concerning the implementation of the classification requirement. In those interactions, we have learned that "implementation is more complex than anticipated and the role for third-party service providers is going to be more extensive than we had originally understood, thereby resulting in even more complexity and raising interpretive questions."[1] In a companion action to the extension of the compliance date, the staff released a lengthy set of Frequently Asked Questions. The interim final rule release also promises that more interpretations are coming.[2] Clearly, the liquidity classification requirement is proving to be much more burdensome than the Commission thought at the time it was adopted.

In addition to our first-hand observations of potential trouble in connection with the classification requirement, the Department of the Treasury ("Treasury"), in its recent Asset Management report, noted that "the rule mandates an overly prescriptive asset classification or bucketing methodology

despite the fluid, and sometimes subjective, nature of liquidity" and that "[t]his uniform bucketing requirement may not help funds improve their current liquidity risk management programs." [3] Treasury raised the real possibility that "funds may continue to use their current methodologies for classifying the liquidity of their investments alongside the costly mandated bucketing methodology." [4] Treasury recommended that the SEC adopt "a principles-based approach to liquidity risk management rulemaking and any associated bucketing requirements."[5] It is a recommendation that the Commission—with only a little more ink and a few more questions—could have explored in this proposal.

The Commission frequently states its support for retrospective review of its rules. Yet, despite the increasingly real complexities and unanticipated burdens associated with the liquidity classification requirement, the Commission is not taking the opportunity presented by today's proposal to review the cost and utility of the classification requirement. The Commission should take advantage of this unique opportunity *prior* to funds' implementation of the classification requirement. Yes, a lot of time and money has been spent on implementation already, but it is worth taking a moment to ask whether this is a project that warrants the expenditure of even more time and resources. Throwing good money after bad is not wise.

We ought to seriously consider whether the benefit the Commission will derive from the classification schema—a benefit beyond the potential to obtain some interesting information has not yet been identified to me —is warranted. It will be much more difficult to conduct a retrospective review and, if justified, rescind or revise a rule requirement once the regulation has been implemented fully. Knowing what we know now—but contenting ourselves only to open up a few minor aspects of the liquidity regime—indicates a lack of seriousness about retrospectively reviewing our regulations.

Asking for comment on whether we would be better off not moving forward with the liquidity classification requirement, would keep our options open and ensure that we are getting the full benefit of input from commenters. At a minimum, we should propose that funds be allowed to take a principles-based approach to classifying the liquidity of their securities.

Surely, the inclusion of such a line of questions about the fundamental value of what we are doing would make more sense than the directive to the staff—added to the release over my objection—to conduct a review of the granular fund-specific liquidity information that the Commission is scheduled to begin receiving in 2019 and present a recommendation to the Commission addressing whether there should be public dissemination of fund-specific liquidity classification information.

Following a discourse about how fund specific data could be useless—or worse—to investors and a proposal to eliminate public dissemination of even aggregate liquidity classification information, it is odd to include a roadmap for possibly disseminating the granular liquidity classification. This information is what we originally proposed and ultimately rejected due to investor confusion concerns similar to those on which we are basing today's proposal to eliminate aggregate fund-specific disclosure to investors.[6] This sets up the absurd possibility that today's proposal, fueled by investor confusion concerns, will result in funds being told once again to disclose the even more confusing granular liquidity classification information.

Today's proposal also bolsters liquidity disclosures in a way that make any benefits classification might offer even more questionable. Would funds' adoption and implementation of a written liquidity risk management program, disclosure of their portfolio holdings on Form N-PORT, the identification of the holdings funds consider illiquid, the 15 percent illiquid investment limit, and disclosure of funds' cash and cash equivalents provide sufficient information for the Commission and staff to evaluate funds' liquidity? Shouldn't we at least consider how this package of liquidity-related requirements compares to a bucketing requirement in terms of cost and effectiveness at achieving our objectives?

I understand that reviewing the liquidity classification requirement so soon after its adoption would be inconvenient. The pressure on the Commission at the time of the rule's adoption was intense. Faced with a swirl of external voices hyperventilating about liquidity risks in the asset management space, we responded with a new rule. Now, however, we have the luxury to take a step back and think more deeply about whether simply checking the box to satisfy others caused us to fall down on our duty to look out for investors.

Thanks again to the staff. I have no questions

[1] Investment Company Liquidity Risk Management Programs; Commission Guidance for In-Kind ETFs, Investment Company Act Release No. 33010 (Feb. 21, 2018) at text following n.42. We also state in the release that based on staff engagement we have learned that: (1) due to a lack of readily available market data for certain asset classes (*e.g.,* fixed income), the implementation of the portfolio classification requirement will be heavily dependent on service providers to provide funds with scalable liquidity models and assessment tools that are necessary for bucketing and reporting; (2) fund groups believe that full implementation of service provider and fund systems will require additional time for further refinement and testing of systems, classification models, and liquidity data, as well as for finalizing certain policies and procedures; and (3) funds are facing compliance challenges due to questions that they have raised about the liquidity rule requirements that may require interpretive guidance. *Id*. at text following n.21.

[2] *Id*. at n.22 ("[W]e expect to receive additional requests for guidance in the future, and will respond to them accordingly.").

[3] U.S. Dep't of the Treasury, A Financial System that Creates Economic Opportunities, Asset Management and Insurance (Oct. 2017) at 34.

[4] *Id*.

[5] *Id.*

[6] Investment Company Liquidity Risk Management Programs, Investment Company Act Release No. 32315 (Oct. 13, 2016) at Section III.C.6.b.