VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS
AND INDEPENDENT FINANCIAL ADVISORS

**VIA ELECTRONIC MAIL**

February 4, 2016

Brent J. Fields
Secretary
U.S. Securities & Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: **Open-End Fund Liquidity Risk Management Programs**

Dear Mr. Fields:

On October 15, 2015, the Securities and Exchange Commission (SEC) published its request for public comment on proposed rules to require open-end funds to maintain liquidity risk management programs and to provide additional disclosures to the SEC and the public (Proposal).[1] The proposed liquidity risk management programs are designed to mitigate the risk that a mutual fund will be unable to meet customer redemptions. To that end, the Proposal would require each mutual fund to classify and monitor each portfolio asset's level of liquidity and to designate a minimum amount of portfolio liquidity. Additionally, the Proposal would require reporting about its liquidity classifications and liquidity risk management programs to the SEC and the public.[2]

The Financial Services Institute[3] (FSI) appreciates the opportunity to comment on this important proposal. We support the SEC's efforts to strengthen the liquidity risk management practices employed by open-end funds by requiring them to maintain formalized liquidity risk management programs. As the Proposal states, daily redeemability has been the hallmark of mutual funds since the passage of the Investment Company Act of 1940.[4] We support efforts to protect mutual fund investors, such as those serviced by our members, by reducing the risk that funds will be unable to meet their redemption obligations. However, we wish to concur with several of the commenters that have called for a more principles-based approach to liquidity risk management program design. We believe the Proposal's prescriptive approach may unintentionally create additional risks for retirement investors.

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[1] 80 Fed. Reg. 62274 (Oct. 15, 2015).
[2] The Proposal also permits but does not require mutual funds to use swing pricing to price their shares so as to avoid dilution of the interest of shareholders.
[3] The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.
[4] 80 Fed. Reg. 62275 (Oct. 15, 2015).

## Background on FSI Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the U.S., there are approximately 167,000 independent financial advisors, which account for approximately 64.5% percent of all producing registered representatives. These financial advisors are self-employed independent contractors, rather than employees of Independent Broker-Dealers (IBD).

FSI member firms provide business support to financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners who typically have strong ties to their communities and know their clients personally. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations and retirement plans with financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their investment goals. Financial advisors often recommend mutual funds to their clients in order to achieve these goals due to their ability to pool investor assets to benefit from professional investment management, diversification, and liquidity.

## Discussion

We have long advocated for responsible regulations that protect investors while preserving investor access and choice to financial products and services. Mutual funds comprise a large percentage of retirement investors' portfolios. They offer investors the ability to achieve a level of diversification that is unavailable to them through holding individual equity or debt securities.

In light of the significant role played by mutual funds in investors' accounts, we believe it is critical for funds to have robust liquidity risk managements programs that are tailored to the particular makeup and strategy of the fund. It is the experience of our members that mutual fund companies already have such programs in place. Mutual fund companies currently manage liquidity risk in manners appropriate for the characteristics of particular funds. Such tailored programs are critical to protecting investors and their hard-earned retirement savings. We support the SEC's efforts to mandate adoption of such a program by all open-end funds.

The Proposal, amongst other things, would require mutual funds to classify each asset position or portion of a position in one of six liquidity categories. These categories are based on the number of days it would take to convert the asset to cash at a price that does not materially affect the value of that asset immediately prior to sale. Additionally, the Proposal would require funds to assess and periodically review their liquidity risk in light of specific factors. The Proposal also would require mutual funds to determine a minimum percentage of its net assets that must be held in cash or assets convertible to cash within three business days. A fund exceeding this minimum percentage would be prohibited from acquiring assets other than those that could be converted to cash within three business days.

We fear that the prescriptive, one-size-fits-all approach will distort the liquidity risk management practices currently employed by portfolio managers and unnecessarily impede investor returns. Additionally, the Proposal creates the potential for significant investor confusion

and misunderstanding. This may result from two unintended consequences. First, we believe that the requirement to classify assets in six liquidity buckets will cause larger funds to appear to be less liquid solely on the basis of their size and irrespective of the assets they hold. We believe that investors would be best served by being able to compare liquidity management practices across funds employing similar strategies and not based solely on the size of the fund. Second we fear that the Proposal incentivizes fund managers to adopt aggressive approaches to assessing liquidity so as to appear to be more liquid. Funds that adopt approaches that are more conservative as compared to their peers may appear less liquid to investors. We are concerned that investors may misinterpret these classifications and choose to place their savings in funds that are not as diligent as they should be in assessing liquidity.

While we support the goals of the Proposal, we are concerned that the prescriptive approach utilized by the SEC will confuse and potentially harm investors. As such, we support the comments calling for a more flexible, principles based approach that offers fund companies the ability to create a liquidity risk management program best suited to manage the particular risks of that fund. We believe that investors would benefit from a rule that allows liquidity risks to be managed in light of the strategies employed by the particular fund. This will avoid the potential distortions that may be unintentionally created by the Proposal and provide funds the ability to structure and alter liquidity risk management programs in response to the fund's particular strategy.

## **Conclusion**

We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with the SEC on this and other important regulatory efforts. We support the SEC's efforts to require funds to maintain robust liquidity risk management programs. We urge the SEC to alter its approach and to adopt a more flexible liquidity risk management program requirement that maximizes the benefits for investors.

Thank you for considering FSI's comments. Should you have any questions, please contact me at (202) 803-6061.

Respectfully submitted,

David T. Bellaire, Esq.
Executive Vice President & General Counsel