INVESTMENT COMPANY INSTITUTE

1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

FACT SHEET: ICI LETTERS COMMENTING ON SEC'S LIQUIDITY RISK MANAGEMENT PROPOSAL

The Securities and Exchange Commission (SEC) has proposed sweeping new rules for liquidity management of mutual funds and exchange traded funds. The SEC says that its proposal is intended to promote the ability of those funds to meet redemptions, while mitigating potential dilution.

ICI strongly endorses adoption of a risk-targeted liquidity management rule. That rule must implement sound risk management principles. ICI supports the SEC's proposal that follows this approach. ICI offers alternative approaches, where the proposal abandons sound risk management principles. The following are critical points from ICI's comment letters:

- A risk-targeted rule could build upon funds' strong 75-year record of meeting redemptions and mitigating dilution.
- ICI opposes, and the record does not support, the misguided, highly prescriptive elements of the proposal.
- ICI offers alternatives to achieve the SEC's goals.
- Swing pricing is a novel concept in the U.S. and would require significant operational changes before it ever could be implemented in the U.S.

A risk-targeted based program rule is a sound approach to liquidity risk management and builds upon funds' strong record.

- Under a risk-targeted based program rule, a fund would develop and implement policies and procedures that are appropriate for that fund's particular liquidity risk profile. That program would include classification of a fund's liquidity, subject to ongoing review by the fund's manager and rigorous oversight by the fund's board.
- Funds and their managers offer diverse portfolios and investment objectives. As a result, there can be no one-size-fits-all approach to liquidity management.
- The SEC has successfully used a risk-based program approach in other rules, including the SEC's compliance program rule (Rule 38a-1 under the 1940 Act).
- Other jurisdictions use a similar approach to liquidity management, as evidenced by a recent report by the International Organization of Securities Commissioners).

ICI opposes, and the record does not support, the misguided, highly prescriptive elements of the proposal.

- ICI strongly opposes the SEC's proposed "six-bucket" asset classification scheme and "three-day liquid asset minimum" requirement.
- The six-bucket classification scheme presents a false appearance of comparability of liquidity across funds.
    - As drafted, this one-size-fits-all classification scheme is highly subjective and presents a misleading picture of fund liquidity.
    - It also does not take into account very basic differences in asset classes, such as securities traded on an exchange as compared to those that do not.
    - ICI believes it will add new risks to funds and to the financial system by increasing the likelihood of fund portfolio correlation.
    - The proposed scheme also is not needed – the "data modernization" rules, once adopted by the SEC, will result in the SEC obtaining portfolio holding data in a structured format from all funds. The SEC can analyze, using any metric it sees fit, fund liquidity – both across the fund industry and at each individual level.
- The three-day liquidity minimum, as proposed, would harm investors by distorting the portfolio management of a fund and hampering a fund's ability to track an index or meet a benchmark. It also could result in removing liquidity from the markets.
- The data presented by the SEC and its staff does not support adoption of those requirements. Indeed, the SEC has not demonstrated a market failure justifying the need for the liquidity classification scheme or the three-day liquidity minimum.
- In place of the "six bucket" asset classification scheme, ICI recommends a requirement that a fund formulate policies and procedures to determine how to classify and monitor the liquidity of portfolio assets within the broader context of portfolio level liquidity.
- In place of the three-day liquid asset minimum, ICI recommends that a fund formulate policies and procedures to determine how best to reasonably ensure that the fund has sufficient liquidity to meet redemptions.

Swing pricing is a novel concept in the U.S. and would require significant changes to make it operational.

- Swing pricing is common in Europe, but is not permitted in the United States.
- Under the proposal, a fund that elects to adopt swing pricing could adjust its NAV on days when net purchases or redemptions exceed a specified threshold.
- ICI member views vary on swing pricing. All members recognize, however, that enormous operational challenges must be overcome before swing pricing could ever be implemented in the U.S.