INVESTMENT COMPANY INSTITUTE

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

August 11, 2015

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-9303

Re: Investment Company Reporting Modernization and Amendments to Form ADV and Investment Adviser Act Rules – File Nos. S7-08-15 and S7-09-15

Dear Mr. Fields:

The Investment Company Institute[1] ("ICI" or "Institute") appreciates the opportunity to comment on Securities and Exchange Commission ("SEC" or "Commission") proposals that would require registered investment companies ("funds") to engage in additional and more frequent reporting of portfolio holdings, allow funds to provide shareholder reports via websites, and require investment advisers to provide to the SEC information about their separately managed account businesses.[2]

Broadly speaking, we support the proposals, notwithstanding the extraordinary effort, cost and burdens involved in implementing them. Much of the additional information the SEC proposes to collect can enhance its ability to monitor and oversee the fund industry. Obtaining that information in a structured data format will help the SEC to better analyze information and improve its ability to carry out its regulatory mission. As Chair White explained last year, the SEC must have the capability to monitor for any risks at the fund level and across the entire industry in order to effectively identify and

[1] The Investment Company Institute (ICI) is a leading, global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. The U.S. members of ICI manage total assets of $18.0 trillion and serve over 90 million shareholders.

[2] *Investment Company Reporting Modernization*, 80 Fed. Reg. 33590 (June 12, 2015), available at http://www.gpo.gov/fdsys/pkg/FR-2015-06-12/pdf/2015-12779.pdf ("Fund Reporting Proposal"); *Amendments to Form ADV and Investment Advisers Act Rules*, 80 Fed. Reg. 33718 (June 12, 2015), available at http://www.gpo.gov/fdsys/pkg/FR-2015-06-12/pdf/2015-12778.pdf ("Adviser Reporting Proposal").

address risks in the asset management industry.[3] The proposals meet these goals and will provide the SEC with additional data and other information it needs to draw conclusions about any risks in the asset management industry and to inform its consideration of any appropriate regulatory responses.

As an active participant in the assessment of financial stability issues, ICI has strongly endorsed an SEC-led review of industry-wide activities or products to assess their risk potential, as distinct from designating individual funds or asset managers as systemically important financial institutions or "SIFIs." The SEC has the required expertise in the asset management industry, and the capital markets more broadly, and is the appropriate regulatory body to lead the efforts to review for risks in those areas. We believe the proposed rules will greatly improve the SEC's ability to conduct this review and, subject to a number of changes discussed below intended to enhance the final rules, we support the SEC's adoption of the proposed rules.

We particularly applaud two aspects of the proposals. First, the SEC made the right decision to propose not making public the portfolio holdings and certain other data that the Commission would require funds to file with the SEC each month on Form N-PORT, except for data for the third month of each quarter.[4] That data would not become public until 60 days after quarter-end. Protecting this data ultimately protects fund shareholders from harm emanating from predatory trading practices by other market participants.

We recommend in the discussion below that the SEC take significant steps to fully secure the extensive data it proposes to collect, particularly in light of the sensitivity of portfolio holdings information. We also recommend that the Commission entirely preserve as non-public certain Form N-PORT information where public disclosure at any time has the potential to confuse investors and harm funds and their advisers.

Second, we strongly endorse the Commission's proposal to provide funds with an optional method to satisfy shareholder report transmission requirements by posting those reports online if they meet certain conditions. This aspect of the Fund Reporting Proposal modernizes the manner in which information is transmitted to shareholders, provides substantial cost savings to funds and their shareholders, and appropriately takes advantage of technology for the benefit of investors. Recent Commission investor testing and other empirical research concerning investor preferences about information transmission methods and use of the Internet for financial and other purposes also support this proposal. We recommend taking the logical next step and adopting the same approach for delivery of funds' prospectuses and summary prospectuses.

---

[3] *Enhancing Risk Monitoring and Regulatory Safeguards for the Asset Management Industry*, Speech by SEC Chair Mary Jo White at the New York Times Dealbook Opportunities for Tomorrow Conference (Dec. 11, 2014), available at http://www.sec.gov/News/Speech/Detail/Speech/1370543677722.

[4] For ease of reference, we will refer throughout this letter to the information that the SEC proposes to collect on Form N-PORT as "portfolio holdings" or "portfolio holdings information."

In supporting the proposals, we also recommend that the SEC modify and improve them in some significant ways. Our intent with these recommendations is to enhance the final rule set, consistent with the SEC's policy goals. We provide reasonable alternatives to addressing the multitude of business, operational, and compliance challenges the proposed rules present.

A table of contents, an Executive Summary, and other more specific comments on the proposals follow.

TABLE OF CONTENTS

I. Executive Summary

ICI broadly supports the Commission's efforts to update fund reporting. Expanding fund reporting in the manner proposed, however, raises important issues that the Commission must consider regarding the security of the data being collected, the effects of publicly releasing certain information, and the deadlines funds would face to file this information. We address each of these considerations in turn.

A. Indicate How the Commission Intends to Maintain the Security of Critically Important Fund Portfolio Holdings Information

The SEC has not addressed how it intends to maintain the security of the Form N-PORT data it will collect from the fund industry, nor the extent to which it will be made accessible on a current basis to any parties other than the SEC. The SEC's storage of immense volumes of monthly fund data would create a vast, unique, single repository of structured data that undoubtedly will attract the attention of cyber criminals. That information, particularly industry-wide portfolio holdings, reflects the intellectual capital and very lifeblood of the fund business. A hack of portfolio holdings information could expose the entire universe of funds to predatory trading practices, including front-running of fund trades, "free riding" of fund investment research, and reverse engineering or "copycatting" of fund investment strategies—all at the expense of fund shareholders. Such a data breach would cause major financial losses that not only would impact fund shareholders and fund advisers, but also would cause great harm to the SEC itself and the overall capital markets.

The SEC must ensure that it is prepared to protect this enormously sensitive fund data before beginning to require large-scale monthly disclosure of portfolio holdings that would reach across the entire fund industry. We specifically recommend that the SEC have an expert third-party test and verify its capabilities both prior to requiring firms to commence monthly filing of portfolio holdings on Form N-PORT and on a continuing basis. This third-party review also must address potential risks that arise from the SEC's sharing of data with other regulatory agencies. (As an alternative, the SEC could limit the information shared in a way to mitigate these concerns, such as providing summaries of information rather than access to the raw data collected.) Based on discussions with information security experts among our membership, we have developed a partial list of protective steps for the SEC and any third-party examination to consider, at a minimum, which we outline in Appendix A.

In balancing the SEC's need for information with funds' responsibility to maintain the confidentiality of this information for the benefit of shareholders, we respectfully recommend that it adopt a more staged and targeted approach to this data collection. We recommend that, at least until it has implemented the recommendations of a third-party expert, the SEC initially collect fund portfolio holdings information quarterly with a 60-day lag (rather than monthly, as proposed) and begin

collecting other Form N-PORT information on a monthly basis.[5] This initial amount of data would significantly enhance the SEC's ability to oversee the fund industry. In particular, because the information would be in a structured data format, the SEC would be able to more readily collect, aggregate, and analyze this information. Experience with this enhanced data set would position the SEC to reevaluate the necessity of expanding its data collection to encompass complete fund portfolio holdings on a monthly basis.

B. Do Not Mandate Public Disclosure of Risk Metrics; Delta for Convertible Securities, Options, and Warrants; Illiquidity Determinations; Country of Risk Determinations; and Proprietary Information about Derivatives and Securities Lending

The Commission should not disclose publicly risk metrics; delta for convertible securities, options, and warrants; illiquidity determinations; country of risk determinations; derivatives financing rates; and securities lending agent compensation (including revenue sharing splits) and other fees. Each of these items poses unique issues that necessitate non-public treatment.

- The risk metrics information and delta for convertible securities, options, and warrants the Commission requests are complex, and their calculation depends on a number of subjective assumptions. In many cases these measures are easily subject to misinterpretation. While we are confident that the Commission can analyze this data for its regulatory oversight purposes, we are concerned that it would be of limited utility and would be confusing to investors.
- Illiquidity determinations and determinations of country of risk require considered judgment, and different firms reasonably can arrive at different conclusions. Public disclosure likely will stifle today's robust processes of making independent determinations, instead incenting firms to seek homogenized determinations from third-party service providers.
- Derivatives financing rates and securities lending agent compensation (including revenue sharing splits) and other fees are sensitive and proprietary information. If such information were disclosed, a fund's ability to negotiate effectively on behalf of its shareholders would be severely compromised.

Public disclosure of these specific data items is neither appropriate nor necessary for the public interest or the protection of investors. To ensure this information remains non-public, we recommend that these items be reported either on Part D of Form N-PORT, which is proposed to be non-public, or on an additional non-public schedule to that form.

[5] Notably, in addition to quarterly portfolio holdings information, the SEC's receipt of risk metrics, flow information, and illiquidity determinations on a monthly basis will provide it with important new tools to conduct oversight of the fund industry.

C. Make a Number of Other Changes to Forms N-PORT, N-CEN, and Regulation S-X

We highlight below other recommendations regarding proposed Forms N-PORT, N-CEN, and the proposed amendments to Regulation S-X.

1. Form N-PORT

- Modify the proposed risk metrics standards to require funds to:
  - report the total portfolio duration and spread duration;
  - employ a *de minimis* five percent threshold to a foreign currency's contribution to total duration before any risk metrics information about that currency is required to be reported or, alternatively, only require reporting of a single duration measurement that is a weighted average of the top five currencies (including the base currency) or those currencies that constitute at least 50% of the portfolio's exposure; and
  - define "investment grade" consistent with a more conventional definition of that term, without reference to liquidity.
- Increase the risk metrics reporting threshold to an amount greater than 25% of a fund's net asset value ("NAV") determined over a three-month period and exclude index funds from risk metrics reporting.
- Require funds to disclose information only about the five securities lending counterparties to which a fund has the greatest exposure.
- Use a definition of "derivatives" consistent with accounting guidance to enable funds to appropriately determine whether to provide derivatives-related information about an instrument.
- Require disclosure of derivatives gain or loss information by contract type (*e.g.*, futures, forwards, swaps, *etc.*) rather than by risk category (*e.g.*, commodity contracts, credit contracts, equity contracts, *etc.*).
- Require funds using derivatives that are based on non-public indices or custom baskets to report only the largest 50 issues and the components that exceed one percent of the index or basket when the notional amount of the derivative exceeds five percent of the fund's NAV. Do not require funds to disclose non-cash collateral received on the schedule of investments.

2. Forms N-PORT and N-CEN

- Explicitly state in any adopting release that funds may make and rely on reasonable judgments and assumptions in providing responses to Forms N-PORT and N-CEN.

- Permit funds to provide third-party Legal Entity Identifier ("LEI") information based on their reasonable belief that the information is accurate.

3. Regulation S-X

- Modify the written option contracts disclosure to omit written option notional amount.
- Require funds using derivatives that are based on non-public indices or custom baskets to report only the 50 largest issues and the components that exceed more than one percent of the index or basket when the notional amount of the derivative exceeds five percent of the fund's NAV. Require funds to provide a graphical depiction of portfolio holdings by country or geographic region and by industry, rather than a categorization of holdings by type, industry, and geographic region in the schedule of investments.
- Omit the proposed requirement to report federal income tax basis information for securities and derivatives by type.
- Modify financial reporting requirements to remove disclosure regarding *de minimis* income, eliminate the written options schedule, and incorporate the proposed derivatives schedules into the fund's financial statements rather than in the notes to the financial statements.

D. Permit Funds to Provide Shareholder Reports and Prospectuses Electronically to Fund Shareholders

We strongly support proposed rule 30e-3, which would provide funds with an optional method to satisfy shareholder report transmission requirements by posting such reports online if they meet certain conditions. The proposal is consistent with earlier Commission efforts to modernize the manner in which information is transmitted to fund shareholders and to improve accessibility by taking advantage of technology for the benefit of investors. Our members anticipate that reliance on the proposed rule will result in significant cost savings for fund shareholders. The proposed rule, for example, has the potential to save fund shareholders an estimated $140 million per year on a net basis within the first three years of adoption. If the Commission adopts the few minor modifications to rule 30e-3 that we recommend in Section VIII.B, potential net savings for fund shareholders could more than triple to $465 million over a three-year timeframe. We provide a more detailed cost savings analysis in Section VIII.C and Appendix B.

We recommend that the SEC also allow funds to deliver summary and statutory prospectuses (together "prospectuses") via the Internet to shareholders using the same proposed framework. The potential for cost savings to fund shareholders is significant.

We highlight below a number of additional steps the Commission should take to facilitate the use of proposed rule 30e-3, reduce operational burdens, increase efficiency, and provide additional cost savings for fund shareholders.

- Modify the proposed requirement of a postage-paid reply form, and permit funds to provide a toll-free phone number **or** a pre-addressed, postage-paid reply form.
- Permit funds to mail shareholders a separate written statement ("Initial Statement") and a notice that each shareholder report is available online ("Notice") accompanied by other important account materials, such as new account welcome kits, account statements, dividend checks, and Notices for other funds.
- Give fund complexes or intermediaries the option to create a single, consolidated Notice for all of a shareholder's funds with the same fiscal year-end, so that the shareholder could receive a single Notice for those funds.
- Clarify that intermediaries would be able to fulfill obligations under rule 30e-3 on behalf of funds.
- Allow funds to add information to the Initial Statement and Notice giving shareholders the option to affirmatively consent to delivery via electronic mail ("e-delivery").
- Allow funds to "household" the Initial Statement in addition to the Notice.
- Permit shareholders' implied consent to cover all series and funds in which they are invested in any single fund complex, and all funds held through a single intermediary. Shareholders' implied consent should carry through to any new investments in that fund complex or through that intermediary.
- Modify filing requirement for form of Notice, either requiring a subsequent filing of the form of Notice only when there is a change to the form of Notice, or permitting funds to file the form of Notice as an exhibit to Form N-CEN.
- Retain existing Commission guidance that permits funds to deliver shareholder reports by email to shareholders who affirmatively consent to e-delivery.
- Allow any fund to continue relying on proposed rule 30e-3 even if it did not meet the posting requirements of the rule for a temporary period of time because of technical difficulties.
- Continue to permit funds to provide shareholders access to a summary schedule of holdings in addition to the full schedule.

E. ICI Supports the Form ADV Amendments and Amendments to Advisers Act Recordkeeping Rule

We generally support the SEC's collection of information from investment advisers about their separately managed account business.[6] We also do not object to the Commission's proposed amendments to the recordkeeping rule to increase documentation of investment performance claims.

F. Provide Adequate Time to Permit Compliance

We highlight below a number of recommendations regarding the timing of funds' compliance with Form N-PORT, Form N-CEN, and Regulation S-X requirements.

- Permit funds to file monthly reports on Form N-PORT within 45 days after the end of the period and to file data on a "T+1" accounting basis.
- Permit funds to submit Form N-CEN filings within 75 days after the end of the period.
- Permit funds to attach their Regulation S-X compliant portfolio holdings schedules (required at the end of the first and third fiscal quarters) to Form N-PORT within 60 days after the end of the reporting month, consistent with the filing deadline for current Form N-Q.
- Adopt a compliance date of 30 months after the effective date, implemented on a rolling basis according to a fund's fiscal year-end, for filing Form N-PORT.
- Adopt a compliance date of 30 months after the effective date for filing Form N-CEN.
- Adopt a compliance date of 18 months after the effective date for the amendments to Regulation S-X.

II. Data Security of Form N-PORT Information

A. Introduction

The Fund Reporting Proposal would require funds to file with the SEC, for the first time, complete portfolio holdings in a structured data format on a monthly basis.[7] Other than filings made at the end of each fiscal quarter, the SEC would not publicly disclose the information contained in the monthly filings.[8] We generally support the SEC collecting additional information about funds'

[6] We recognize the Commission's need to obtain information to better monitor for risk, although we do not intend our comments to address any particular aspect of the proposed amendments.

[7] *See* Part C of Proposed Form N-PORT.

[8] *See* Fund Reporting Proposal at 33613-14.

portfolio holdings to assist the SEC to more effectively oversee individual funds and the fund industry, particularly in times of market stress.

We strongly endorse the SEC's decision to not publicly disclose monthly Form N-PORT filings except for funds' four annual quarter-end filings, subject to a 60 day delay.[9] This is a critically important aspect of the Fund Reporting Proposal. As discussed below, more frequent portfolio disclosure would harm fund shareholders by expanding the opportunities for professional traders to exploit this information by engaging in predatory trading practices, such as trading ahead of funds (frequently referred to as "front-running"). We agree with the SEC's assessment that front-running poses a very real, demonstrable harm to fund investors.[10]

And while more frequent, mandatory disclosure of portfolio holdings information would harm fund shareholders, exposure of this information through an information security breach would be devastating to funds and their shareholders, individual fund sponsors, the SEC itself, and potentially the overall capital markets. We discuss these consequences in more detail below. Information security breaches in both the public and private sectors have become frequent occurrences, and as an SEC commissioner recently stated, "[n]o single organization has the resources or the expertise to combat the advanced and persistent cyberattacks that are being launched today."[11] Portfolio holdings information, updated monthly, would present an especially inviting target for those who would wish to engage in front-running or otherwise exploit that data.

The SEC staff underscored its own understanding of the cyber threat to data held by funds in its recent release of cyber security guidance.[12] Although the SEC staff therefore seemingly recognizes the importance of protecting fund data, the Fund Reporting Proposal contains no discussion of steps the SEC intends to take to ensure secure Form N-PORT data, including transmission of that data. We understand from the staff that the SEC would use the same security protocols to protect Form N-PORT information as are used to protect data collected on Forms N-MFP and PF. However, we are

---

[9] *Id.*

[10] *See id.* at 33613.

[11] *See A Threefold Cord-Working Together to Meet the Pervasive Challenge of Cyber-Crime*, Speech by SEC Commissioner Luis Aguilar, at SINET Innovation Summit, New York, NY (June 25, 2015), available at http://www.sec.gov/news/speech/threefold-cord-challenge-of-cyber-crime.html#_edn16.

[12] The SEC staff's guidance advocates periodic assessment of "(1) the nature, sensitivity and location of information that the firm collects, processes and/or stores, and the technology systems it uses; (2) internal and external cybersecurity threats to and vulnerabilities of the firm's information and technology systems; (3) security controls and processes currently in place; (4) the impact should the information or technology systems become compromised; and (5) the effectiveness of the governance structure for the management of cybersecurity risk." *See* SEC Division of Investment Management, IM Guidance Update No. 2015-02 (Apr. 2015), available at http://www.sec.gov/investment/im-guidance-2015-02.pdf. While we do not dispute the general validity of this guidance, we do have significant concerns with the staff's practice of issuing new guidance and interpretations of law without undergoing the normal, transparent notice and comment process.

concerned that these protocols will not be sufficient, given that the market sensitivity of the Form N-MFP and Form PF data does not come close to approaching that proposed to be reported on Form N-PORT. In particular, money market funds reporting on Form N-MFP are not subject to the same risks of front-running or free riding, and Form PF data does not include detailed portfolio holdings information.

Given these concerns and the extraordinary implications for millions of fund investors, we can support the SEC's monthly collection of fund portfolio holdings only to the extent, as explained more fully below, the SEC undertakes aggressive ongoing measures to protect the information it proposes to collect. These measures include independent third-party testing and verification of the security of this information, prior to requiring firms to commence monthly filing of portfolio holdings on Form N-PORT and on an on-going basis thereafter.

We recommend that the SEC initially collect fund portfolio holdings information quarterly with a 60-day lag and begin collecting other Form N-PORT information on a monthly basis.[13] Depriving hackers of the opportunity to access monthly portfolio holdings data would greatly decrease their ability to successfully exploit it for predatory trading purposes. This initial amount of data would enhance significantly the SEC's ability to oversee the fund industry. Because this data would be in a structured format, the SEC would be able to more readily collect, aggregate, and analyze this information. Experience with this enhanced data set would position the SEC to reevaluate the necessity of expanding its data collection to encompass complete fund portfolio holdings on a monthly basis. During this time, the SEC additionally could make particular requests for information from funds based on market developments. For example, if the SEC wanted current information about fund holdings of Puerto Rican bonds, it could request that information from particular funds, and perform any necessary analysis.

We intend our recommended approach to strike the appropriate balance between the SEC's need for additional information to effectively oversee funds, and funds' need to protect their proprietary, confidential information from information security breaches to protect the best interests of fund shareholders. We explain our views more fully below.

B. Protect Fund Shareholders from Exposure to Predatory Trading Practices

The SEC's storage of immense volumes of monthly fund Form N-PORT data would create a valuable repository of structured data that undoubtedly will attract the attention of cyber criminals. This repository also may attract foreign state actors who have an interest in obtaining a macro view of

[13] This monthly information will include risk metrics that the Commission can use to better understand how funds are implementing their investment strategies through particular exposures, thereby facilitating better monitoring of risks and trends in the fund industry as a whole.

U.S. mutual fund investment positions.[14] Moreover, access to mutual fund portfolio holdings provides access to more than mutual funds' investing strategies, since many advisers manage their non-registered investment vehicles similarly to their mutual funds. As the Commission recognizes, empirical studies show that the portfolio holdings information that funds disclose to the Commission and shareholders contains information that traders can use to front-run and copycat the positions of reporting funds.[15] The Commission further has recognized that more frequent portfolio disclosure could potentially harm fund shareholders by expanding the opportunities for professional traders to exploit this information by engaging in predatory trading practices.[16] Historically, the SEC has addressed these concerns in the context of individual funds and their personnel.[17] The Fund Reporting Proposal requires the Commission now to consider the concerns in the context of an industry-wide database reflecting flows, trading activity and holdings, which is expected to include a quarter of all outstanding equity securities.[18]

For our entire industry and the millions of shareholders we serve, this is a matter of deep concern. We consistently have stated that frequent or premature disclosure of information regarding fund trades can lead to front-running of those trades, adversely impacting the price of securities that the fund is buying or selling.[19] Numerous market participants conduct trading strategies utilizing sophisticated techniques that seek to ascertain from available information the existence of large buyers (or sellers) in the market, seeking to buy (or sell) ahead of large orders with the goal of capturing a price movement in the direction of the large trading interest.

Generally speaking, the more frequent and earlier the disclosure, the easier and more profitable front-running and other predatory trading will be, all to the detriment of fund shareholders. Market participants can use portfolio holdings information to anticipate fund trades, and earlier or more frequent disclosure of this information would provide another crucial "piece of the puzzle" to those

---

[14] We are concerned that certain parties will be willing to pay substantial sums to obtain this position data and that a rogue employee might be tempted to reap financial benefit from selling the data.

[15] *See* Fund Reporting Proposal at 33613-14.

[16] *See* Fund Reporting Proposal at 33614.

[17] The SEC's adoption of rule 17j-1 under the Investment Company Act of 1940 ("1940 Act") illustrates its appreciation of the sensitivity of information related to fund securities trading. Rule 17j-1 requires fund advisers to adopt written codes of ethics and have procedures in place to prevent their personnel from abusing their access to information about the fund's securities trading, and requires "access persons" to submit reports periodically containing information about their personal securities holdings and transactions. *See* rule 17j-1(c)(1) and (d) under the 1940 Act.

[18] *See 2015 Investment Company Fact Book, 55th edition*, Investment Company Institute, at 14, available at https://www.ici.org/pdf/2015_factbook.pdf.

[19] *See, e.g.,* Letters from Paul Schott Stevens, President, Investment Company Institute, to Christopher Cox, Chairman, Securities and Exchange Commission, dated September 14, 2005, August 29, 2006, and September 19, 2008; Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated April 30, 2013.

who intend to profit from fund orders. Regardless of the length of the time lag between when the data is transmitted to the SEC and posted publicly, the provision of 12 public data points would almost certainly increase the likelihood of predatory trading.

The Fund Reporting Proposal would require flow information in addition to information about portfolio holdings.[20] Portfolio investment information, combined with flow information, can enhance opportunities for other market participants to front-run the portfolio purchases and sales of funds experiencing large flows.[21] A fund that experiences large inflows needs the flexibility to move into new positions over time, without inadvertently showing its hand via inopportune portfolio holdings disclosure. Market participants with access to flow information and current portfolio holdings may deduce quite easily if and when a fund is planning to add to its outstanding positions. Conversely, a fund experiencing large outflows might need the flexibility to move out of existing positions. A predatory trader with access to the fund's flow information, current portfolio holdings, and illiquidity determinations (all of which the SEC has proposed that funds provide on a monthly basis) may be able to front-run a fund's trades.

The Commission also appropriately has expressed its sensitivity to concerns that more frequent portfolio disclosure may facilitate the ability of outside investors to "free ride" on a mutual fund's investment research, by allowing those investors to reverse engineer and "copycat" the fund's investment strategies and obtain for free the benefits of fund research and investment strategies that are paid for by fund shareholders.[22] Free riding can disadvantage funds with longer investment horizons by reducing their ability to benefit from researching investment opportunities and developing new strategies.[23] Funds with longer investment horizons are more susceptible to free riding than funds with shorter investment horizons because of the increased likelihood that the disclosed portfolio investment information would reveal their long-term investment strategies.[24] Both front-running and copycatting can reduce the returns of shareholders who invest in actively-managed funds.[25]

We also share the Commission's concern that the exposure of fund trading strategies would disadvantage funds vis-à-vis investment vehicles that, unlike funds, are not bound by investment objectives as stated in a prospectus. Vehicles with this flexibility have an unfair advantage that would permit them to earn similar if not higher after expense returns as compared to funds.[26]

---

[20] *See* Item B.6 of Proposed Form N-PORT.

[21] *See* Fund Reporting Proposal at 33661, n.664.

[22] *See* Fund Reporting Proposal at 33613-14.

[23] *See* Fund Reporting Proposal at 33661, n.667 and accompanying text.

[24] *Id.*

[25] *See* Fund Reporting Proposal at 33614.

[26] *See* Fund Reporting Proposal at 33661, n.666.

C. Address Data Security Concerns

Recent events have demonstrated the need for government entities to employ stringent measures to protect sensitive data. The extraordinary hacking of the Office of Personnel Management ("OPM") and the Internal Revenue Service computer systems indicate that cyber criminals are quite willing and able to target U.S. government agencies successfully and sustain their penetrations undetected over substantial periods of time.[27] FINRA's Comprehensive Automated Risk Data System ("CARDS") proposal, which would have required certain firms to periodically submit in an automated, standardized format specific information relating to their securities accounts, recently was put on hold so that FINRA could first conduct additional analyses and engage third-party experts to analyze potential threats to the security of the information being collected.[28] We strongly urge the SEC to take responsible steps similar to those that FINRA outlined.

1. GAO Findings Question the Ability of the SEC to Keep Secure an Extraordinarily Large Volume of Data

We have particular cause for concern about the SEC's ability to maintain the security of monthly portfolio holdings information. The most recent GAO information security audit of the SEC found that, "[u]ntil SEC mitigates control deficiencies and strengthens the implementation of its security program, its financial information and systems may be exposed to unauthorized disclosure, modification, use, and disruption."[29] In fact, the GAO audit found numerous weaknesses in the SEC's information security controls that "limited [the SEC's] effectiveness in protecting the confidentiality, integrity, and availability of a key financial system."[30]

Quite troublingly, many of the GAO's findings related to the SEC's failure to implement adequate "access controls."[31] As the report explains, the SEC "did not consistently protect its system boundary from possible intrusions; identify and authenticate users; authorize access to resources; encrypt sensitive data; audit and monitor actions taken on the Commission's networks, systems, and

---

[27] *See Hacking of Government Computers Exposed 21.5 Million People*, New York Times (July 9, 2015), available at http://www.nytimes.com/2015/07/10/us/office-of-personnel-management-hackers-got-data-of-millions.html; *China Hackers Got Past Costly U.S. Computer Security with Ease*, Bloomberg (June 5, 2015), available at http://www.bloomberg.com/news/articles/2015-06-06/china-hackers-got-past-costly-u-s-computer-security-with-ease.

[28] *See* Testimony of Richard G. Ketchum, Chairman & CEO, FINRA, Before the Committee on Financial Services, U.S. House of Representatives (May 1, 2015), available at http://financialservices.house.gov/uploadedfiles/hhrg-114-ba16-wstate-rketchum-20150501.pdf.

[29] *See* U.S. Gov't Accountability Office, GAO-14-419, *SEC Needs to Improve Controls over Financial Systems and Data,* GAO-14-419 (Apr. 2014), available at http://gao.gov/products/GAO-14-419.

[30] *Id.*

[31] *Id.* at 5-6.

databases; and restrict physical access to sensitive assets."[32] The GAO found, for example, that the SEC did not effectively protect sensitive data by failing to configure server settings supporting key financial applications to use encryption when transmitting data. As a result, increased risk existed that unauthorized individuals could intercept, view, and modify transmitted data.

As recently as April 2015, a GAO report highlighted continuing vulnerabilities in information security at the SEC.[33] This report cited deficiencies, first noted in 2013, in adequate security configuration baselines standards and management, which are part of very basic information security protocols. As noted in the report, the absence of these controls can result in "exploitation without detection."[34] We are confident that the SEC is working diligently to address the GAO's outstanding information security control recommendations. These and several recommendations from prior reports, however, appear to remain unresolved,[35] raising concerns that the SEC may have difficulty identifying active or passive unauthorized access to N-PORT data.

2. SEC Inspector General Findings Reinforce the GAO's Concerns

In 2014, an internal audit found that the SEC's information technology office had failed to address several significant areas of potential risk identified in prior cyber security evaluations.[36] These areas included: "(1) failure to implement personal identity verification cards for logical access, to the maximum extent practicable; (2) lack of full implementation of continuous monitoring; (3) lack of multi-factor authentication of external systems; (4) outdated procedures and inconsistencies with policy; and (5) improper review of user accounts."[37]

In two more recent cases, one in September 2014 and another in May 2014, the inspector general found deficiencies in the SEC's handling of information technology. The inspector general issued a report revealing that the SEC could not account for 24 of 488 SEC laptops for which the inspector general reviewed records.[38] The inspector general further found that the SEC was not always

---

[32] *Id.* at 6-9.

[33] *See* U.S. Gov't Accountability Office, GAO 15-387R, *Management Report: Improvements Needed in SEC's Internal Controls and Accounting Procedures*, (Apr. 2015), available at http://www.gao.gov/assets/670/669952.pdf.

[34] *Id.* at 15.

[35] *Id.* at 14.

[36] Office of Inspector General, *Semiannual Report to Congress, 10.01.14 to 03.31.15* (Feb. 24, 2014), available at http://www.sec.gov/oig/reportspubs/office-of-inspector-general-semiannual-report-spring-2015.pdf.

[37] *Id.*

[38] Office of Inspector General, Report No. 524, *Controls over the SEC's Inventory of Laptop Computers*, Report No. 524 (Sept. 22, 2014), available at http://www.sec.gov/oig/reportspubs/524.pdf.

encrypting hard drives of its computers, a violation of the Federal Information Security Management Act and a potential security risk.[39]

3. SEC Technical Issues Gave Priority Access to Certain Traders

The SEC has an unfortunate track record of failing to discover and respond to data security issues. This extends to the recent discovery of a longstanding technical glitch in the SEC data transmission process that gave certain traders priority access to market-moving data. Several academic researchers published findings in October 2014 showing that the SEC was transmitting direct notice of filings made pursuant to the SEC's Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") system to paying subscribers up to a minute before those filings were posted publicly on the SEC website.[40] The study examined filings concerning corporate insiders' purchases and sales of stock and found that subscribers were using that priority access to trade ahead of the market. A fund company brought the timing issue to the SEC's attention several months before the research publication, after the fund company noticed irregular trading in a stock it had put up for sale in a dark pool shortly before a regulatory filing was made through EDGAR.[41] Although the fund company reported the incident to the SEC in February 2014, the SEC declined to respond to the concerns and failed to take action until the nature of the issue became public in October 2014.[42]

4. SEC Sharing of Fund Data with Other Agencies Raises Data Security Concerns

SEC staff has indicated that it may share with other regulatory agencies some or all of the information that the SEC would collect from funds if the Commission adopts the Fund Reporting Proposal. This serves to compound our concerns about the compromise of massive amounts of market sensitive data, because many other government agencies also struggle to implement effective cyber security controls.[43] Therefore, any third-party review also must address potential risks that arise from

---

[39] Office of Inspector General, Report No. 521, *Review of the SEC's Practices for Sanitizing Digital Information System Media*, Report No. 521 (May 30, 2014), available at http://www.sec.gov/about/offices/oig/inspector_general_audits_reports.shtml.

[40] *Fast Traders Are Getting Data from SEC Seconds Early*, Wall Street Journal (Oct. 29, 2014), available at http://www.wsj.com/articles/fast-traders-are-getting-data-from-sec-seconds-early-1414539997. The researchers analyzed thousands of corporate insider trades going back to March 2012.

[41] *SEC Warned before about Early Release Weak Spot*, Wall Street Journal (Oct. 29, 2014), available at http://blogs.wsj.com/moneybeat/2014/10/29/sec-warned-before-about-early-release-weak-spot.

[42] *Id.*

[43] *See, e.g.,* U.S. Gov't Accountability Office, GAO-15-573T, *Actions Needed to Address Challenges Facing Federal Systems* (Apr. 22, 2015), available at http://www.gao.gov/products/GAO-15-573T (noting that, for fiscal year 2014, 19 of 24 major federal agencies reported that deficiencies in information security controls constituted either a material weakness or significant deficiency in internal controls over their financial reporting). In recent months, other agencies, as well as the White House itself, have failed to keep sensitive data secure. *See, e.g.*, *Fed Economic Forecasts Released Early*, Wall Street Journal (July 24, 2015) (the Fed's accidental public disclosure of sensitive internal economic forecasts remained

the SEC's sharing of data. As an alternative, the SEC could limit the information shared in a way to mitigate these concerns, such as providing summaries of information but not access to the raw data collected.

D. Consider Consequences of a Data Breach

A data breach of portfolio holdings information would not only harm fund shareholders by exposing funds to predatory trading practices; it would cause serious damage to the reputations of individual funds and fund complexes, and tarnish the reputation of the SEC and the fund industry as a whole. Despite the gravity of these and other potential consequences of a data breach, the SEC has not proposed a remediation process in case of a breach, including protocols for contacting affected funds.

1. A Data Breach Would Irrevocably Damage Fund Managers' Reputations

Clearly, fund investors would be hurt by any compromise of the security of this vast database. If a data breach occurred at the SEC, funds and fund sponsors also would face significant reputational damage, as would the entire fund industry. The recent data breaches of a number of companies show just how badly a breach can harm a company's reputation.[44] One of the largest known breaches, which eBay experienced, affected 145 million customers.[45] Health insurer Anthem disclosed earlier this year that hackers gained access to personal information on as many as 80 million customers.[46] Last year, Home Depot announced that a five-month attack on its payment terminals may have compromised 56 million credit cards.[47] In particular, organizations that rely on public trust often face public outrage when that trust is breached, as seen by the angry response to the recent OPM hack, which impacted

undiscovered for nearly a month), available at http://www.wsj.com/articles/fed-economic-forecasts-released-early-1437750067; *Russian Hackers Read Obama's Unclassified Emails, Officials Say*, New York Times (Apr. 25, 2015) (Russian hackers obtained access to White House email archives), available at http://www.nytimes.com/2015/04/26/us/russian-hackers-read-obamas-unclassified-emails-officials-say.html; *Three Months Later, State Department Hasn't Rooted Out Hackers*, Wall Street Journal (Feb. 19, 2015) (investigators still see signs of hackers on State Department computers despite months-long effort to secure data), available at http://www.wsj.com/articles/three-months-later-state-department-hasnt-rooted-out-hackers-1424391453.

[44] *See, e.g.*, *To Regain Trust, Target Must Do More, Crisis Experts Say*, New York Times (Jan. 10, 2014), available at http://www.nytimes.com/2014/01/11/business/to-regain-trust-target-must-do-more-crisis-experts-say.html (discussing impact of data breach on Target's reputation and profits).

[45] *See supra* note 11.

[46] *See U.S. Suspects Hackers in China Breached about 4 Million People's Records, Officials Say*, Wall Street Journal (June 5, 2015).

[47] *Id.*

over 21 million individuals.[48] This reputational harm especially could damage funds, which rely on the trust of individuals that invest their savings with them. Furthermore, this reputational damage may not be limited to affected funds, but may cast doubt on the adequacy of the data security of information held throughout the industry.

2. There Is No Effective Remediation Process for a Data Breach at the SEC

The Fund Reporting Proposal does not mention any remediation process in event of a breach. Indeed, there is no effective remediation. Minimal, but not particularly useful, steps the SEC could take include immediately notifying funds and determining the damage caused. As an additional step, we recommend that the SEC agree to share breach communication protocols with funds submitting N-PORT data, including identifying specific contacts at each fund before data collection begins.

E. Undertake a Third-Party Review

It is imperative that the SEC critically re-examine its existing data security policies to ensure that the SEC can adequately protect data submissions. In particular, we recommend that the SEC have an independent third-party expert test and verify the SEC's capabilities prior to requiring firms to commence monthly filing of portfolio holdings on Form N-PORT and revisit these capabilities on an on-going basis.

Any third-party assessment should take into account current service industry information standards that could be applied to security protocols for Form N-PORT data. When outsourcing tasks to third-party service providers, fund sponsors routinely require those service providers to demonstrate the precautions taken to maintain the safety of information the fund sponsor has entrusted to the service provider. Fund sponsors may require, among other items, that a service provider allow the fund sponsor to undertake a detailed examination of the service provider's security protocol, inspect the service provider's processes, allow access to control logs, and demonstrate appropriate firewalls. Fund sponsors also may require the third-party service provider to provide an independent assessment of an operation's internal controls and security protocols. In Appendix A to our letter, we provide further suggestions as to what the SEC and any third-party expert should consider when assessing the security of any non-public fund filing.

We recognize that the SEC intends to use Form N-PORT information to carry out its regulatory responsibilities related to the asset management industry. In balancing the SEC's need for information with funds' responsibility to maintain the confidentiality of this information for the benefit of shareholders, we respectfully recommend that it adopt a more staged and targeted approach

[48] *See New OPM Data Breach Numbers Leave Federal Employees Anguished, Outraged*, Washington Post (July 9, 2015), available at http://www.washingtonpost.com/blogs/federal-eye/wp/2015/07/09/new-opm-data-breach-numbers-leave-federal-employees-anguished-outraged/.

to this data collection. In particular, we recommend that the SEC initially collect fund portfolio holdings information quarterly with a sixty-day lag and not begin collecting other N-PORT information on a monthly basis[49] until an independent third-party tests and verifies the SEC's ability to maintain the security of the confidential proprietary information it proposes to collect on an ongoing basis.

We also recommend that, during this evaluation period, the Commission reconsider the costs and benefits of receiving complete portfolio holdings on a monthly basis in light of all of the information it already will be receiving on Form N-PORT and the risks of monthly holdings information being subject to a data breach.

III. Public Disclosure of Information Reported on Form N-PORT

The Commission proposes not to publicly disclose monthly Form N-PORT filings for the first and second months of the fiscal quarter, or any information reported in Part D of the form. Information reported for the third month of the fiscal quarter, other than that reported in Part D, however, would be publicly available, with a 60-day lag.

We strongly support the Commission's keeping information filed on Form N-PORT non-public for the first two months of a fund's fiscal quarter. We also support the Commission's proposal to make public most of the information that funds would report for the third month of the quarter. There are, however, a few information items the public disclosure of which, at any time, would confuse investors and potentially harm funds and advisers. The Commission has not demonstrated the benefit of public disclosure of this information with respect to these few items – and such disclosure in fact is neither necessary nor appropriate in the public interest or for the protection of investors. Instead, we recommend that funds report these items either under Part D of Form N-PORT, which the SEC has proposed to be non-public, or as an additional non-public schedule to the form.

Specifically, the following items of information are not appropriate for public disclosure:

- Portfolio-level risk metrics;[50]
- Delta for convertible securities, options, and warrants;[51]
- Illiquidity determinations;[52]

---

[49] Notably, in addition to quarterly portfolio holdings information, the SEC's receipt of risk metrics, flow information, and illiquidity determinations on a monthly basis will provide it with important new tools to conduct oversight of the fund industry.

[50] *See* Item B.3 of Proposed Form N-PORT.

[51] *See* Item C.9.f.v of Proposed Form N-PORT; Item C.11.c.vii of Proposed Form N-PORT.

[52] *See* Item C.7 of Proposed Form N-PORT.

- Country of risk determinations;[53] and
- Derivatives financing rates.[54]

Our rationale differs in the case of each of these items, and we address them specifically in the discussion of Form N-PORT or Regulation S-X, as relevant, below.[55] In the discussion that follows, we discuss the context, and the basic principles and precedents that support such a non-public disclosure determination.

A. Introduction

Form N-PORT is primarily designed for the Commission's use, and not for individual investors, as the Commission acknowledges throughout the Fund Reporting Proposal. The Commission believes that monthly portfolio holdings information, as opposed to quarterly information, will significantly assist the Commission in performing its regulatory oversight, and the proposal explains its reasoning in some detail.[56] The Commission also analyzes the regulatory benefits it (not investors) expects from each item of information.

The Commission clearly recognizes that it does not need to nor should it publicly disclose all information of regulatory value. While the Commission states that some information on Form N-

[53] *See* Item C.5 of Proposed Form N-PORT.

[54] *See* Items C.11.f and g of Proposed Form N-PORT.

[55] *See infra* Section IV.A.3 (discussing portfolio-level risk metrics); Section IV.E.1.a (discussing delta for convertible securities); Section IV.E.1.b (discussing illiquidity determinations); Section IV.E.1.c (discussing country of risk determinations); Section IV.E.2.a (discussing derivatives financing rates); and Section IV.E.2.b (discussing delta for options and warrants). The SEC also has proposed that funds include certain information in fund financial statements that is not appropriate for public disclosure. *See* Fund Reporting Proposal at 33616 (proposing amendments to Regulation S-X). Specifically, the SEC should not require funds to include securities lending agent compensation (including revenue sharing splits) and other fee information, and information about illiquidity determinations in fund financial statements. We recommend that the SEC eliminate these information items from that proposal. We discuss this information and the reasons we believe it is not appropriate for public disclosure in the section of this comment letter addressing the proposed amendments to Regulation S-X. *See infra* Sections VI.C and VI.E.

[56] For example, the Commission states:

> The quarterly portfolio reports that the Commission currently receives on Forms N-Q and N-CSR can quickly become stale due to the turnover of portfolio securities and fluctuations in the values of portfolio investments. Monthly portfolio reporting would decrease the delay between reports, which should prove useful to the Commission for fund monitoring, particularly in times of market stress. This also would triple the number of data points reported to the Commission in a given year, as well as ensure that the Commission has current information, which should in turn enhance the ability of Commission staff to perform analyses of funds in the course of monitoring for industry trends, or identifying issues for examination or inquiry.

See Fund Reporting Proposal at 33613.

PORT could help investors make more informed investment decisions, it also acknowledges that public disclosure of other information valuable to the Commission for regulatory oversight can harm investors more than it benefits them. The Commission seeks to draw this distinction throughout the Fund Reporting Proposal and requests comment specifically on this aspect.

B. Do Not Publicly Disclose Certain Items on Form N-PORT

The Commission has broad discretion to determine not to publicly disclose information filed in reports required under the Investment Company Act of 1940 ("1940 Act"), if it finds that public disclosure of such information is neither necessary nor appropriate in the public interest or for the protection of investors.[57] This finding is appropriate for each of the specific items for which we request non-public treatment.

We support the Commission taking steps to ensure that it can fulfill all of the elements of its mission – protecting investors, maintaining fair, orderly and efficient markets, and promoting capital formation – through oversight and regulation of the investment management industry.[58] We also support the Commission's goal of ensuring that investors have all material information necessary to make investment decisions. But the universe of information the SEC needs to effectively oversee the industry differs from that which investors need to make investment decisions. The regulatory regime for funds, advisers, and other regulated entities is replete with provisions that distinguish between these two types of information.[59] It is critical for the Commission to examine each proposed component of Form N-PORT to determine the information's purpose and the effect of public disclosure.

---

[57] *See* Section 45(a) of the 1940 Act.

[58] *See The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, available at http://www.sec.gov/about/whatwedo.shtml.

[59] For example, as discussed in more detail below, Form PF, which SEC-registered investment advisers to private funds must file, calls for information that is considered valuable, indeed critical, for regulatory oversight but not appropriate for disclosure to investors. This is also the case for Form CPO-PQR, adopted by the Commodity Futures Trading Commission ("CFTC") for reporting by commodity pool operators, which include many registered investment advisers. Other examples of regulatory provisions providing for confidentiality of sensitive information include Section 210(b) of the Investment Advisers Act of 1940 ("Advisers Act"), which generally requires that the Commission and its staff not make public information they have collected in the course of an examination or investigation, a vital part of the Commission's oversight program for investment advisers; and exemptions from the disclosure requirements of the Freedom of Information Act, 5 U.S.C. § 552 ("FOIA"), to protect the confidentiality of trade secrets and confidential commercial or financial information (exemption 4), records or information compiled by regulators for law enforcement purposes where disclosure could reasonably be expected to interfere with law enforcement proceedings (exemption 7), and information contained in or relating to examination, operating, or condition reports prepared by or for the use of financial institution regulators (exemption 8). In this context, we note that the FOIA exemptions protect from public disclosure exactly the type of information for which we request non-public treatment on Form N-PORT. In particular, Form N-PORT contains confidential financial information that would cause competitive harm (exemption 4) and operating and condition reports prepared for and submitted to the Commission for the purpose of financial institution regulation and supervision (exemption 8). Exemption 8 has been interpreted by the courts as "particularly broad" and "all-inclusive," in order to fulfill

We agree with the line the Commission proposes to draw with respect to most information it proposes to publicly disclose on Form N-PORT. We also generally would resolve cases in favor of public disclosure when the benefit to investors may be in doubt and there is no substantive downside (other than additional reporting burdens). With respect to the specific items identified above, however, the Commission understates the potential harm from public disclosure and overstates the expected benefits to investor decision making. In this regard, the Commission's actions in other recent rulemakings, specifically the amendments to Form ADV and adoption of Form PF in 2011, provide valuable and instructive precedent.[60]

1. Absence of Benefits for Investor Decision Making

Both generally and with respect to specific items, the Commission asserts that the information required on Form N-PORT may assist individual investors in making investment decisions. For example, in connection with the proposal to require reporting of risk metrics, the Commission states that the proposed information "would complement the risk disclosures that are contained in the registration statement, thereby potentially helping all investors to make more informed investment choices."[61]

The Commission has developed a comprehensive disclosure regime over the course of decades that is designed to help investors understand the material aspects of funds without drowning them in information. For some thirty years, the Commission, the fund industry, investor and consumer groups, and others devoted a tremendous amount of time, attention, and resources to improving the fund disclosure regime for the benefit of investors, culminating in the adoption of the summary prospectus in 2009. The Commission has long taken the position that fund investors are best served by clear, concise disclosures, in plain English, that focus investors' attention on the fundamental characteristics of the funds they are considering. The ICI and its members consistently have supported and actively participated in SEC initiatives to improve fund disclosure. Years of investor research also support the Commission's focus on clear, concise disclosure as the right approach for investors.[62]

---

the Congressional intent behind it. *See Public Investors Arbitration Bar Ass'n v. Securities and Exchange Commission*, 771 F.3d 1, 8 (C.A.D.C. 2014).

[60] *See Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF*, 76 Fed. Reg. 71128 (Nov. 16, 2011), available at http://www.gpo.gov/fdsys/pkg/FR-2011-11-16/pdf/2011-28549.pdf ("Form PF Release"); *Rules Implementing Amendments to the Investment Advisers Act of 1940*, 76 Fed. Reg. 42950 (July 19, 2011), available at http://www.gpo.gov/fdsys/pkg/FR-2011-07-19/pdf/2011-16318.pdf ("Form ADV Release").

[61] *See* Fund Reporting Proposal at 33599.

[62] *See, e.g.,* Investment Company Institute, *Shareholder Assessment of Risk Disclosure Methods* (Spring 1996) (empirical research on risk disclosure to supplement SEC's concept release on improving fund risk disclosure); Investment Company Institute, *The Profile Prospectus, An Assessment by Mutual Fund Shareholders* (May 1996) (study by ICI and several members

By contrast, the Commission designed Form N-PORT primarily to provide information to the Commission for its regulatory oversight purposes. Form N-PORT will have none of the investor protections imposed by the registration form and registration process, inasmuch as the Commission, a highly sophisticated consumer of information, does not need these safeguards. Indeed, the Commission for some purposes is far better served by receiving voluminous unfiltered "raw" information. The Commission has designed Form N-PORT not with plain English in mind, but in a structured data format that, in most cases, requests rigid "yes/no" and numerical responses.

The Commission itself has acknowledged the difference between information that is provided in a manner and format that is valuable to individual investors and information primarily intended for use by regulators. Evidence of this is the proposal (which we support) to require that funds provide, as an Exhibit to Form N-PORT, a separate portfolio holdings schedule in human readable form for the first and third quarters. Although this information would duplicate the information that funds would provide on Form N-PORT, the Commission "recognize[d] that the amount and structured format of the data contained in those reports are not primarily designed for individual investors" and that "such investors might prefer that portfolio holdings schedules for the first and third quarters continue to be presented using the form and content specified by Regulation S-X, which investors are accustomed to viewing in reports on Form N-Q and in shareholder reports."[63]

2. Recent Commission Treatment of Non-Public Data

The Commission's recent treatment of non-public data in an analogous situation is instructive. Specifically, the Commission's determination to take all necessary steps to protect from public disclosure similar types of information reported on Form PF supports our request.

First, the specific items identified above are in the nature of risk monitoring information. In authorizing Form PF, Congress recognized that this type of information, while valuable for the SEC and other regulators, can often be sensitive and proprietary and thus not appropriate for public disclosure. Second, the Commission committed to extra safeguards with respect to information on Form PF, further recognizing the importance of keeping certain risk monitoring information non-public. Third, in the release proposing Form PF, the Commission specifically asked whether it should move some of the information it proposed reporting on Form ADV to Form PF (which is not publicly

---

to evaluate investor reactions to proposed profile prospectus); Investment Company Institute, *Investor Views on the U.S. Securities and Exchange Commission's Proposed Summary Prospectus* (March 2008) (survey of investor reactions to SEC's proposal). *See also* Abt SRBI Inc., *Final Report: Focus Groups on a Summary Mutual Fund Prospectus*, Prepared for the Securities and Exchange Commission, May 2008 (finding that focus group participants were generally in favor of the concept of providing investors with a streamlined disclosure document).

[63] *See* Fund Reporting Proposal at 33611.

available) in order to protect that information from public disclosure.[64] In fact, the Commission decided to transfer two critical items from Form ADV to Form PF for exactly this reason. And finally, the Commission's actions with respect to Form PF demonstrate its recognition that information may play a vital role in the Commission's mission to protect investors, even when investors themselves do not have access to that information.

a. Parallel Consideration of Public and Non-Public Disclosure Forms for Disclosure by Private Fund Advisers

In 2011, the Commission adopted two sets of rules, forms, and amendments designed to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") that required advisers to hedge funds and other private funds ("private fund advisers") to register with the Commission. These rules and forms required, for the first time, that private fund advisers report extensive information about their activities, using two separate forms: (1) amended Form ADV, the registration form for investment advisers; and (2) a new Form PF, designed to provide regulators with information about systemic risk, information that Congress and the Commission determined to protect from public disclosure.

The Commission adopted Form PF to implement the Dodd-Frank Act, which added a new subsection to the Advisers Act.[65] That provision authorized the Commission to require any registered investment adviser to maintain records and file reports with the SEC regarding private funds advised by the adviser, as necessary and appropriate in the public interest and for the protection of investors "or for the assessment of systemic risk by the Financial Stability Oversight Council [FSOC]."[66] The provision also specifies certain types of information that advisers must maintain for each private fund (such as amount of assets under management, use of leverage, counterparty credit risk exposure, trading and investment positions, valuation policies and practices of the fund and types of assets held).[67] In addition, the provision requires the Commission to adopt rules requiring each private fund adviser to file information the Commission deems necessary and appropriate in the public interest and for the protection of investors, or for the assessment of systemic risk.[68]

---

[64] *See Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF*, 76 Fed. Reg. 8068, 8082 (Feb. 11, 2011) ("Form PF Proposing Release").

[65] *See* Section 404 of the Dodd-Frank Act (adding a new Section 204(b) of the Advisers Act).

[66] *See* Section 204(b)(1) of the Advisers Act.

[67] *See* Section 204(b)(3) of the Advisers Act.

[68] *See* Section 204(b)(5) of the Advisers Act. As explained by the Commission in the release accompanying the proposal of Form PF, the information reported on Form PF and Form ADV, respectively, is designed to be complementary, and not duplicative. Form ADV and Form PF have different principal purposes. Form ADV primarily aims at providing the SEC and investors with basic information about advisers (including private fund advisers) and the funds they manage for investor protection purposes, as well as providing the SEC with information necessary for its administration of the Advisers Act and its adviser examination program. In contrast, the Commission intended to use Form PF primarily as a confidential systemic

b. Commission Recognition of Potential Adverse Effects of Publicly Disclosing Information Valuable for Regulatory Oversight

The section pursuant to which the Commission adopted Form PF provides the Commission with express authority to protect the information reported therein from public disclosure.[69] As the Commission explained in the adopting release for Form PF:

> Form PF elicits non-public information about private funds and their trading strategies, **the public disclosure of which could adversely affect the funds and their investors.** The SEC does not intend to make public Form PF information identifiable to any particular adviser or private fund, although the SEC may use Form PF information in an enforcement action. The Dodd-Frank Act amends the Advisers Act **to preclude the SEC from being compelled to reveal this information except in very limited circumstances**.[70]

The adopting release for Form PF emphasizes the Commission's strong commitment to maintain the confidentiality of Form PF information and the special confidentiality status afforded by Congress. For example, the Commission stated that:

> [p]rior to sharing any Form PF data [with other agencies, as contemplated by the Dodd Frank Act], the SEC also intends to require that any such [agency] represent to us that it has in place controls designed to ensure the use and handling of Form PF data in a manner consistent with the protections established in the Dodd-Frank Act.[71]

---

risk disclosure tool to assist FSOC in monitoring and assessing systemic risk, although information on Form PF also would be available to assist the Commission in its regulatory programs, including examinations and investigations and investor protection efforts relating to private fund advisers. *See* Form PF Proposing Release at 8069 n.16.

[69] *See* Section 204(b) of the Advisers Act. The statute also imposes confidentiality constraints on FSOC and other regulators to whom the SEC provides the information, and exempts the Commission, FSOC, and other regulators from producing the information under FOIA. *See* Section 204(b)(7) and (9).

[70] *See* Form PF Release at 71155-56 (*emphasis added)*. Form PF was adopted jointly by the Commission and the CFTC (with respect to certain portions of Form PF). The Dodd-Frank Act also exempts the CFTC from being compelled under FOIA to disclose to the public any information collected through Form PF and requires that the CFTC maintain the confidentiality of that information consistent with the level of confidentiality established for the SEC in Section 204(b) of the Advisers Act. Both Commissions stated that they would make information collected through Form PF available to FSOC, as the Dodd-Frank Act requires, subject to the confidentiality provisions of the Dodd-Frank Act. *Id.*

[71] *See* Form PF Release at 71156.

The Commission also designed certain aspects of the Form PF reporting requirements to help mitigate the potential risk of inadvertent or improper disclosure. For example, the Commission designed data on Form PF generally so that a third party could not, on its own, use the data to identify individual investment positions, thus limiting the ability of a competitor to use Form PF data to replicate a trading strategy or trade against an adviser.[72] In addition, the Commission stated in the Form PF adopting release that its staff was working to design controls and systems for the use and handling of Form PF data "in a manner that reflects the sensitivity of this data and is consistent with the confidentiality protections established in the Dodd-Frank Act."[73] These steps included programming the Form PF filing system with appropriate confidentiality protections.[74] All of these efforts demonstrate a recognition of the potential adverse consequences of public disclosure of information reported on Form PF.

c. Transfer of Disclosure Items from Form ADV to Form PF to Preserve Confidentiality

Finally, and most relevant in the Form N-PORT context, the Commission decided to "transfer" two items to Form PF that it had originally proposed requiring on Form ADV, specifically because the Commission decided it was important to protect that information from public disclosure:

> We have also added to section 1b two questions that the SEC originally proposed as part of the expanded private fund reporting in Form ADV. The first, Question 14, requires that advisers report the assets and liabilities of each fund broken down using categories that are based on the fair value hierarchy established under U.S. generally accepted accounting principles ("GAAP"). The second, Question 16, requires that advisers provide the approximate percentage of each fund beneficially owned by certain types of investors. As discussed in the [Form ADV Release], the SEC determined not to adopt these questions on Form ADV in response to commenter concerns that they would result in the public disclosure of competitively sensitive or proprietary information. We have added these questions to Form PF (with the modifications discussed below) because, as the SEC explained in the [Form ADV Release], this information may be

[72] As examples of how the Commission designed the information required to address confidentiality concerns, the Commission stated that questions 26, 30, 35 and 57 on Form PF ask about exposures of the reporting fund but require only that the adviser identify the exposure within broad asset classes, not the individual investment position. *See* Form PF Release at 71156, n.343.

[73] *See* Form PF Release at 71156.

[74] The Commission stated that it was carefully considering recommendations of commenters who confirmed that the information collected on Form PF would be competitively sensitive or proprietary. These recommendations included: (1) storing identifying information using a code; (2) limiting the ability to transfer Form PF data by email or portable media; (3) limiting access to personnel who "need to know;" (4) extending filing deadlines so the data contains less current information; and (5) sharing the data with other regulators only in aggregated and anonymous form. *Id.*

important to FSOC's systemic risk monitoring activities and to our investor protection mission.[75]

C. Apply Form PF Rationale to Form N-PORT

Under the 1940 Act, Congress has given the Commission discretion to determine that not all information that Form N-PORT requires is appropriate for public disclosure. With this authority, Congress has recognized that certain types of information should not be publicly disclosed. And the Commission has used that authority to propose that it not make public substantial portions of the form – namely, information filed on Form N-PORT for the first two months of the quarter, as well as information provided on Part D. In further recognition of its authority, indeed responsibility, to make the public availability determination for Form N-PORT information requested, the Commission expressly has asked for comment on whether funds should submit all or a portion of the requested information on Form N-PORT to the Commission in non-public reports.[76]

Importantly, the history of Form ADV and Form PF shows that the Commission may respond to concerns about confidentiality by taking measures to safeguard fund information from public disclosure. The Commission may take these measures in the context of a form that, like Form N-

---

[75] *See* Form PF Release at 71145 (*footnotes and internal quotation marks omitted)*. As explained further in the Form ADV Release, in response to commenters' concerns about sensitive and proprietary information, the Commission decided not to adopt three items it had proposed to include in Form ADV, including the two discussed above that were later adopted in Form PF and one that was eliminated altogether, finding that the benefit of public disclosure of this information would not outweigh the potential competitive harm. First, with respect to the proposed requirement that an adviser report both the gross and net asset values of each private fund it manages, commenters asserted that public disclosure of this information could reveal a fund's leverage, which may be competitively sensitive strategy information. Second, commenters expressed concerns about the competitive effects of the proposal to require that advisers report the assets and liabilities of each fund broken down by class and categorization in the fair value hierarchy established under GAAP. Commenters explained that third parties could use this disclosure to harm an adviser's competitiveness, for example, as a means of ascertaining the values of private companies held by venture capital funds that make only one or a few investments. This could potentially harm the private company and the interests of the private fund and its investors. Finally, the proposal would have required that advisers report the approximate percentage of each fund beneficially owned by certain types of investors. Commenters argued that public disclosure of these data could reveal potentially sensitive information that third parties could use to reverse engineer investor identities where a fund is owned by a few investors, which could serve to deter certain institutional clients from investing in private funds. The Commission was persuaded by these concerns about potential harm from public disclosure and did not adopt in Form ADV the amendments that would have required an adviser: (i) to disclose each private fund's net assets; (ii) to report private fund assets and liabilities by class and categorization in the fair value hierarchy established under GAAP; and (iii) to specify the percentage of each fund owned by particular types of beneficial owners. Form ADV Release at 42967.

[76] The Commission requested comment on the following questions: "Would restricting public disclosure of the information reported on Form N-PORT to information reported for the third month of each fund's fiscal quarter alleviate concerns about front-running or other possible harms that might be caused by making the monthly information reported on Form N-PORT public? Should we instead provide that all or a portion of the requested information on Form N-PORT be submitted in non-public reports to the Commission? If so, please identify the specific items that should remain non-public and explain why." *See* Fund Reporting Proposal at 33614.

PORT, has the protection of investors as an express statutory purpose.[77] While Form PF is often thought of as a form designed for assessing systemic risk, it was adopted under a law that charges the Commission with considering the public interest and the protection of investors, as well as the assessment of systemic risk. The history above demonstrates that the Commission can, and often must, implement its mandate to effectively oversee the industry through the receipt and evaluation of information that investors themselves will never see.

There are a number of mechanisms that are available to the Commission for treating portions of Form N-PORT as non-public. The easiest of these would be to use the method currently proposed for Part D of Form N-PORT (miscellaneous securities), which is to submit the non-public items under Part D, either as part of Part D, or on a separate schedule. The Commission also could determine to adopt a separate filing form for this purpose.

IV. Form N-PORT

The SEC proposes requiring funds to file a new form, with complete portfolio holdings and additional holdings-related information in a structured data format. Funds would file in XML format on a monthly basis no later than 30 days after the end of the month. ICI understands the Commission's desire for more frequent and better quality information regarding a fund's portfolio holdings, and therefore generally supports the proposal. We have a number of specific comments to the form discussed below.[78]

A. Modify Portfolio-Level Risk Metrics

As proposed, Form N-PORT would require funds that invest in debt instruments or in derivatives that provide exposure to debt instruments or interest rates, to report duration and spread duration over key rates along the risk-free interest rate curve. The requirement would apply to funds whose debt instruments and related derivatives' notional values represent at least 20% of the fund's net asset value as of the reporting date.[79] Determination of duration would require a fund to calculate the

---

[77] We recognize that Congress provided additional statutory support for the confidentiality of information that advisers provide on Form PF, which provisions are not present in the 1940 Act. However, this grant of authority under Form PF serves to support the view that information requested for the same purpose as on Form PF may also merit protection from public disclosure. For the reasons discussed above and as the Commission itself recognizes, the Commission has adequate authority under the 1940 Act to keep non-public any information reported under Form N-PORT if it finds that public disclosure of such information is neither necessary nor appropriate in the public interest or for the protection of investors.

[78] Because the Commission may not choose to follow our recommendations provided above to address our data security concerns, our comments on Form N-PORT are based on the Commission's proposed monthly collection of portfolio holdings information.

[79] *See* Item B.3 of Proposed Form N-PORT. Notional value would be the sum of: (i) the value of each debt security; (ii) the notional value of each swap for which the underlying reference asset or assets are debt securities or an interest rate; and (iii)

change in value in the fund's portfolio from a one basis point change in interest rates (commonly known as DV01) for each applicable key rate along the risk-free interest rate curve (*i.e.*, 1 month, 3 month, 6 month, 1 year, 2 year, 3 year, 5 year, 7 year, 10 year, 20 year and 30 year interest rate), for each applicable currency in the fund.[80] Determination of spread duration would require a fund to calculate the change in value in the fund's portfolio from a one basis point change in credit spreads (commonly known as SDV01) for each of the same key rates along the risk-free interest rate curve, aggregated by non-investment grade and investment grade exposures.[81] According to the Fund Reporting Proposal, the Commission would benefit from risk metrics information by getting a better understanding of the risk profiles of funds and the credit spreads of fund investments. The Commission believes this information will help it better understand fund composition, investment strategy and interest rate and credit risk.

We recommend several modifications to the Commission's proposed approach. The Commission should:

- Increase the risk metrics reporting threshold to an amount greater than 25% determined over a three-month period;
- Require funds to report the total portfolio duration and spread duration;
- Employ a *de minimis* five percent threshold to a foreign currency's contribution to total duration before reporting of any risk metrics information for the currency in question;
- Alternatively, only require a single duration measurement that is a weighted average of the top five currencies (including the base currency) or those currencies that constitute at least 50% of the portfolio's exposure;
- Define "investment grade" consistent with a more conventional definition of that term, without reference to liquidity; and
- Exclude index funds from risk metrics reporting.

Each of these comments is explained in more detail below.

---

the delta-adjusted notional amount of any option for which the underlying reference asset is an asset classified in (i) or (ii). *See* Instruction to Item B.3 of Proposed Form N-PORT.

[80] *See* Item B.3.a of Proposed Form N-PORT.

[81] *See* Item B.3.b of Proposed Form N-PORT.

1. Modify Risk Metrics Standards

The Commission proposes to use a one basis point change in interest rates for computing both duration and spread duration. While larger changes in interest rates or credit spreads may be more appropriate for certain kinds of securities (*e.g.*, mortgage-backed securities), a one basis point change is a common standard that reasonably would balance the goals of illustrating the effects of interest rates or credit spreads on a fund while avoiding more complex or costly calculations.

We recommend, however, that the Commission modify the standards for determining duration and spread duration in three ways in order to focus on the most material information. First, we recommend that the Commission request total portfolio duration or spread duration (*i.e.*, a single measure) rather than at multiple points along the yield curve to reduce the burden on funds of reporting key rate duration and spread duration. Members indicate that for most funds, a single duration measure and a credit spread duration would capture the vast majority of a fund portfolio's risk. This is significant because some funds use risk monitoring systems that do not provide risk metrics at more than a single point on the yield curve. The proposed requirement would force these funds to opt for other more expensive risk monitoring systems. Consequently, by adopting this approach, the Commission could reduce reporting burdens and costs from that proposed and still gain considerable new information with which to evaluate portfolio risk.

Second, we recommend that, for duration determinations, the Commission permit the application of a *de minimis* five percent threshold to a foreign currency's contribution to total duration before requiring reporting of any risk metrics information related to the currency.[82] Alternatively, we suggest a single duration measurement that is the weighted average of the top five currencies (including the base currency) or those representing at least 50% of the portfolio's exposure. International funds may hold hundreds of positions in numerous countries. Requiring a separate risk measurement for each country could result in a pages-long list that would include country exposures that have very little impact on the overall duration of the fund. For example, a fund may have exposure to twelve different currencies at any given time. Given the proposed requirement to provide duration calculations for each currency across eleven points on a yield curve, the fund would have to report 132 duration measures (12x11) on a monthly basis. Consequently, many of these data points would add little to the Commission's ability to understand fund portfolio risk but would add to funds' reporting and compliance burdens. Also, while we are asking that risk metrics be kept non-public (see Section III and Section IV.A.3), if the Commission decides to make them public, we are concerned that such a wide array of metrics for a given fund could be confusing to investors.

[82] *See* Fund Reporting Proposal at 33601 (requesting comment on whether the Commission should apply a *de minimis* amount for exposure to different currencies and suggesting an alternative approach only requiring funds to provide risk metrics information about currencies whose exposures equal or exceed five percent of the fund's NAV).

Third, we recommend revising the proposed definition of "investment grade" used for determining spread duration. As proposed, the form would require funds to report spread duration by aggregating "investment grade" and "non-investment grade" exposures. It would define "investment grade" as:

> an investment that is sufficiently liquid that it can be sold at or near its carrying value within a reasonably short period of time and is subject to no greater than moderate credit risk.[83]

Liquidity is an inappropriate component for the definition of "investment grade" and would lead to unexpected or peculiar results. For example, many registered funds hold bonds from typically highly rated industries (*e.g.*, regional banks, insurance companies and real estate investment trusts) that may have lower trading volumes than those from other industries. These bonds typically are considered "investment grade." Similarly, an "off the run" corporate debt security of a high quality issuer (*e.g.*, General Electric) that is not the most recently issued bond or note from the issuer may be less liquid than its "on the run" counterparts but viewed as "investment grade" based on the issuer's credit rating. Indeed, inconsistencies might arise, for instance, if a fund holds a bond that it, and market participants generally, consider to be investment grade, but because of the bond's characteristics (*e.g.*, low current trading volume) the fund has deemed illiquid.

The Commission can avoid these kinds of anomalies and unintended results by adopting a conventional definition of "investment grade" that depends only on credit risk. As commonly understood, a security is "investment grade" if the issuer of the security is considered able to meet its obligations, exposing bondholders to minimal default risk. The ability to meet obligations does not depend on the liquidity of the instrument. Therefore, we recommend defining "investment grade" as "an investment that is of high credit quality and subject to no greater than moderate credit risk with respect to which the issuer's capacity for payment of financial commitments is considered strong."[84]

2. The Commission Should Increase the Risk Metrics Reporting Threshold to an Amount Greater than 25% Determined over a Three-Month Period and Should Not Require Risk Metrics Reporting for Index Funds

---

[83] *See* General Instruction E of Proposed Form N-PORT. While this standard is consistent with that in Form PF, we are not otherwise aware of its use by market participants. *See* Glossary of Terms on Form PF.

[84] Our recommended definition is based on the standards set forth by rating agencies when evaluating whether an issuer or security is "investment grade." *See*, *e.g.*, Standard & Poor's Ratings Manual, available at http://www.standardandpoors.com/aboutcreditratings/RatingsManual_PrintGuide.html ("The term "investment grade" is used more broadly in the investment community to identify categories of issuers and issues with relatively higher levels of creditworthiness and credit quality"). Our recommendation, however, does not require reliance on any credit rating agency's determination of creditworthiness.

a. Increase Risk Metrics Reporting Threshold to an Amount Greater than 25% Determined over a Three-Month Period

We recommend increasing the threshold used to determine whether a fund must report risk metrics from the proposed 20% to an amount greater than 25% that is determined over a three-month period. Our recommended approach would make the risk metrics threshold consistent with the Commission's threshold for requiring funds to disclose industry concentration in their prospectuses and would exclude funds that temporarily cross the threshold.

The Commission's proposed 20% threshold is based on its belief that the threshold would capture only funds that use debt instruments as a significant part of their investment strategy to monitor and report risk metrics. While the 20% threshold would not subject all funds to monthly monitoring and risk metrics reporting requirements, it still would capture many funds that do not use debt investments as a significant part of their investment strategy.

Registered funds must disclose in their registration statements their policy of concentrating in a particular industry or group of industries.[85] Although the 1940 Act does not define the term "concentration," the Commission staff has taken the position that a fund is concentrated in a particular industry or group of industries if the fund invests or proposes to invest more than 25% of the value of its net assets in a particular industry or group of industries.[86] In setting this threshold for mandatory disclosures, the Commission stated that an investment in an industry that exceeds this threshold is likely central to a fund's ability to achieve its investment objective.[87] Likewise, a fund investing in debt and debt-related instruments in amounts greater than 25% of the fund's NAV indicates that such instruments are central to a fund's investment objective and are a significant part of its investment strategy. As with industry concentrations, a fund only should have to disclose risk metrics if it exceeds a 25% threshold.

We recommend that the Commission employ the threshold based on the three-month average of a fund's notional value as a percentage of NAV, immediately prior to the reporting date.[88] The three-month average better reflects a fund's true investment strategy than a one-day value determined at the end of the reporting period, as it would exclude month-end, short-term market fluctuations that could cause a fund to temporarily exceed the threshold (*e.g.*, a significant one-day drop in the value of a fund's

---

[85] *See* Section 8(b)(1)(E) of the 1940 Act.

[86] *See Registration Form Used by Open-End Management Investment Companies*, 63 Fed. Reg. 13916, 13927 (March 23, 1998), available at http://www.gpo.gov/fdsys/pkg/FR-1998-03-23/pdf/98-7070.pdf. The Commission has stated that it believes that greater than 25% is an appropriate level of investment concentration that could expose investors to additional risk. *See id.*

[87] *Id.*

[88] *See supra* note 79 (defining notional value).

equity-related holdings could cause the fund's debt-related holdings to constitute an abnormally large portion of the fund's value). Using a three-month average would accomplish the Commission's goal of obtaining risk metrics for funds that use debt instruments as a significant part of their investment strategy.

b. Do Not Require Risk Metrics Data for Index Funds

The Commission should not require risk metrics reporting for index funds. Index funds are passive investment vehicles that attempt to track their corresponding index regardless of market conditions, even if the index's underlying investments lose value. While some index funds utilize risk metrics to operate their fund (*e.g.*, for optimization) within tight tolerances, other index funds may not. Fund shareholders indirectly would bear the costs resulting from requiring index funds to report risk metrics—a requirement that may add additional new burdens to index funds. We therefore believe the Commission should not impose this requirement on index funds.

c. Do Not Require Funds of Funds to "Look Through"

We recommend that the Commission issue affirmative guidance that, for fund of funds arrangements in which one fund invests in other underlying funds, the "top-tier" fund need not "look through" each of its underlying fund investments to determine whether it meets the threshold for reporting risk metrics. Rather, the application of the greater than 25% threshold only at the "top-tier" fund level should be sufficient. The Commission should not require funds to "look through" to the underlying funds' holdings, given the number of funds that one fund could invest in, the amount of underlying portfolio data that each fund would need to accumulate, and the fact that the information for underlying funds would be available in their Form N-PORT filings. The "look through" requirement would be unwieldy and unnecessarily burdensome.

In providing the requested guidance, the Commission also would avoid receiving duplicative reporting of the same holdings from top-tier funds and underlying funds, which would be redundant and would serve no regulatory purpose. The Commission's proposal otherwise would require top-tier funds to rely on underlying funds to provide them with monthly information. This would likely result in a reporting delay by top-tier funds, as they would be unable to report until they received information from the underlying funds.

3. Keep Risk Metrics Data Non-Public

While ICI members do not object to reporting risk metrics data to the Commission, they have serious concerns about making this data publicly available. Our general concerns about public availability are discussed above, in Section III. We therefore urge the Commission to keep non-public the risk metrics data reported to it for three primary reasons. First, investors may mistakenly view risk metrics as representing overall fund risk. Each of these risk metrics captures only a single element of

risk to a bond fund – there is no single, commonly agreed on, measure of risk due, in part, to the inherent limitations of each available risk measure.[89] For example, in addition to duration risk and spread duration risk, bonds and bond funds are subject to inflation risk, call risk and other risk factors.[90]

Second, investors may seek to compare risk metrics across funds, with confusing results. Many funds use third-party systems to calculate these kinds of risk metrics. Member firms indicate that these systems use (and allow funds to adjust) a variety of assumptions, inputs and algorithms. It is likely that no two third-party systems are identical in their modeling methods. Funds also must provide assumptions when computing duration and spread duration, including assumptions on prepayment rates and volatility, which will affect the final output. There could be several reasonable assumptions for these measures. There also could be significant differences among pricing sources for certain types of securities (*e.g.*, mortgage-backed securities), which could impact the risk metrics for those securities. Consequently, two funds that hold identical securities that are managed by two different advisers who use different third-party systems likely will not report identical risk metrics.

Recently, the Office of Financial Research of the U.S. Department of Treasury issued a working paper assessing similar risk metrics disclosures on Form PF concluding that, because of the measurement tolerances permitted, "Form PF submissions may obscure reporting funds' actual risks."[91] While we have no doubt that the SEC has learned from its experience with Form PF, Form N-PORT is a new form requesting new items, and has similar types of measurement tolerances that could cause a fund's actual risks to be obscured. While the Commission has the expertise and broader context necessary to evaluate and understand nuances in reported risk metrics data, we are concerned that these risk metrics present a similar risk of obfuscation to investors, and are of limited utility to them.

It does not allay these concerns that intermediaries may analyze risk metrics data on behalf of investors. The Commission explains in the Fund Reporting Proposal that the data it proposes to collect regarding duration and spread duration will enable institutional investors and service providers

---

[89] *See*, *e.g.*, Letter from Dorothy Donohue, Acting General Counsel, the Investment Company Institute, to Kevin M. O'Neil, Deputy Secretary, Securities and Exchange Commission (June 9, 2014), available at https://www.ici.org/pdf/28186.pdf (noting that adoption of a single-dimensional risk standard cannot adequately convey the multi-dimensional aspects of risk); Letter from Paul Schott Stevens, Senior Vice President, General Counsel, the Investment Company Institute, to Joan Conley, Office of the Corporate Secretary, NASD Regulation, Inc. (Feb. 24, 1997), available at https://www.ici.org/policy/comments/97_NASD_VOLATILITY_RTGS_COM (noting that risk ratings are illusory because risk is not a unitary concept nor identical for all investors); Letter from Paul Schott Stevens, General Counsel, the Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (July 28, 1995) (noting that risk is a multifaceted concept, having different meanings for different investors).

[90] *See*, *e.g.*, FINRA, *Duration – What an Interest Rate Hike Could Do to Your Bond Portfolio*, February 2014, available at https://www.finra.org/investors/alerts/duration-what-interest-rate-hike-could-do-your-bond-portfolio.

[91] *See* Mark. D. Flood, Phillip Monin, and Lina Bandyopadhyay, *Gauging Form PF: Data Tolerances in Regulatory Reporting on Hedge Fund Risk Exposures* (July 30, 2015), available at http://financialresearch.gov/working-papers/files/OFRwp-2015-13_Gauging-Form-PF.pdf.

to both institutional and individual investors to conduct their own analyses in order to help them better understand fund composition, investment strategy and interest rate and credit spread risk.[92] While intermediaries may provide some context for data, reliance on intermediaries has limitations because of the variance in inputs and assumptions.

Third, disclosing risk metrics information in conjunction with other information about a fund's portfolio (*e.g.*, holdings information) could help predatory traders to more easily reverse engineer a fund's investment strategy. As noted above, risk metrics information is based on a series of decisions that could lead to varied outlooks on risk. From the choice of risk management systems to the decisions on assumptions and other inputs, a fund makes several decisions when implementing its risk program that affect duration and spread duration computations. These decisions emphasize a fund's unique management style and could enable a competitor to better understand a fund's trading strategy in response to market changes. Disclosing risk metrics publicly also could give competitor funds more insight into a fund's process, making it harder for funds to find investment opportunities that add value for shareholders. As with the Commission's treatment of risk monitoring information for purposes of Form PF, the Commission should keep this information non-public.

In sum, the Commission should keep risk metrics non-public because of the likelihood that the market will treat duration and spread duration incorrectly as fund risk ratings because of the lack of comparability from one fund to another, and because disclosure could lead predatory traders to take advantage of a fund's investment strategy. In addition, risk metrics required by Form N-PORT, at least in its proposed form, would provide little to no benefit to an investor's decision making, and indeed may impair informed decisions.[93] Accordingly, the benefits of publicly disclosing risk metrics do not outweigh the potential harm that would result. For all these reasons, we urge the Commission to find that public disclosure of risk metrics information is neither necessary nor appropriate in the public interest or for the protection of investors.

B. Limit Securities Lending Disclosure to Top Five Counterparties

Form N-PORT would require the identification of *all* counterparties and the disclosure of the aggregate value of securities on loan to those counterparties. Funds also would disclose the LEI of the counterparty (if any).[94] According to the Fund Reporting Proposal, the Commission believes that this information will help the Commission and investors better understand the level of potential counterparty risk assumed as part of the fund's securities lending program.

---

[92] *See* Fund Reporting Proposal at 33598-99.

[93] *See supra* Section III.B.1 (discussing absence of benefits for investor decision making).

[94] *See* Item B.4 of Proposed Form N-PORT. *See also infra* Section V.A. (discussing issues related to LEI disclosure).

We support the Commission's efforts to increase transparency regarding funds' securities lending activities by requiring additional data about these activities.[95] Nevertheless, we recommend that the Commission limit the disclosure to the top five counterparties to which the fund has the greatest exposure.[96]

Information about a fund's top five counterparties would give the Commission and investors the information necessary to understand the material exposure that a fund has to securities lending counterparties, without imposing unnecessary costs on funds and their shareholders. The top five counterparties often represent most of the fund's securities lending exposure. Funds often have multiple securities lending counterparties, exposure to many of which constitutes only a mere fraction of a fund's overall assets and represents only a minor portion of the fund's securities lending activity. Providing information about all securities lending counterparties would capture counterparties to whom the fund does not have material exposure. In addition, a fund's borrowing pool is ever changing, so responses would contain information about many counterparties that may change frequently. By showing only the top five securities lending counterparties, the information provided would convey a more meaningful long-term view of the fund's counterparties.[97]

C. Require Disclosure of Derivatives Gain/Loss Information by Contract Type

Form N-PORT would require funds to report, for each of the preceding three months, monthly net realized gain (loss) and net change in unrealized appreciation (depreciation) attributable to derivatives by risk category (*e.g.*, commodity contracts, credit contracts, equity contracts, *etc.*).[98]

As a general matter, we support the proposed requirement in Form N-PORT that funds provide the realized gains (losses) and net change in unrealized appreciation (depreciation) associated with derivatives. We oppose, however, the proposed requirement that funds disclose the information aggregated by risk type. Funds currently report realized gains (losses) and unrealized appreciation

---

[95] Currently, funds are required to disclose information about their securities lending activities on Form N-SAR, in their registration statement, in their financial statements filed on Form N-CSR, and in their quarterly schedules of investments filed on Form N-Q. Comments on other aspects of the Fund Reporting Proposal involving securities lending are found in other portions of this comment letter. *See infra* Section IV.E.3 (discussing the proposed Form N-PORT requirements regarding portfolio-level securities lending information in the schedule of investments); *infra* Section VI.E (discussing the proposed Regulation S-X requirements regarding securities lending).

[96] There is precedent for our recommended approach. Under Form PF, registered investment advisers must disclose the exposure to the five counterparties to which one of its reporting private funds has the greatest mark-to-market net counterparty exposure. *See* Item 22 of Form PF.

[97] Under our recommendations, the Commission and investors still would have information regarding the total amount of securities out on loan, as the Commission still will require funds to identify in the schedule of investments whether any portion of an investment is on loan and the value of securities on loan.

[98] *See* Item B.5.c of Proposed Form N-PORT.

(depreciation) associated with derivatives by contract type (*e.g.*, futures, forwards, swap agreement), and many funds already have systems in place to classify derivatives by contract type.[99] To impose a change in the manner of categorizing these investments would cause the industry to make large-scale changes in the way that derivatives are currently tracked. While funds are required to disclose realized gains (losses) and the net change in unrealized appreciation (depreciation) associated with derivatives by risk type by GAAP,[100] we understand these disclosures are compiled manually. Providing these disclosures monthly would impose additional significant costs on funds and fund shareholders – without any material benefit to justify them. Therefore, we recommend that the Commission permit funds to report derivatives realized gain (loss) and unrealized appreciation (depreciation) by contract type, rather than risk type.

D. Require Flow Information at the Omnibus Account Level

Form N-PORT would require funds to report for each month, the total net asset value for: (1) shares sold (including exchanges but excluding reinvestment of dividends and distributions); (2) shares sold in connection with reinvestments of dividends and distributions; and (3) shares redeemed or repurchased (including exchanges).[101] The Commission appears to require this information at the omnibus account level. In other words, funds would not have to look through to underlying investors, which they generally are unable to do. The Commission seeks this information to help it better monitor trends in the fund industry, including analyzing funds that become popular among investors and analyzing funds that might be at risk of experiencing liquidity stress due to increased redemptions. We support the proposed approach because the Commission could use this information towards accomplishing its goals.

The Commission recognizes that certain factors may affect the usefulness of the flow information, such as the fact that omnibus accounts, which generally have significant amounts of purchases and redemptions, typically net their transactions prior to executing with the funds' transfer agents.[102] We agree with the Commission's assessment, and we support the disclosure as long as the Commission does not expect funds to look through omnibus accounts. It is critical that the Commission understand that funds have very limited ability to look through omnibus positions to obtain more detailed flow data.

Over the last ten years, the processing models that intermediaries use to service their customers have changed significantly. As technology and systems have improved, more and more intermediaries have transitioned to the use of omnibus structures to provide enhanced services and efficiencies to their

---

[99] *See* rule 6.07.7 of Regulation S-X.

[100] *See* FASB ASC 815-10-50.

[101] *See* Item B.6 of Proposed Form N-PORT.

[102] *See* Fund Reporting Proposal at 33603-04.

customers. As a result, the majority of intermediaries support and use an omnibus structure in which typically the intermediary in its name holds an account per fund on the records of the fund's transfer agent, and maintains the customer data underlying the omnibus position on its own books. Trading within the omnibus position generally occurs on a net basis. The intermediary accomplishes this by placing one trade or a few trades per day that represent the net purchase, redemption, and exchange activity processed for the underlying customers.

Some intermediaries currently provide funds with transparency files, including underlying account data, but by no means do all intermediaries do so. Intermediaries that provide transparency into data underlying the omnibus positions typically do so for sales reporting purposes and to facilitate compliance with the Commission's redemption fee rule.[103] In any case, if funds do receive data, they generally have no ability to integrate the data into their transfer agent records. It would be burdensome and costly for funds to build systems and processes to repurpose those transparency files to track purchase, sales and exchange activity within the omnibus position to monitor flows. As intermediaries have no regulatory obligation to provide this information to funds, many do not. Without a regulatory mandate, funds have little, if any, leverage to require that intermediaries provide transparency into the underlying activity.

Thus, as a result of omnibus accounting, there are certain limitations in the data that funds can report to the Commission. For example, funds would report purchases and sales that flow into and out of the fund from omnibus accounts, including the reinvestment of dividends and distributions, to the Commission at the omnibus account level. Typically, a fund pays intermediaries, such as omnibus accounts, dividends in cash. The intermediary calculates how much cash it should reinvest based on its underlying customer accounts, then places a purchase with the fund (as of the dividend date) representing the reinvested portion of the dividend payment. In this scenario, the fund has no way of knowing that the purchase represents reinvested dividends (and, correspondingly, what portion of the cash dividend was subsequently reinvested). Rather, the fund only would have access to the total cash distribution made to a given intermediary account.

E. Modify Schedule of Investments

1. ICI Generally Supports Portfolio Holdings Reporting

We generally support the Commission's collection of information on an investment-by-investment basis in the schedule of investments on Form N-PORT.[104] We support the requirement to provide basic identifying information about each investment, such as the name of the issuer, title of issue or description of the investment. We support the general requirements to provide the amount of

[103] *See* rule 22c-2 under the 1940 Act.

[104] Of course, this is predicated on ensuring that the Commission takes the steps necessary to ensure the security of these data. *See supra* Section II.

each investment, including the number of units or principal amount for each investment, as well as the value of each investment and percentage value of each investment when compared to the net assets of the fund, much of which Regulation S-X already requires. Additionally, we generally support funds disclosing an investment's payoff profile (long, short or N/A), the classification of asset type (*e.g.*, short-term investment vehicle, repurchase agreement, equity-common, *etc.*) and the categorization of the investment as a Level 1, Level 2 or Level 3 fair value measurement in the fair value hierarchy under GAAP. Receiving this information in XML format will facilitate the Commission's ability to efficiently analyze fund portfolio information on a regular basis.

While we generally support the proposed requirement to provide a schedule of investments on Form N-PORT, we have concerns about three issues: (1) publicly disclosing the delta of convertible securities, (2) publicly disclosing illiquidity determinations for particular securities; and (3) publicly disclosing country of risk determinations for particular securities. Our general concerns about public disclosure are discussed above in Section III. Each of these specific concerns is more fully described below, along with ICI's recommended alternative approach.

a. Do Not Require Public Disclosure of Delta for Convertible Securities

Form N-PORT would require funds to identify the delta of convertible securities.[105] The delta is the ratio of the change in the value of the option of converting the bond to the change in the value of the asset into which the debt is convertible.[106] The Commission believes that providing the delta for convertible securities is important to understand the extent of both the credit exposure of the debt portion of the convertible bond as well as the market price exposure relative to the underlying security into which it can be converted or exchanged.[107]

We recommend that the Commission not publicly disclose the delta for convertible securities because public disclosure of this information almost certainly will confuse investors. Members indicate that deltas are one of the most subjective measures that funds compute. As with risk metrics, determining the delta is highly dependent on a variety of assumptions and inputs, and accordingly, deltas from different fund complexes likely are not comparable. Funds make volatility and multiple other assumptions when determining deltas, and there is a wide range of reasonable assumptions that could be used on any particular convertible security. Consequently, two funds that hold identical convertible debt instruments that are managed by two different advisers likely will not report identical deltas. Given the wide range of deltas that could be derived for a convertible security, this measure would have limited utility to investors. Rather, objective data that funds would report to the Commission on Form N-PORT, such as conversion ratio, information about the underlying asset, and

[105] *See* Item C.9.f.v of Proposed Form N-PORT.

[106] *See* Fund Reporting Proposal at 33606.

[107] *See id.*

the market value of the convertible bond, should be sufficient information to understand the instrument. For these reasons, we recommend that the Commission find that public disclosure of the delta for convertible securities is neither necessary nor appropriate in the public interest or for the protection of investors.

b. Do Not Require Public Disclosure of Assets Deemed Illiquid

Form N-PORT would require funds to identify whether an asset is an illiquid asset.[108] Consistent with the Commission's prior guidance on liquidity, Form N-PORT would define "illiquid asset" as "an asset that cannot be sold or disposed of by the [f]und in the ordinary course of business within seven calendar days, at approximately the value ascribed to it by the [f]und."[109]

Although the long-standing legal standard defining an illiquid asset is clear, liquidity determinations can be complex and entail reasonable judgments based on a variety of information. Funds have developed their own standards and policies for determining and monitoring whether an asset is illiquid to ensure that mutual fund and ETF portfolios do not exceed the Commission's guidelines limiting such funds' investments to no more than 15% of the fund's assets.[110] These standards and policies often require fund personnel to make reasonable judgments about whether a fund could sell an asset for its approximate carried value within seven calendar days based on their views of the markets. These judgments may differ among personnel and certainly among fund complexes.[111]

Currently, funds must make these illiquidity determinations, but there is no requirement to disclose such determinations publicly. Different funds reasonably could differ in their assessment of a particular security, even though each fund has a sound method of determining liquidity.[112] Publicly

---

[108] *See* Item C.7 of Proposed Form N-PORT.

[109] *See* General Instruction E of Proposed Form N-PORT. *See also*, Acquisition and Valuation of Certain Portfolio Instruments by Registered Investment Companies, 51 Fed. Reg. 9773, 9777 (Mar. 21, 1986) (providing characteristics of illiquid securities).

[110] *See*, *e.g.*, *Statement Regarding "Restricted Securities,"* 35 Fed. Reg. 19989 (Dec. 31, 1970); *Revisions of Guidelines to Form N-1A*, 57 Fed. Reg. 9828 (Mar. 20, 1992).

[111] Funds that have multiple sub-advisers also may face issues regarding different illiquidity determinations for the same security. Sub-advisers that manage different sleeves of a fund but own shares of the same security may classify those securities differently when reporting holdings to the primary adviser. In those cases, the primary adviser must separately evaluate the security and make its own determination for reporting purposes.

[112] As noted *infra*, we recommend that the Commission explicitly acknowledge that funds may make reasonable judgments and assumptions in providing responses to the form. Under the proposed amendments to Regulation S-X, the Commission would require funds to identify in the schedule of investments each security or derivative contract that they deem to be illiquid. *See*, *e.g.*, note 13 to proposed rule 12-12 of Regulation S-X. The schedule of investments requirement raises the same concerns as the similar requirement under Form N-PORT. It also raises additional issues regarding how auditors would assess and audit illiquidity determinations. *See infra* Section VI.C.

disclosing these variations could lead to confusion among investors who may not understand how or why one fund complex could deem a particular security liquid while another deems it illiquid. Third parties also could "second guess" funds on their rational determinations, especially if differences are identified and highlighted in XML format. Public disclosure likely will stifle today's robust processes, instead incenting firms to seek homogenized determinations from third-party firms.[113]

For these reasons, we recommend that the Commission find that public disclosure of assets deemed illiquid is neither necessary nor appropriate in the public interest or for the protection of investors.[114] The Commission and its staff will obtain the information about the illiquidity determinations that they desire, while the 15% limit on illiquid investments will continue to serve mutual fund and ETF shareholders

c. Do Not Require Public Disclosure of Country of Risk Determinations

Form N-PORT would require funds to report the country that corresponds to the country of investment or issuer based on the concentrations of the risk and economic exposure of the investment.[115] The form also would require funds to report the country in which the issuer is organized if that is different from the country of risk and economic exposure. While we are not opposed to reporting this information, we recommend that the Commission not require it be publicly reported.[116]

Similar to liquidity determinations, country of risk determinations have subjective elements and entail reasonable judgments. The process and procedures for making country of risk determinations can vary among fund complexes, and the country of risk classification of a security reasonably could differ between two funds.[117] For example, an adviser reasonably could determine in good faith that a hypothetical multinational company that has the majority of its assets and economic exposure in Great Britain and 25% of its assets in Greece has Great Britain as its country of risk due to its economic exposure to the British economy. Alternatively, an adviser reasonably could determine

---

[113] Requiring funds to report these determinations may cause investment advisers to place undue reliance on third-party determinations – a result that the Commission specifically has sought to prevent with credit rating agencies. *See*, *e.g.*, *Removal of Certain References of Credit Ratings under the Investment Company Act of 1940*, 79 Fed. Reg. 1316 (Jan. 8, 2014).

[114] *See supra* Section III.

[115] *See* Item C.5 of Proposed Form N-PORT.

[116] Currently, funds are required to publicly report the related industry, country *or* geographic region of the investment in their schedule of investments included in their financial statements. If a fund categorizes its schedule of investments by country or geographic region, there is no requirement to disclose whether the country selected is the country of issuance or risk. Form N-PORT, however, would require funds to identify and publicly disclose both countries (country of issuance and country of risk).

[117] As with illiquidity determinations, multiple sub-advisers to a single fund may reach differing conclusions regarding country of risk determinations. *See supra* note 111.

that Greece is its country of risk of that issuer due to the large scale uncertainty currently surrounding the Greek economy that would affect 25% of that issuer's assets.

Although funds reasonably could differ with respect to their country of risk determinations, we do not recommend that the Commission provide a particular standard for determining country of risk. It is important for funds to have the flexibility to make these determinations using their own good faith judgment. Likewise, a fund should be able to determine whether to look through its derivatives holdings to its underlying reference assets to determine country of risk or look to the country in which the counterparty is organized. This would permit funds to exercise the necessary judgment in determining the appropriate country of risk for derivatives holdings. In contrast, public disclosure of country of risk determinations will highlight divergent approaches that are in themselves quite reasonable and potentially drive funds to migrate to third-party service providers to determine a holding's country of risk, which will minimize differences across funds and complexes.[118]

We therefore recommend that the Commission find that public disclosure of country of risk determinations is neither necessary nor appropriate in the public interest or for the protection of investors.[119] As with liquidity determinations, non-public reporting of this information will enable the Commission and its staff to obtain the information about country of risk determinations for oversight purposes. Investors would avoid the potential costs of funds utilizing third-party service providers for these determinations, and possible confusion resulting from funds reaching different conclusions regarding country of risk.[120]

d. Technical Comment on Debt Securities

We have a technical comment regarding the language in the schedule of investments in one item relating to debt securities. Form N-PORT provides that, for convertible debt securities, funds must provide the CUSIP, "ISIN (if CUSIP is not available), ticker (if CUSIP and ISIN are not available), or other identifier (if CUSIP, ISIN and ticker *are* available) for the reference instrument."[121] This last item appears to contain a typographical error. We believe the Commission intended for it to state ". . . or other identifier (if CUSIP, ISIN and ticker are *not* available)" (emphasis added). We recommend that the Commission add the word "not" in order to clarify that for convertible debt securities, an additional identifier is necessary only when the CUSIP, ISIN and ticker for the reference instrument are *not* available.

---

[118] *See supra* note 113 (discussing the Commission's approach to third-party credit rating agencies).

[119] *See supra* Section III.

[120] To the extent that funds turn to third-party service providers to obtain uniformity in these determinations, fund shareholders ultimately would bear the costs of doing so.

[121] *See* Item C.9.f.iii of Proposed Form N-PORT (italics added).

2. ICI Generally Supports Derivatives Reporting

The Institute generally supports the Commission's initiative to standardize derivatives disclosure and increase transparency of funds' derivatives usage with three exceptions. First, we recommend that the Commission not require public reporting of derivatives financing rates, given their proprietary nature. Second, we recommend that the delta for options remain non-public because public disclosure of this information could cause investor confusion. Third, we recommend reporting only the top 50 components and/or any components that constitute greater than one percent of a non-public index or a custom basket that serves as the reference asset for a derivative, rather than an exhaustive report of each component of such reference asset. We recommend that funds only disclose these components when the derivative's notional value exceeds five percent of the fund's NAV. Finally, we recommend that the Commission use a definition of "derivatives" that is applied in accounting literature to enable funds to determine whether to provide disclosures about non-enumerated categories of derivatives.

Form N-PORT would require funds to disclose certain characteristics and terms of enumerated and non-enumerated derivatives contracts that are important to understanding the instrument, such as the category of derivative that most closely represents the investment[122] and information about the counterparty (including the name and LEI of the counterparty).[123] Form N-PORT also would require funds to report terms and conditions of each derivative investment that are important to understanding the payoff profile of the derivative, depending on the category of derivative.[124] This information would include whether the derivative was a put or call, written or purchased, or long or short.[125] Funds also would disclose other information regarding the nature and terms of the derivative, including the number of shares per contract, the exercise price or rate of the contract, the notional amount, and delta of an option, in addition to the unrealized gains or losses of the derivative. For swap agreements and the catch-all category of "other derivatives," funds would disclose a description of the terms of payment, including financing rates, floating rates, fixed rates, payment frequency and the description and terms of payment to be paid to and received from the counterparty.[126]

a. Do Not Require Public Reporting of Derivatives Financing Rates

While we generally support providing the requested derivatives information, we strongly oppose disclosing derivatives financing rates, which are sensitive and proprietary. Before entering into a derivatives contract, advisers, which owe a fiduciary duty to the fund, negotiate financing rates with

---

[122] *See* Item C.11.a of Proposed Form N-PORT.

[123] *See* Item C.11.b of Proposed Form N-PORT. *See also infra* Section V.A (discussing issues related to LEI disclosure).

[124] *See* Items C.11.c-g of Proposed Form N-PORT.

[125] *Id.*

[126] *See* Items C.11.f and g of Proposed Form N-PORT.

counterparties in the best interest of the fund. These financing rates typically are not public today. Rather, they are only reflected in individual contracts between a fund and a counterparty. Disclosing those rates may provide third parties with sensitive information about the management of the fund that could impair the ability of funds to negotiate with various counterparties the best possible terms for derivatives transactions on behalf of fund shareholders. While it is impossible to predict exactly the effect of such public disclosure on future financing rates, it seems certain that public disclosure would affect the bargaining power of parties to these commercial agreements. It is inappropriate for the Commission, through regulation, to influence derivatives financing rates, which are best left to individual participants to determine. The benefits of publicly disclosing derivatives financing rates do not outweigh the potential competitive harm that would result.

Accordingly, although members do not object to reporting derivatives financing rates to the Commission, the Institute recommends that funds not report this information publicly.[127] Therefore, we urge the Commission, consistent with its approach to sensitive and proprietary information on Form PF, to find that public disclosure of derivatives financing rates is neither necessary nor appropriate in the public interest or for the protection of investors.

b. Do Not Require Public Disclosure of Delta for Options and Warrants

Form N-PORT would require funds to identify the delta of options and warrants, including options on a derivative (*e.g.*, swaptions).[128] The delta is the ratio of the change in the value of the option to the change in the value of the reference instrument and reflects the sensitivity of the option's value to changes in the price of the reference instrument.[129] The Commission believes that the measurement of delta for options is important to measure the impact, on a fund or group of funds that holds options on an asset, of a change in such asset's price in order to help better understand the risks that the fund faces as asset prices change.[130]

For the same reasons noted above for convertible securities, we recommend that the delta for options and warrants remain non-public to avoid causing investor confusion.[131] As noted above, members indicate that deltas are one of the most subjective measures that funds compute, and determining the delta for options and warrants is highly dependent on a variety of assumptions and inputs, and accordingly, deltas from different funds likely are not comparable. Rather, objective data that funds would report to the Commission on Form N-PORT, such as conversion ratio, information

---

[127] *See supra* Section III.

[128] *See* Item C.11.c.vii of Proposed Form N-PORT.

[129] *See* Fund Reporting Proposal at 33608.

[130] *Id*.

[131] *See supra* Section IV.E.1.a.

about the underlying asset, and the market value of the option or warrant, should be sufficient information to understand the instrument. We therefore recommend that the Commission find that public disclosure of the delta for options and warrants is neither necessary nor appropriate in the public interest or for the protection of investors.

c. Revise the Proposed Disclosure Requirement for Non-Public Indices or Custom Baskets

Form N-PORT requires funds that hold derivatives that are based on an index or a "custom basket" of assets to disclose additional information about the index or custom basket depending on whether information about the index or basket is publicly available and depending on the size of the derivative.[132] If information about the components of the index or basket is publicly available on a website and updated quarterly, Form N-PORT would require funds to identify the index and index identifier.[133] If the index or basket's components are otherwise not public and the notional value of the derivative represents one percent or less of the fund's NAV, Form N-PORT would require the fund to provide a narrative description of the index or basket.[134] If the index or basket's components are otherwise not public and the notional value of the derivative represents greater than one percent of the fund's NAV, then the Commission would require the fund to provide the name, identifier, number of shares or notional amount or contract value as of the trade date, value, and unrealized appreciation or depreciation of every component in the index.[135]

The Institute does not object to providing identifying index information or providing a narrative description of the index or basket as proposed.[136] We do, however, object to the requirement to list and provide detailed information about each component of a non-public index or basket and the unrealized appreciation or depreciation of every component in the index, because the costs and burdens of providing such information outweigh any possible benefit. We also recommend that the one percent threshold be increased to five percent.

---

[132] Although the Fund Reporting Proposal discusses "custom baskets," Form N-PORT only requires disclosure regarding a non-public "index." Given the discussion in the Proposal, we assume that the term "index" includes "custom baskets" but recommend that the Commission clarify whether this is the case.

[133] *See* Item C.11.c.iii.2 of Proposed Form N-PORT.

[134] *Id.*

[135] *See* Item C.11.c.iii.3 of Proposed Form N-PORT.

[136] We understand that some of our members' licensing agreements with index providers or derivatives agreements with counterparties require them to keep confidential the composition of the index or derivative, although they may provide disclosure subject to the license provider's or counterparty's agreement. In these situations, if no agreement is reached on the disclosure, the index provider has the right to terminate the index license or the counterparty has the right to unwind the derivative. This could harm funds and their shareholders if the license is terminated or a derivative is unwound at an inopportune time.

Disclosure of every index component and its unrealized appreciation or depreciation would be impractical and costly, and would lead to a lengthy list that investors would not find helpful. We understand that some non-public indices could contain more than 2000 individual components. Listing each component and providing detailed information about those components in some cases would yield detailed information for them that constitute only a miniscule percentage of an index for a derivative that may only constitute a small portion of the fund. Requiring funds to list all index components would overwhelm shareholders or could overstate the importance of the derivative in relation to other fund investments.

Likewise, disclosing the unrealized appreciation or depreciation of every component of the index is unnecessary. Determining these unrealized amounts would require a fund to create a record of the value of each security in the index at the time the contract is entered into (a cost basis for each index component) so that, at the Form N-PORT report date, the fund can value each index component and calculate the unrealized appreciation or depreciation (as if the fund owned the index component directly). We question the benefit of this disclosure, as funds already would be reporting the unrealized appreciation or depreciation of each contract it holds.

The substance, frequency and volume of disclosures should be commensurate with the materiality of that information, a standard that the proposed requirements do not meet. Consistent with that standard, we recommend that the Commission require that funds that invest in a derivative for which the reference asset is non-public and the notional value of which exceeds a threshold percent of the NAV of the fund, list the top 50 components and components that represent more than one percent of the index.[137] We also recommend that the Commission eliminate the requirement to provide unrealized appreciation and depreciation of index components. Narrowing the list to the top 50 components and eliminating the requirement to provide unrealized amounts would greatly reduce the amount of information needed to respond to this item. In addition, requiring that all components that constitute greater than one percent of the index would capture any remaining components that may have a material impact on the fund.

We also recommend increasing the threshold percentage for reporting index and basket information from greater than one percent to greater than five percent of NAV, such that funds investing in a derivative that uses a non-public index or basket as its reference asset only would disclose individual components of the index or basket when the notional value of the derivative exceeds five percent of the fund's NAV. Increasing the reporting amount to five percent would eliminate the reporting for derivatives that have little impact on the fund's NAV and is consistent with the Commission's approach to other disclosures. For example, the Commission has taken the position that securities recently purchased and not previously disclosed that constitute less than five percent of a

[137] We note that this standard is analogous to the criteria used to identify holdings in the summary schedule of investments currently required under Regulation S-X. *See* rule 12-12C of Regulation S-X.

fund's unaffiliated securities are immaterial and do not need to be identified in financial statements.[138] In the same way, the Commission has permitted expense items that do not exceed five percent of a fund's total expenses to not be separately presented or identified but cumulated in "other expenses."[139]

These recommendations would provide the Commission and investors with the information that they need to understand the derivative investment and would relieve funds from the costly and unnecessary burden of producing exhaustive information about an index component that has a negligible effect on the fund.

d. Use a Consistent Definition of "Derivatives"

Form N-PORT would require funds to disclose information about "other derivatives" that are not enumerated by the form.[140] The scope of "other derivatives," however, is unclear and potentially could encompass a wide range of investments. To ensure that funds disclose their investments in a consistent manner, we recommend that the Commission include in Form N-PORT the same definition of "derivatives" that is used under GAAP.[141] Funds already are employing this definition for financial reporting purposes and should be able to easily apply it for these purposes. Using a widely accepted standard would establish consistency and provide more certainty to funds reporting derivatives information.

3. Modify Reporting for Securities Lending Collateral for Consistency with Applicable Accounting Standards

Item C.12 of Form N-PORT would require funds to report investment-by-investment disclosure describing: (1) whether any portion of the investment was on loan by the fund, and, if so, the value of the securities on loan; (2) whether any amount of the investment represented reinvestment of the cash collateral and, if so, the dollar amount of such reinvestment; and (3) whether any portion of the investment represented non-cash collateral received to secure loaned securities and, if so, the value of the securities representing such non-cash collateral.

While the Institute supports the first two requirements identifying securities on loan and securities that represent the reinvestment of cash collateral, we have concerns with listing non-cash collateral received on the schedule of investments. Except in unusual circumstances, funds do not

---

[138] *See* rule 12-12 of Regulation S-X, note 1 (permitting securities recently purchased that constitute less than five percent of a fund's unaffiliated securities to not be separately disclosed or identified in the schedule of investments).

[139] *See* rule 6-07 of Regulation S-X.

[140] *See* Item C.11.g of Proposed Form N-PORT. The form enumerates several categories of derivatives, including options, warrants, futures, forwards and swaps). *See* Item C.11 of Proposed Form N-PORT.

[141] *See* FASB ASC 815.

typically recognize non-cash collateral as a fund asset because funds do not typically "control" the non-cash collateral and do not bear any investment risk for it.[142] Without the necessary control or investment risk, it is not appropriate or consistent with accounting standards to list the non-cash collateral on the schedule of investments or provide the attributes/elements requested by the Commission. Therefore, we recommend that the Commission clarify that the item relating to non-cash collateral applies only in instances where the fund "controls" the non-cash collateral and recognizes it as a fund asset.

We further recommend that the Commission add a new item to the portion of the form describing securities lending counterparties[143] that would enable funds to report non-cash collateral received that it does not control. This new item would be similar to the item proposed for repurchase agreement collateral,[144] and would ask:

> Did any counterparty provide any non-cash collateral? [Y/N]. If yes, provide the following information concerning the non-cash collateral:
>
> 1) Principal amount
> 2) Value of collateral
> 3) Category of investments that most closely represents the collateral, selected from among the following (asset-backed securities; agency collateralized mortgage obligations; agency debentures and agency strips; agency mortgage-backed securities; private label collateralized mortgage obligations; corporate debt securities; equities; money market; U.S. Treasuries (including strips); other instrument). If "other instrument," include a brief description, including, if applicable, whether it is a collateralized debt obligation, municipal debt, whole loan or international debt.

This information effectively would allow the Commission to meet its goal of assessing collateral risk in a manner that is consistent with the current accounting treatment of fund assets.

In addition, we recommend that the Commission clarify that the securities lending requirements on Form N-PORT only apply to the particular series making the filing, and not to the registrant. As proposed, Form N-PORT would require funds to report whether any part of an

---

[142] *See* FASB ASC 860 (setting forth guidance establishing when a transferor has surrendered control over a transferred asset).

[143] *See also* Item B.4 of Proposed Form N-PORT.

[144] *See* Item C.10.f. of Proposed Form N-PORT (setting forth proposed disclosure requirements regarding repurchase agreement and reverse repurchase agreement collateral).

investment is on loan by the "[r]egistrant."[145] Reporting securities lending information on behalf of the registrant and, not each series, may result in the misimpression that portfolio securities are on loan by the reporting series when, in fact, they are on loan by a different series of the registrant.

F. Permit "T+1" Accounting

Form N-PORT would require each fund to report certain information on an investment-by-investment basis as of the end of the reporting period. It is unclear from the form whether funds would be required to list month-end holdings on a trade date plus zero or "T+0" basis, reflecting transactions through the end of the month.[146] If funds were required to report on a T+0 basis, if the reporting month was December, for example, the form would require reporting of purchases and sales information up through and including December 31 transactions.

Most funds, however, do not account for their day-to-day transactions on a T+0 basis, but on a trade date plus one or "T+1" basis, which is specifically permitted for NAV determinations.[147] Under the T+1 standard, the fund's records or NAV would not reflect transactions that occur on a particular day until the following day.

It would be very expensive and inefficient, and provide little benefit to the Commission or investors, for funds to convert to T+0 accounting on a monthly basis solely for purposes of filing Form N-PORT. To convert to T+0 accounting for the period, the fund would have to obtain various data from the first business day of the next period and aggregate it with information from the remainder of the period. It also would have to eliminate information from the first business day of the current NAV reporting period. Often, in order to convert to T+0, a fund must obtain the necessary transaction information from its third-party administrators, custodians or other service providers. Before providing this transaction information to the fund, these service providers generally must reconcile the data as part of a process that may add several business days or more after the close of the period.[148] After obtaining the data, a fund often must make amortization and accretion computations, gather information from several different sources for any adjustments to gains and losses, and quality check the data. These critical steps can add multiple days to the process. Given that certain fund complexes have hundreds of funds, a 30-day filing period would be insufficient to provide data on a T+0 basis, especially in conjunction with the other information that Form N-PORT would require within 30 days of month-end.

---

[145] *See* Item C.12.c. of Proposed Form N-PORT.

[146] *See* General Instruction A to Proposed Form N-PORT (requiring funds to report portfolio holdings as of the last business day of the month). *See* FASB ASC 946-320-25.

[147] *See* rule 2a-4 under the 1940 Act (permitting T+1 accounting for purposes of computing NAV).

[148] Many third-party service providers will face similar workload issues in providing report packages to their fund clients.

Funds currently file portfolio holdings on a T+0 basis four times a year.[149] In each instance, however, funds have at least 60 days from the end of the reporting period to gather, review and provide this information.[150]

We therefore strongly recommend that the SEC permit funds to prepare Form N-PORT, other than the attached Regulation S-X compliant schedule of portfolio holdings, on a T+1 basis. Permitting funds to prepare their Form N-PORT on a T+1 basis would fully satisfy the SEC's regulatory objectives, while significantly reducing the effort and costs that funds would incur to convert to T+0 accounting – costs that fund shareholders ultimately would bear.

We recognize that preparing the Form N-PORT on a T+1 basis may lead to discrepancies between the portfolio holdings data on the monthly Form N-PORT filings provided to the Commission and the quarterly portfolio holdings data in the financial statements provided to shareholders. Those two sets of information, however, are intended for different purposes and different audiences – monthly Form N-PORT filings, which funds will provide in a data tagged format, are intended for the Commission and its staff, while quarterly portfolio holdings reports primarily are intended for shareholders (and are not data tagged).[151] Commission staff and others would see minor differences between the monthly Form N-PORT filings and the quarterly portfolio holdings schedules, but they would know that the differences were attributable to variations in the accounting methodology. Any differences are likely to be slight and are unlikely to materially change the substance of the information.

As further discussed immediately below, even if the Commission permits funds to prepare the Form N-PORT on a T+1 basis, we strongly recommend increasing the filing period to 45 days after the end of the month to provide funds with sufficient time to compile, check and report information. For example, apart from time necessary for T+0 conversion, the short filing timeframe would require funds to find alternative methods for more quickly collecting data. It will take several days for fund staff to gather the necessary data, following which fund staff would have to evaluate, review and report this information, which could take multiple weeks – especially for larger fund complexes.

---

[149] *See* Form N-CSR and Form N-Q.

[150] *See* rules 30b2-1 and 30e-1 under the 1940 Act (permitting funds to file annual and semi-annual shareholder reports on Form N-CSR 10 days after transmission to shareholders, which the Commission requires funds to transmit to shareholders of management investment companies 60 days after the end of the period); rule 30b1-5 under the 1940 Act (permitting funds to file quarterly reports on Form N-Q not more than 60 days after the end of the first and third quarters of the fund's fiscal year).

[151] As noted above, the fund's financial statements also are prepared on a T+0 basis.

G. Extend the Filing Period for Form N-PORT and Portfolio Holdings Schedules

The Institute strongly recommends extending the filing period for Form N-PORT from 30 days to 45 days. We also recommend extending the filing period for the first and third quarter portfolio holdings schedules from 30 days to 60 days, to align with the existing periods for filing Form N-Q.[152] Extending these filing periods would provide funds with the necessary time needed to collect and review the data needed to prepare these filings.

The proposed requirement to file Form N-PORT within 30 days after the end of the month would not provide sufficient time for funds to gather, process and review the data necessary for the filing. The amount of data requested is significantly greater than what the Commission currently requires of funds. Apart from time necessary for T+0 conversion (in the event T+0 reporting is required),[153] the short timeframe would require funds to find alternative methods of more quickly collecting data, some of which is not, as the Commission posits, "readily available to funds as a general business practice."[154] In many cases, data, such as repurchase agreement collateral information and securities lending counterparty information, are available only through third-party systems (*e.g.*, tri-party banks or securities lending agents). In other cases, funds will have to compile data manually, such as certain derivatives holdings information (*e.g.*, realized gains and losses and changes in unrealized appreciation and depreciation by risk type). Funds also would need additional time to convert risk metrics data received from third-party systems to an appropriate format for filing. In addition, funds that have sub-advisers will need time to acquire portfolio information from those sub-advisers within a compressed time period. Funds with multiple sub-advisers also would have to compile this information and reconcile the different treatment of similar securities within this compressed time period. Further, third-party EDGAR filers often will need additional time to convert filings into an XML format, which generally takes more than one day. Many members believe that 45 days would be an adequate period of time to complete these processes.

The proposed requirement to file Regulation S-X compliant portfolio holdings schedules for the first and third fiscal quarters within 30 days of the end of the quarter, rather than the 60 days funds currently have to file reports on Form N-Q, similarly provides funds with inadequate time to prepare and review these schedules. While the Commission notes that eliminating the portfolio holdings' certification requirement would save funds time, the amount of that savings is only a portion of the overall time spent in preparing the schedule. In addition to certification, funds spend substantial time obtaining, reviewing and conducting quality checks on the data. The Commission should give funds 60 days to file the first and third quarter portfolio holdings schedules because it would provide

[152] Specifically, we suggest that the Commission permit funds to file Form N-PORT 45 days after month-end, and the Regulation S-X compliant schedule of investments relating to the first and third fiscal quarter through an amendment to the previously filed N-PORT not more than 60 days after month-end.

[153] *See supra* Section IV.F.

[154] *See* Fund Reporting Proposal at 33611-12.

shareholders with public access to those filings on the same schedule as exists currently under Form N-Q, and would not delay funds' filing Form N-PORT with the Commission.

V. General Comments

In addition to our specific comments on Form N-PORT, we have several general comments. First, it is critical that the Commission explicitly acknowledge that it is permissible for funds to make reasonable judgments and assumptions in responding to the items in the forms. Second, we have a number of significant recommendations regarding the Commission's proposed uses of LEIs. Third, we strongly support the Commission's approach to certifications. These comments are explained in more detail below.

A. Explicitly State that Funds May Make and Rely on Reasonable Assumptions

The Commission appears to acknowledge that funds may have to utilize various assumptions and inputs, which may differ among fund complexes (or even within a fund complex), to generate certain of the data that the Commission ultimately might require on Form N-PORT and Form N-CEN.[155] In fact, the Commission proposes that Part E of Form N-PORT would provide an opportunity for funds to include any information they believe would be helpful to understanding information reported in the form, including explaining any assumptions made in responding to any item in the form.

We appreciate the Commission's acknowledgement of this issue, and recommend that the Commission explicitly state that it is permissible for funds to make and rely on reasonable judgments and assumptions in providing responses to Forms N-PORT and N-CEN, regardless of whether a fund chooses to provide explanatory notes with respect to its assumptions, including in Part E of Form N-PORT. Because some of the items in the forms request information that is subjective in nature or request data that relies on certain assumptions or judgments, fund responses may not be fully comparable across the industry. As previously noted, this issue arises in connection with the information sought regarding the liquidity of securities. One fund may classify a security as illiquid while another fund may reasonably and appropriately not similarly classify that same security.[156]

While ICI members generally support providing the SEC with the additional information it requests, the SEC's explicit statement that funds are permitted to make and rely on reasonable

---

[155] The Commission asks, with respect to risk metrics: "To what extent would the values reported for these risk metrics be affected by the inputs and assumptions underlying the methodologies by which funds would calculate these metrics, including assumptions regarding the valuation for the investments or underlying securities of investments, particularly for investments that have pre-payment options, such as mortgage-backed securities?" *See* Fund Reporting Proposal at 33601.

[156] *See supra* Section IV.E.1.a. Another area in which variations by funds could occur includes country of risk determinations. *See supra* Section IV.E.1.b.

judgments and assumptions in providing responses would provide funds with needed assurance when responding to such items.

B. Provide a Reasonable Belief Standard for Third-Party LEIs

The Commission proposes requiring listing of LEIs in response to various items in Forms N-PORT and N-CEN.[157] These requirements would pose several operational challenges for funds seeking to obtain and provide this information. For the reasons below, we urge that the Commission explicitly acknowledge the limitations to which funds are subject in providing LEI information about third parties. Specifically, we recommend that the Commission state in Form N-PORT and Form N-CEN that funds may provide LEI information regarding third parties in response to these items based on their reasonable belief that the information reported is accurate.

While a fund can obtain an LEI for itself (and many have) and provide this information, it does not have the same control or transparency regarding the LEIs of third parties, including for service providers and counterparties. A fund may not know the identity of a third party and therefore may need to rely on intermediaries to obtain LEIs. For example, a fund's securities lending agent often solely maintains the identities of the counterparties to a securities lending agreement, and may or may not have the LEIs of those counterparties. In addition, a third party may not be required to provide that information to the fund, and, in some cases, may not be willing to provide it.

Knowing the specific legal name of the entity for purposes of ascertaining the appropriate LEI presents an additional significant challenge for funds. Although there is a central location that provides a listing of entities and their LEIs, many entities have multiple (sometimes hundreds of) affiliates with names that are substantially similar to the name of the relevant entity. While using other securities identifiers could provide more precision, there currently is no established process to use an identifier of a particular investment to search for its corresponding LEI. Furthermore, industry working groups have identified differences in practices undertaken by various LEI Local Operating Units ("LOUs"), which can create further discrepancies among different LOU databases. Therefore, a fund employee may have extreme difficulty identifying with certainty the LEI of any entity with a number of affiliates. For example, Form N-PORT would require funds to list the LEI, if any, of each investment it holds.[158] If a fund invests in a debt issuance, the fund might have the name of the issuance and a securities identifier but no mechanism to match the securities identifier with an LEI. The fund may have to search the name of the issuer on an LEI database. If the issuer has several affiliates with LEIs, the fund may pull up several names that could be the issuer and must decide which LEI to use. This can create

[157] *See*, *e.g.*, Item A.1 of Proposed Form N-PORT (requiring the LEI of the registrant); Item 2.d of Proposed Form N-CEN (same). In some cases, the requirement to provide LEI information depends on whether the entity in question has an LEI. *See*, *e.g.*, Item B.4 of Proposed Form N-PORT (requiring the LEI of a securities lending counterparty of the fund, *if any*); Item 17.a.iv of Proposed Form N-CEN (requiring the LEI of a principal underwriter of the fund, *if any*).

[158] *See* Item C.1.b of Proposed Form N-PORT.

inconsistencies in reporting across funds. The use of LEIs is evolving, and as such, until companies adopt it, and there are service providers that can report LEIs along with their securities identifiers, as well as systems built to support fund reporting of LEIs, funds face significant challenges in obtaining and correctly identifying LEIs.

C. Adopt Proposed Approach to Certification

Form N-Q and Form N-CSR currently require the principal executive and financial officers of a fund to make quarterly certifications relating to (1) the accuracy of information reported to the Commission, and (2) the effectiveness of disclosure controls and procedures and internal control over financial reporting. These certifications cover the accuracy of the entire filing, including the schedule of a fund's portfolio holdings and financial statements, presented in accordance with Regulation S-X. Funds must provide the certifications after the first and third fiscal quarters on Form N-Q and after the second and fourth fiscal quarters on Form N-CSR.

The Fund Reporting Proposal would rescind Form N-Q. In its place, funds would file a monthly schedule of investments on Form N-PORT, and, for the first and third quarters of a fund's fiscal year, attach a Regulation S-X compliant schedule of its portfolio holdings. Importantly, the Commission would not require fund officers to certify to any information on Form N-PORT, including the attached schedule of portfolio holdings. Thus, Form N-PORT would eliminate certifications as to the accuracy of the portfolio schedules reported for the first and third fiscal quarters.

The rescission of Form N-Q would eliminate certifications regarding disclosure controls and procedures and internal control over financial reporting for the first and third quarters. To address this gap, the Commission proposes to amend Form N-CSR's form of certification to extend the required certification's look-back period to the registrant's most recent fiscal half-year, rather than the registrant's most recent fiscal quarter, as is currently required. This would result in the fund filing two certifications annually which, together, cover the full fiscal year.

We strongly support the Commission's decision not to require fund officers to certify to information on Form N-PORT, including the schedule of investments. We commend the Commission for considering the time and costs that the certification process would impose on funds. We also strongly support the proposed revisions to Form N-CSR extending the certifications regarding disclosure controls and procedures and internal control over financial reporting to cover the most recent fiscal half year.

Extending the period covered by Form N-CSR's required certifications without requiring monthly Form N-PORT certifications would satisfy the Commission's regulatory objective of ensuring the adequacy of the accuracy and internal controls relating to funds' reporting, while minimizing unnecessary burdens on funds. It would be impractical to require certification of the monthly Form N-

PORT filings, given the detailed reporting data that the Commission is proposing and the short timeframe for submitting the filings.[159]

To certify to monthly Form N-PORT filings, fund officers would require extensive sub-certifications from fund personnel regarding the accuracy of the data, which would be extremely difficult to complete in the proposed time frame. Furthermore, while funds will make every effort to ensure the data they report on Form N-PORT is accurate, the standard of liability implied by certifying to that data is not appropriate given the granularity of this data and the frequency with which funds will report. Limiting certification to semi-annual certifications that, together, cover the entire year, will permit funds to report to the SEC more efficiently, while avoiding unnecessary costs to fund shareholders.

VI. Proposed Amendments to Regulation S-X

We generally support the proposed amendments to Regulation S-X, which prescribes the form and content of financial statements required in fund registration statements and shareholder reports. In particular, we support the proposed amendments that would standardize disclosures regarding fund holdings of derivatives contracts and make their presentation within the financial statements more prominent. We also support the proposed amendments that would update the disclosures for investments in securities and amend the rules regarding the general form and content of financial statements. We are concerned, however, that certain of the proposed disclosures that would appear in the investment schedules and the notes to the financial statements would reveal sensitive or subjective information. As described below, we recommend that the Commission omit these proposed disclosures from the financial statements and instead move them to the non-public portion of Form N-PORT.

A. Modify Written Open Option Contracts and Open Swap Contracts Disclosure

1. Omit Written Option Notional Amounts

The Regulation S-X amendments would modify the current disclosure of written option contracts by requiring a description of the contract (replacing the current column for name of issuer), the counterparty to the transaction, and the contract's notional amount.[160] We support the proposed changes requiring a description of the contract and the counterparty to the transaction for over-the-

[159] Even if the Commission extends the filing deadlines as we recommend, funds would not have adequate time to engage in the certification process.

[160] *See* proposed rule 12-13 of Regulation S-X.

counter options.[161] Disclosure of the notional amount of the contract is unnecessary. We recommend that the Commission omit this item from the Fund Reporting Proposal. In contrast to futures or swap contracts, where the notional amount communicates economic exposure, the exercise price component of an option contract makes the notional amount less relevant.[162] If the Commission requires reporting of the notional amount on options contracts, it should specify the methodology for calculating notional amount as: a) the number of contracts multiplied by b) the exercise price multiplied by c) the contract multiplier.

2. Revise the Proposed Disclosure Requirement for Non-Public Indices or Custom Baskets

Similar to Form N-PORT, the Regulation S-X amendments would require disclosure about an index or basket of investments underlying an option contract.[163] If the underlying investment is an index the components of which are not publicly available on a website as of the fund's balance sheet date, and the notional value of the option contract exceeds one percent of the fund's NAV as of the close of the period, the proposal would require the fund to list separately each of the investments comprising the index, the value of each of the investments, and the percentage value of each of the investments as compared to the index.

While we support providing transparency into non-public indices or custom baskets underlying option contracts, we are concerned that listing each of the investments comprising the index may overwhelm shareholders or overstate the importance of the option contract in relation to the fund's other investments. We therefore recommend disclosure of the 50 largest issues and any other issue the value of which exceeds one percent of the index as of the close of the reporting period.[164] Further, we recommend such disclosure be required only if the notional value of the contract exceeds five percent of the fund's NAV. This standard strikes an appropriate balance between the need for transparency and overwhelming shareholders with information about holdings that have relatively little effect on the fund's performance.

We also recommend the same standard for disclosing constituent securities for swaps on non-public indices or custom baskets in which the notional value of the swap exceeds five percent of the

---

[161] We also support note four to proposed rule 12-13 indicating that counterparty is not required for exchange-traded options. This exception recognizes that a clearing corporation associated with the exchange guarantees performance on the option contract.

[162] We note that the Commission would not require reporting of the notional amount on options contracts in Form N-PORT.

[163] *See* proposed rule 12-13 of Regulation S-X.

[164] This standard is analogous to the criteria used to identify holdings in the summary schedule of investments required in rule 12-12C of Regulation S-X.

fund's NAV as of the close of the period.[165] Our recommended standard would provide the Commission and investors with the necessary information to understand an option or swap contract based on a custom basket or index disclosed in the fund's financial statements, without imposing unnecessary reporting burdens on funds.

3. Omit Financing Rates for Open Swap Contracts

Similar to Form N-PORT, the Regulation S-X amendments would require disclosure of the terms of payments to be received from or paid to another party, including among other things, a description of the reference instrument or index, the financing rate to be paid or received, and payment frequency.[166]

While we generally support providing the requested derivatives information, we strongly oppose disclosing financing rates, which are sensitive and proprietary. Disclosing financing rates may provide third parties with sensitive information about the management of the fund that could impair the ability of funds to negotiate with various counterparties the best possible terms for derivatives transactions on behalf of fund shareholders. The benefits of publicly disclosing swap financing rates do not outweigh the potential competitive harm that would result.

We recommend that the Commission find that disclosure of swap financing rates is neither appropriate nor necessary for the public interest or the protection of investors and omit financing rates on open swap contracts from the required disclosures. Instead, we recommend that the Commission permit disclosure of financing rates on open swap contracts in a non-public section of Form N-PORT.[167]

B. Provide Pictorial Depicting Portfolio Holdings by Country, Geographic Region, or Industry

Currently funds are required to categorize investments in securities by (i) the type of investment (*e.g.*, common stocks, preferred stocks, fixed income securities), and (ii) the related industry, country, or geographic region. The Regulation S-X amendments would require funds to categorize investments in securities by (i) the type of investment, (ii) the related industry, and (iii) the related country or geographic region.[168] The Fund Reporting Proposal indicates that disclosure of both the industry and the country or geographic region would be particularly beneficial for investors in global

---

[165] *See* proposed rule 12-13C of Regulation S-X. *See also supra* Section IV.E.2.a (discussing similar recommendations for Form N-PORT).

[166] *See* Instruction 3 to proposed rule 12-13C.

[167] *See supra* Section III.

[168] *See* proposed rules 12-12, 12-12A, 12-12B, and 12-14 of Regulation S-X.

and international funds, where currently funds only are required to categorize their schedule by industry, country, or geographic region.

The proposal would add considerable length to the schedule of investments and make it more difficult to comprehend. In particular, we are concerned that the tertiary categorization (*e.g.*, country) would not illustrate a fund's overall exposure to a particular country. For example, a fund could categorize its schedule of investments by (i) security type, (ii) industry, and (iii) country. If so, then a particular country could appear as a sub-category under each of the different industries, without indication of the fund's overall exposure, either in dollar terms or as a percentage of net assets, to the particular country. Stated differently, a financial statement reader would have to sum the exposures to the particular country, as they appear under each of the different industries, in order to understand the fund's overall exposure to that country.

We recommend that the Commission, instead, amend the graphical representation of holdings required in annual and semi-annual shareholder reports set forth on Form N-1A.[169] For example, the form could require international and global funds to provide a table, chart, or graph depicting portfolio holdings by country or geographic region and a second table, chart, or graph depicting portfolio holdings by industry. Our recommended alternative would avoid adding undue length and complexity to the schedule of investments and would be more comprehensive and easier to understand.

C. Do Not Require Disclosure of Illiquidity Determinations

Each of the proposed rules in Article 12 (both those rules relating to investments in securities and investments in derivatives), other than the rule relating to securities sold short,[170] would require the fund to identify by symbol each issue of illiquid securities. The Fund Reporting Proposal indicates that liquidity is an important consideration for a fund's investors in understanding the risk exposure of a fund. The Commission believes that indicating which investments are illiquid would allow an investor to understand which holdings a fund is likely to sell at a discount if the fund must sell a portion of its investments to meet cash needs, such as redemptions or distributions. Generally, an illiquid asset is any asset which a fund may not be able to sell or dispose of in the ordinary course of business within seven days at approximately the value at which the fund has valued the investment.

Similar to our concerns discussed above in the context of Form N-PORT, we are concerned that the subjective nature of liquidity determinations may cause different funds to reach different conclusions as to the liquidity of a particular security. Further, we are concerned that independent accountants auditing the fund's financial statements will be unable to obtain sufficient evidence that would allow them to verify the fund's liquidity determinations. For these reasons, we recommend that

[169] *See* Item 27(d)(2) of Form N-1A

[170] *See* proposed rule 12-12A of Regulation S-X.

the proposed amendments to Article 12 omit the requirement to identify each issue of illiquid securities.[171]

D. Do Not Require Tax Basis Information

Certain rules under Article 12 currently require funds to disclose Federal income tax basis information. In particular, funds must disclose tax basis: (i) gross unrealized appreciation; (ii) gross unrealized depreciation; (iii) net unrealized appreciation or depreciation; and (iv) the aggregate cost of securities for each of the investments in securities of unaffiliated issuers,[172] summary schedule of investments in unaffiliated issuers,[173] and investments other than securities.[174] The proposal would require funds to disclose this Federal income tax basis information for each of the different derivatives schedules (*i.e.*, options written, futures, forwards, and swaps), and also for investments in securities sold short[175] and investments in affiliates.[176] The Commission believes that tax basis information is important to investors in investment companies, which typically are pass-through entities under Subchapter M of the Internal Revenue Code.

GAAP for investment companies requires funds to disclose the tax basis components of dividends paid (*i.e.*, from ordinary income, capital gains, or tax return of capital).[177] In addition, GAAP requires disclosure of the tax basis components of distributable earnings as of the most recent tax year-end by type: undistributed ordinary income, undistributed long-term capital gains, capital loss carryforwards, and unrealized appreciation (or depreciation).[178] This GAAP-required information enables investors to determine the amount of accumulated and undistributed earnings they may receive in the future in the form of taxable distributions.

We agree that Federal income tax basis information is important to investors in funds. Providing tax basis information for each of the different schedules under Article 12 in both the annual and semi-annual financial statements as proposed, however, is unnecessary and may confuse investors. In particular, the GAAP-required disclosures provide shareholders with a comprehensive and concise presentation of the tax basis components of dividends paid and the tax basis components of

---

[171] In our comments on Form N-PORT we have recommended that the fund identify those investments that are illiquid in the non-public portion of the filing. *See supra* Section IV.E.1.b.

[172] *See* rule 12-12 of Regulation S-X.

[173] *See* rule 12-12C of Regulation S-X.

[174] *See* rule 12-13 of Regulation S-X.

[175] *See* rule 12-12A of Regulation S-X.

[176] *See* rule 12-14 of Regulation S-X.

[177] FASB ASC 946-20-50-8.

[178] FASB ASC 946-20-50-12.

distributable earnings. These tax basis disclosures were added to GAAP relatively recently and make the long-standing Article 12 required disclosure of tax basis unrealized appreciation, unrealized depreciation, net unrealized appreciation or depreciation, and aggregate cost unnecessary and redundant. For example, gross amounts of appreciation and depreciation, and aggregate cost are unnecessary in light of the GAAP-required disclosure of the net unrealized appreciation or depreciation. Accordingly, we recommend that the Commission eliminate tax basis disclosure from each of the different Article 12 investment schedules.

We recommend eliminating the Article 12 required disclosure of tax basis information. If the Commission determines not to do so, we recommend that funds provide the disclosure for the portfolio as a whole (all securities and all derivatives combined) on an annual basis. Investors would understand more easily tax basis information relating to the portfolio as a whole. This approach would avoid the need for investors to combine tax basis information across the different investment schedules to derive the fund's overall tax position. Further, we recommend that the SEC require funds to provide tax basis information relating to the portfolio as a whole only in the annual financial statements. Annual disclosure would comport with the GAAP-required tax basis disclosure, which is required on an annual basis. Finally, we recommend that the Commission require funds to present tax basis information relating to the portfolio as a whole in the notes to the financial statements, alongside the GAAP-required tax basis components of distributable earnings.

E. Exclude Securities Lending Agent Compensation and Other Fee Information

The Regulation S-X amendments would require financial statement note disclosure regarding securities lending activities and cash collateral management. In particular, the proposed rule would require disclosure of: (i) the gross income from securities lending activities, including income from cash collateral management; (ii) the dollar amount of all fees and/or compensation paid by the fund for securities lending activities, including borrower rebates and cash collateral management services; (iii) the net income from securities lending activities; (iv) the terms governing compensation of the securities lending agent, including any revenue sharing split, with the related percentage split between the fund and the securities lending agent, any fee for service, and a description of the services provided; (v) the details of any other fees paid directly or indirectly, including any fees paid by the fund for cash collateral management and any management fee deducted from a pooled investment vehicle in which cash collateral is invested, and (vi) the monthly average value of the securities on loan.[179]

As a preliminary matter, we note that funds currently provide significant disclosures in their financial statements regarding their securities lending activities. For example, funds currently disclose the value of securities on loan at the report date, the value of the cash collateral received at the report date, a liability reflecting the obligation to return the cash collateral received to the borrower at the conclusion of the loan, and the net income from securities lending for the reporting period. In

[179] *See* proposed rule 6-03(m) of Regulation S-X.

addition, funds typically identify in the schedule of investments each issue of security on loan at the report date.

We support each of the proposed securities lending disclosures other than the terms governing the compensation of the securities lending agent, and the details of any fees paid directly or indirectly. Securities lending services and fee rates, including any revenue sharing splits, are competitively sensitive, proprietary fund information and are not appropriate for public disclosure.[180] Advisers negotiate arrangements with securities lending agents in the best interest of fund shareholders. We are concerned that disclosure of the terms governing the compensation of the lending agent along with a description of the services provided could diminish the fund's ability to negotiate the fee rates and services that best suit the needs of the fund and its securities lending program. The benefits of publicly disclosing these terms of securities lending compensation and any fees paid directly or indirectly do not outweigh the potential competitive harm that would result.

We therefore recommend that the Commission not require financial statement disclosure of the compensation of the securities lending agent, including any revenue sharing splits, and the details of any other fees paid directly or indirectly. We recommend that funds instead be required to report this information on Part D of Form N-PORT or on a separate non-public schedule.[181] So long as the terms governing compensation of the securities lending agent are kept non-public, including any revenue sharing splits, and the details of any other fees paid directly or indirectly, we support qualitative disclosure of the services provided by the securities lending agent.

F. Modify Additional Financial Statement Requirements

1. Remove Separate Disclosure Regarding *de minimis* Income

The Fund Reporting Proposal would amend Regulation S-X to require separate disclosure of cash dividends, non-cash dividends, interest on securities excluding payment in kind interest, and payment in kind interest.[182] We support the proposed separate disclosure of income by type. We recommend, however, the Commission not require funds to disclose income type where any income type represents a *de minimis* amount of the fund's total income. In particular, we recommend that the Commission include an instruction relating to the reporting of investment income, similar to that included under the reporting of expenses,[183] indicating that funds should report separately any income

[180] *See supra* Section III (discussing non-public disclosures).

[181] The "acquired fund fees and expenses" line item in a prospectus fee table would capture management and other fees paid by the fund associated with investment of cash collateral in an investment company. *See* Item 3 of Form N-1A.

[182] *See* proposed rule 6-07.1 of Regulation S-X.

[183] *See* rule 6-07.2(b) of Regulation S-X.

type that exceeds five percent of total income.[184] The Fund Reporting Proposal seeks comment on whether the Commission should require funds to separately disclose in the statement of operations all non-cash interest, including accretion of discount and amortization of premium. Shareholders do not distinguish between cash interest income and income in the form of accretion or amortization, and therefore we recommend that the Commission not require separate disclosure.

2. We Support Eliminating the Written Options Schedule

The Fund Reporting Proposal would eliminate the written options schedule required by Regulation S-X.[185] As noted in the proposal, the written options schedule was adopted by the Commission prior to FASB's adoption of disclosures applicable to derivatives, including written options. We believe the written options schedule is unnecessary in light of disclosures required by ASC Topic 815 and therefore support its elimination.

3. We Support Commission's Approach to Presenting Derivatives Schedules in the Fund's Financial Statements

The Fund Reporting Proposal would rescind the provision in Regulation S-X which enables funds to present information in the notes to the financial statements instead of in a schedule, provided that the note presentation is not unclear or confusing.[186] Some funds have interpreted this guidance to allow presentation of open derivatives contracts in the notes to the financial statements. According to the Fund Reporting Proposal, the rescission of this provision would require funds to present all schedules together within a fund's financial statements, and not in the notes. We support the rescission of the provision. The rescission combined with the proposed derivatives schedules under Article 12 of Regulation S-X will standardize and make more prominent the presentation of open derivatives contracts within the financial statements.

VII. Form N-CEN

The Commission proposes to amend the framework by which funds report census-type information by rescinding Form N-SAR and proposing Form N-CEN, which would require funds to report data publicly in a structured data format. Form N-CEN would update the reporting requirements for funds, including requiring information on, among other things, ETFs, securities lending, and variable insurance products. Funds would report annually, rather than semi-annually, as is currently required for Form N-SAR. The Commission would require funds to file the form 60 days after fiscal year-end.

---

[184] Under our recommendation, for example, a fund would not separately report payment in kind interest if that interest amounted to five percent or less of total income.

[185] *See* rule 6-07.7(c) of Regulation S-X.

[186] *See* rule 6-10(a) of Regulation S-X.

We support the Commission's efforts to enhance and streamline the census-type information that funds report. We commend the Commission for proposing to rescind Form N-SAR, which we agree is outdated, and appreciate the Commission's efforts to improve the relevance of the information it requests. Similar to our views on proposed N-PORT, discussed above, we support providing the Commission with information on Form N-CEN in a structured data format in order to facilitate the Commission's ability to most effectively utilize the data for its regulatory purposes.

We support the proposal to require this information on an annual, rather than a semi-annual basis. Requiring census-type data on an annual basis would significantly lessen reporting burdens for funds and lower costs for fund shareholders, but would still achieve the SEC's regulatory purposes.

We believe proposed Form N-CEN would benefit from further refinement in several areas, as described in more detail below.

A. Extend the Filing Period for Form N-CEN

The Commission proposes a filing period of 60 days after the end of the fiscal year, similar to the current requirement for Form N-SAR. We recommend that, in light of the additional filing burdens placed on funds by monthly filing on Form N-PORT, the Commission lengthen this filing period to at least 75 days. Providing a longer filing period will ensure that funds have adequate time to obtain the necessary data following year-end, including data that may reside in multiple systems or that funds must obtain manually.

B. Revise the "Fund of Funds" Definition

Form N-CEN would require a fund to identify whether it is any of several types of funds, including: an ETF; an exchange-traded managed fund; an index fund; a fund that seeks to achieve performance results that are a multiple, inverse, or a multiple of an inverse of a benchmark; an interval fund; a fund of funds; a master-feeder fund; a money market fund; a target date fund; or an underlying fund to a variable annuity or variable life insurance contract.[187] The item provides that a fund may check all types of funds that apply, and includes definitions for many of these funds. The SEC has

[187] *See* Item 27 of Proposed Form N-CEN. Section 12(d)(1) of the 1940 Act, in relevant part, generally prohibits a registered investment company from purchasing or otherwise acquiring securities issued by another investment company if immediately after the acquisition the registered investment company: (i) owns more than three percent of the outstanding voting stock of the acquired investment company; (ii) has more than five percent of its total assets invested in the acquired investment company; or (iii) has more than ten percent of its total assets invested in the acquired investment company and all other investment companies ("Section 12(d)(1)(A) Limits"). *See* Section 12(d)(1)(A) of the 1940 Act.

proposed defining "fund of funds" as "a fund that acquires securities issued by another investment company in excess of the amounts permitted under Section 12(d)(1)(A) of the [1940 Act]."[188]

We are concerned that the proposed definition of "fund of funds" is overly broad and would inadvertently capture many funds listed in proposed Item 27 that utilize registered money market funds as short-term cash investment vehicles.[189] We do not believe it was the Commission's intent to capture these arrangements as "fund of funds" under this item, as it would not provide the Commission with useful information about the fund's investment strategy. We therefore recommend that the Commission narrow the definition of "fund of funds" to exclude funds that invest in money market funds in amounts that exceed the Section 12(d)(1)(A) Limits, as defined in proposed Item 27. Narrowing the definition in this manner would more accurately capture as a "fund of funds" those funds that invest in other funds as part of their investment strategy, rather than those that invest in money market funds for short-term cash management purposes.

C. Revise Securities Lending Default Reporting

Form N-CEN would require a fund to disclose for the reporting period whether it lent fund securities and, if so, whether any borrower of those securities defaulted.[190] The form would require "yes/no" responses that would flag these items for follow-up, if necessary, by Commission staff.[191] The Commission seeks the information to "illuminate the commonality of borrower default" and provide information about whether any borrower "defaulted on its obligations to the management company to return loaned securities or return them on time in connection with a security on loan during that period."[192] The Commission believes this information will allow "the Commission, investors, and other potential users to assess the counterparty risks associated with borrower default in the securities lending market."[193]

We are concerned that this item could be read to require reporting of any technical default that may arise due to processing or operational issues. Reading it that way may result in many, if not all, funds engaged in securities lending customarily answering "yes" each time they file Form N-CEN, even

---

[188] *See* Instruction 1 of Item 27 of Proposed Form N-CEN.

[189] Funds often rely on rule 12d1-1 under the 1940 Act to invest in registered money market funds in excess of the limits under Sections 12(d)(1)(A) and (B) of the 1940 Act.

[190] *See* Items 30.b and 30.b.i of Proposed Form N-CEN.

[191] *See* Fund Reporting Proposal at 33634 n.366 ("For example, staff of the Office of Compliance, Inspections and Examinations may rely on responses to flag questions in Form N-CEN to indicate areas of follow-up discussion or to request additional information.").

[192] *See* Fund Reporting Proposal at 33640-41.

[193] *See id*.

though the activity the Commission is concerned about detecting has not actually occurred. To collect information that will enable the Commission to evaluate the risks associated with borrower default, we recommend that the Commission instead request disclosure about any defaults in which a fund liquidates securities lending collateral. This approach would solicit information in a more targeted way about those situations in which fund shareholders potentially could suffer a loss from a default.

While the Commission already proposes to require reporting on whether the securities lending agent or any other entity provides an indemnification against borrower defaults,[194] to ascertain the frequency of funds exercising their indemnification rights, the Commission could additionally ask if the fund exercised its indemnification rights. Asking each of these questions would illuminate the frequency of true defaults and indemnifications thereby providing the Commission with information about such counterparty defaults and the extent to which those risks are covered by third parties that provide indemnification.[195]

D. Base Closed-End Fund Management Fees on Historical Data

The Fund Reporting Proposal would require closed-end funds and small business investment companies to complete Part D of Form N-CEN. Form N-CEN would require closed-end funds to report the fund's advisory fee as of the end of the reporting period as a percentage of net assets.[196] The proposed instruction states that the fund should base the percentage on the amount incurred during the reporting period. Among other things, the Commission asks whether the fee information requested should be forward-looking or backward-looking, as proposed, providing a management fee based on fees charged during the reporting period and, if so, which NAV (*e.g.*, year-end or average) should the form use.[197]

We agree with the Commission that closed-end funds should base management fee information on historical data; therefore, the fees should be backward-looking. This approach would

---

[194] See Item 30.c.iv of Proposed Form N-CEN (asking whether the securities lending agent or any other entity indemnifies the fund against borrower default on loans administered by the agent).

[195] Indemnifications typically are triggered only if a borrower fails to return the lent securities *and* the value of the collateral is insufficient to replace those securities, neither of which is likely to occur because defaults requiring indemnification are rare and securities loans are typically over-collateralized and required to be marked-to-market daily. *See, e.g.,* Securities Lending by U.S. Open-End and Closed-End Investment Companies (Aug. 5, 2015), available at https://www.sec.gov/divisions/investment/securities-lending-open-closed-end-investment-companies.htm. Accordingly, if a default does occur, the amount of the indemnified loss (the shortfall) likely will be a small fraction of the value of the securities the borrower failed to return. As a result, the potential that a fund will suffer significant losses is remote. *See*, *e.g.*, ICI Viewpoints, Securities Lending by Mutual Funds, ETFs, and Closed-End Funds: Regulators' Concerns (Sept. 17, 2014), available at https://www.ici.org/viewpoints/view_14_sec_lending_03.

[196] *See* Item 51 of Proposed Form N-CEN.

[197] *See* Fund Reporting Proposal at 33645.

be consistent with how funds charge fees because funds do not charge fees in advance. The fee reported should reflect the fee charged during the reporting period. We therefore recommend that the Commission request that funds report the actual management fee paid as a percentage of the average NAV of the fund during the reporting period, as this will provide the most meaningful information in response to this item.

VIII. Proposed Rule 30e-3: Shareholder Report Delivery

A. Introduction

Proposed rule 30e-3 would permit funds to make shareholder reports available on their websites rather than having to deliver printed paper reports to shareholders via U.S. mail (hereinafter referred to as "print" or "paper" shareholder reports), provided the fund satisfies certain conditions. A fund seeking to do so would have to: (i) obtain implied consent from shareholders; (ii) provide notices of the availability of each shareholder report on the website via U.S. mail to consenting shareholders; and (iii) deliver print shareholder reports to requesting shareholders.

To obtain a shareholder's consent, the proposed rule would require a fund to mail to the shareholder an Initial Statement at least 60 days before it begins to rely on the rule. The Initial Statement would notify the shareholder of the fund's intent to make future shareholder reports available on the fund's website and alert the shareholder to the fact that he or she would no longer receive print reports unless the shareholder notifies the fund of a preference for them. Thereafter, the fund would mail a Notice to the shareholder in connection with the publication of each shareholder report, notifying the shareholder that the report is available online and again providing information on how to obtain a paper copy of the report.

We strongly support the Commission's proposal to provide funds with an optional method to satisfy shareholder report transmission requirements by posting such reports online if they meet certain conditions.[198] The proposal is consistent with earlier Commission efforts to modernize the manner in which information is transmitted to fund shareholders and to improve accessibility by taking advantage of technology for the benefit of investors. We commend the Commission for recognizing and seeking

[198] The New York Stock Exchange ("NYSE") Mutual Fund Working Group also expressed support for electronic delivery of shareholder reports. In particular, the NYSE Mutual Fund Working Group noted that the shareholder report delivery requirements for funds are inconsistent with the requirements for operating companies. Operating companies are currently permitted to use "notice and access" to satisfy their shareholder report delivery obligation, but the SEC rules regarding "notice and access" do not apply to funds' obligations to provide shareholder reports under the 1940 Act. *See* Letter from Scott R. Cutler, EVP, Head of Global Listings, NYSE Euronext, to Dorothy M. Donohue, Deputy General Counsel – Securities Regulation, Investment Company Institute, dated January 23, 2014. The Commission's proposal would resolve this discrepancy.

to capitalize on the advantages that technology can offer given that many investors now prefer enhanced availability of information on the Internet.[199]

Recent Commission investor testing efforts and other empirical research concerning investors' preferences about information transmission methods and use of the Internet for financial and other purposes generally underscore the importance of this initiative.[200] A 2014 ICI survey found that 94% of U.S. households owning mutual funds had Internet access (up from 68% in 2000), with widespread use among various age groups, education levels and income levels.[201] The ICI also found that with increased ease of access, investors also increasingly prefer enhanced availability of financial information on the Internet. In fact, in 2013, an ICI survey found that 82% of U.S. households owning mutual funds used the Internet for financial purposes.[202]

Other federal agencies have also recognized this trend in their rulemaking, including the Consumer Financial Protection Bureau ("CFPB"), which Congress specifically established to ensure that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and service are fair, transparent, and competitive.[203] The CFPB recently finalized a rule permitting financial institutions to satisfy certain privacy notice transmission requirements by posting the privacy notice online and informing consumers annually via U.S. mail

---

[199] We find it unsurprising that a number of commenters from the paper, envelope, and related industries oppose proposed rule 30e-3. *See generally* comments on Fund Reporting Proposal at http://www.sec.gov/comments/s7-08-15/s70815.shtml. We also note that a recent press article described at least one commenter as an individual wanting paper versions of shareholder reports without indicating the commenter's apparent experience as an executive officer at an envelope company. *See Paper Lovers Slam SEC Modernization Proposal*, Ignites (July 24, 2015). We support the proposal's requirement that funds deliver paper versions of shareholder reports to those shareholders who, like this commenter, affirmatively desire them.

[200] *See* Fund Reporting Proposal at 33626. We note that several commenters opposing proposed rule 30e-3 have referenced a 2012 investor testing study by Siegel & Gale LLC. *Investor Testing of Selected Mutual Fund Annual Reports (Revised)*, Siegel & Gale LLC at 181-185 (submitted to the SEC on Feb. 9, 2012), available at http://www.sec.gov/comments/s7-08-15/s70815-3.pdf. The Siegel & Gale survey, however, asked a limited group of investors each to indicate a singular preference for *receiving* information about their investments (in print or electronically), and then asked them their preference for *reading* an annual report in print or electronically. Neither of these limited choices is presented by proposed rule 30e-3, nor did the Siegel & Gale survey acknowledge that shareholders effectively pay a higher cost for paper delivery.

[201] *See 2015 Investment Company Fact Book, 55th edition*, Investment Company Institute, at 129, available at https://www.ici.org/pdf/2015_factbook.pdf. For example, the study found the following with respect to Internet access in mutual fund owning households: (1) head of household age 65 or older, 86% have access, (2) education level of high school diploma or less, 84% have access, and (3) household income of less than $50,000, 84% have access.

[202] *See 2014 Investment Company Fact Book, 54th edition,* Investment Company Institute, at 115-117, available at https://www.ici.org/pdf/2014_factbook.pdf.

[203] *See* 12 U.S.C. § 5511 (Dodd-Frank Act § 1021).

about the availability of the disclosures.[204] In moving toward a notice and access model for delivery of certain privacy notices, the CFPB noted that U.S. household Internet access has increased drastically from 2000 to 2012, thus making easy access to electronic notices significantly more widespread.[205]

Of even greater relevance to proposed rule 30e-3, many investors prefer to access mutual fund documents on the Internet. Investor testing sponsored by the Commission and conducted in 2011 suggested that an investor looking for a fund's annual report is most likely to seek it out on the fund's website, rather than request it by mail or phone or by retrieving it from the Commission's EDGAR system.[206] Recent investor testing and general Internet usage trends have highlighted that preferences about electronic delivery of information have evolved, and that many investors would prefer enhanced availability of fund information on the Internet.[207]

We enthusiastically support adoption of rule 30e-3. Not only would the proposed rule satisfy investor preferences, it has the potential to save fund shareholders an estimated $140 million per year on a net basis in the first three years of adoption. Savings, however, do not begin until the second year, as the cost of the proposed Initial Statement and two notices in the first year outweigh the savings from no longer printing and mailing the shareholder reports. If the Commission adopted the few minor modifications to rule 30e-3 that we recommend in Section VIII.B, potential net savings for fund

---

[204] *Amendment to the Annual Privacy Requirement under the Gramm-Leach-Bliley Act (Regulation P)*, 79 Fed. Reg. 64047 (Oct. 28, 2014), available at http://www.gpo.gov/fdsys/pkg/FR-2014-10-28/pdf/2014-25299.pdf ("CFPB Final Release").

[205] *Amendment to the Annual Privacy Requirement under the Gramm-Leach-Bliley Act (Regulation P)*, 79 Fed. Reg. at 27218 (Oct. 28, 2014), available at http://www.gpo.gov/fdsys/pkg/FR-2014-10-28/pdf/2014-25299.pdf (citing to U.S. Census data and the Pew Internet Research Project). *See also U.S. Census data, Households with a Computer and Internet Use: 1984 to 2012*, available at https://www.census.gov/hhes/computer/publications/2012.html and Pew Research Internet Project, available at http://www.pewinternet.org/2014/02/27/summary-of-findings-3/. Similar to proposed rule 30e-3, the CFPB's new privacy notice delivery option requires a financial institution to promptly mail its current privacy notice to those customers who request it by telephone. The CFPB implemented this requirement to assist customers without Internet access and customers with Internet access who would prefer to receive a hard copy of the notice, so that all customers could receive whatever form of privacy notice they prefer. CFPB Final Release at 64070-71.

[206] *See* Fund Reporting Proposal at 33627. In fact, when asked "If you wanted to see a mutual fund annual report, how would you access/obtain the report? Please check all that apply." 59.5% of respondents selected "look on the mutual fund company's website," compared with 33.3% who selected "ask my financial advisor," 24.5% who selected "request by mail," 21.0% who selected "do a web search (Google, etc.)," 18.8% who selected "request by phone," 12.3% who selected "check with my employer's HR or employee benefits representative," 11.3% who selected "look on the SEC's website or on EDGAR," and 2.3% who selected "other." *Id.*

[207] *See* Fund Reporting Proposal at 33636. A few commenters opposing proposed rule 30e-3 have suggested that the proposed rule 30e-3 delivery option will reduce the number of shareholders who read their funds' annual and semiannual reports. However, there are no current figures on the percentage of shareholders who currently read their hard copy reports and no reliable means of obtaining these figures. As such, it is not possible to conclude that fewer shareholders will read reports online, since we have no way of knowing what percentage of shareholders currently read their hard copy reports.

shareholders could more than triple to a total of $465 million over a three-year timeframe.[208] Our recommended modifications are expected to result in substantial net savings in the first year and significantly higher net savings each year thereafter as compared to the rule as proposed. We provide a more detailed cost-benefit analysis in Section VIII.C and Appendix B.

1. The Commission Should Extend This Delivery Approach to Prospectuses

We recommend that the SEC also allow funds to deliver summary and statutory prospectuses to shareholders via the Internet using an implied consent framework or other similar means. We long have encouraged the Commission to allow electronic delivery of this information given the potential for cost savings to shareholders.[209] Therefore, we were very pleased to see the Commission's request for comment on this.

Moving regulatory policy in this direction makes sense. First, it would avoid significant, needless costs to fund shareholders. Our prior research in connection with the summary prospectus rule estimated print costs for annual fulfillment at $123 million[210] and the Commission's estimate was similar.[211] Updating for an increase in the cost of standard postage and growth in both shareholder accounts and e-delivery in the intervening years, ICI estimates annual fulfillment of summary prospectus costs approximately $94 million per year.[212] If the SEC adopted a similar implied consent approach for prospectuses, funds would be able to mail Initial Statements and Notices alerting shareholders that their summary prospectuses were posted on a website. This approach, if the same as proposed for shareholder reports, would save funds, on a net basis, an estimated $11 million annually.[213]

---

[208] Our cost savings analysis in Appendix B only addresses our recommended modification to eliminate the requirement to mail a postage-paid reply form with the Initial Statement and Notice. Adoption of our other recommended modifications would provide additional, likely substantial savings. *See* Section VIII.B for an explanation of our other recommended modifications to proposed rule 30e-3.

[209] *See, e.g.*, Letter to Nancy M. Morris, Secretary, Securities and Exchange Commission, from Karrie McMillan, General Counsel, Investment Company Institute, dated Feb. 28, 2008, at n.3, available at http://www.ici.org/pdf/22290.pdf ("2008 ICI Letter").

[210] *See id.* at B-9.

[211] *See id.*; *see also Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies*, SEC Release Nos. 33-8861, IC-28064 (Nov. 21, 2007), available at http://www.sec.gov/rules/proposed/2007/33-8861.pdf.

[212] We calculated this estimate as the sum of unit print costs of $0.17 (*see* 2008 ICI Letter, at B-10) and standard bulk rate postage of $0.28 multiplied by an estimated 208 million summary prospectuses that were printed and mailed in 2014. We derived the 208 million summary prospectus figure from applying an 85% opt-in rate for summary prospectus to an estimate of 430 million shareholder accounts and then adjusting for an e-delivery rate of 43% (430 million*.85*.57 = 208 million). For more information on the estimated 430 million shareholder accounts and e-delivery rate, *see* Appendix B, at n.5.

[213] We calculated this estimate as the difference between current estimated cost to print and mail summary prospectuses ($94 million) and the estimated cost for one Notice ($83 million), assuming that funds can bundle the Initial Statement

If, however, the Commission adopts our recommendation to remove the postage-paid reply form requirement, the annual net cost saving would increase to $25 million, ultimately providing more cost savings for fund shareholders without sacrificing investor protection.[214]

Second, as with shareholder reports, this approach would preserve the option for shareholders to receive a paper prospectus. We appreciate that different investors may have different preferences regarding how they receive mutual fund information.[215] Importantly, proposed rule 30e-3 is designed to accommodate the preferences of *all* of these investors, while providing substantial cost savings to fund shareholders. Extending the Commission's proposed approach to prospectus delivery would allow investors to receive any or all of their prospectuses both in print and online, and would permit them to change this preference at any time. The proposed rule maintains the paper option for investors who wish to receive reports in paper and reminds them of this option twice per year, while also lowering costs for all fund shareholders. This approach should be extended to prospectuses.

Third, simplifying the prospectus delivery requirement would help facilitate ongoing efforts to shorten the securities settlement cycle by automating this step in the securities settlement process.[216] The shortening of the settlement cycle, in turn, will increase the overall efficiency of the securities markets and promote financial stability.[217]

For all these reasons, we strongly urge the SEC to move forward in adopting an implied consent option (or other reasonable means) for electronic delivery of prospectuses.

---

mailing together with the summary prospectus or other permissible accompanying documents. *See* proposed rule 30e-3(c)(3). We calculate the $83 million estimate by multiplying the sum of unit print costs ($0.12, *see* 2008 ICI Letter, at B-10) and standard bulk rate postage ($0.28) by an estimated 208 million summary prospectuses. We assume the bulk standard postage rate because, if funds were required to mail the summary prospectus notice at the pre-sort first class rate of $0.42, there would be no net cost savings to the proposal.

[214] We calculated this estimate as the difference between current estimated cost to print and mail summary prospectuses ($94 million) and the estimated cost for one postcard notice ($69 million). The $69 million estimated is calculated by multiplying the sum of unit print costs ($0.05, *see* Appendix B, at B-5) and first-class pre-sort postcard rate ($0.28) by an estimated 208 million summary prospectuses.

[215] For example, one member receives several complaints each year from investors expressing concern over receiving too many regulatory mailings.

[216] *See* Letter from Paul Schott Stevens, President & CEO, Investment Company Institute, and Kenneth E. Bentsen, Jr., President & CEO, Securities Industry and Financial Markets Association, to Mary Jo White, Chair, Securities and Exchange Commission, dated June 18, 2015.

[217] *See id. See also* White Paper, *Shortening the Settlement Cycle: The Move to T+2*, Shortened Settlement Cycle Industry Steering Committee (ISC) (2015), available at http://www.ust2.com/pdfs/ssc.pdf?n=83191.

2. The Commission Should Further Enhance Consistency with Existing Regulatory Requirements, Reduce Burdens, and Increase Cost Savings

The Commission should take a number of additional steps to facilitate the use of proposed rule 30e-3, reduce operational burdens, increase efficiency, and provide additional cost savings for fund shareholders. Our comments are intended to ensure that compliance with the Commission's proposed framework results in delivery of information to shareholders in a manner that improves the information's overall accessibility while reducing burdens such as printing and mailing costs borne by fund shareholders. The following recommended modifications and clarifications also would enhance consistency with existing requirements.[218]

B. Enhance Consistency with Existing Regulatory Requirements and Reduce Burdens

The Commission described the elements of proposed rule 30e-3 as generally being consistent with similar conditions in other Commission rules, including rules regarding the use of a summary prospectus,[219] Internet delivery of proxy materials[220] and "householding" of certain disclosure documents.[221] We highlight below areas where increased consistency with existing regulation would offer clarification and reduce operational burdens, providing cost savings to fund shareholders.

[218] The Commission noted that the rule 30e-3 conditions are substantially similar to certain of the conditions relating to the Commission's rules on "householding" prospectuses, shareholder reports, and proxy statements and information statements to investors who share an address. *See, e.g.*, rule 154 under the Securities Act of 1933 ("Securities Act") (permitting householding of prospectuses); rules 30e-1 and 30e-2 under the 1940 Act (permitting householding of fund shareholder reports); rules 14a-3 and 14c-3 under the Exchange Act (permitting householding of proxy statements and information statements). *See generally* Delivery of Disclosure Documents to Households, SEC Release Nos. 33-7766; 34-42101; IC-24123 (Nov. 4, 1999) (adopting householding rules with respect to prospectuses and shareholder reports); *Delivery of Proxy Statements and Information Statements to Households*, SEC Release Nos. 33-7912; 34-43487;IC-24715 (Oct. 27, 2000) (adopting householding rules with respect to proxy statements and information statements). For purposes of the householding rules, funds may obtain written or implied shareholder consent.

[219] *See* rule 498 under the Securities Act. *See also Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies*, Release. Nos. 33-8998, IC-28584 (Jan. 13, 2009), available at https://www.sec.gov/rules/final/2009/33-8998.pdf.

[220] *See* rule 14a-16 under the Exchange Act. *See also Shareholder Choice regarding Proxy Materials*, Exchange Act Release No. 56135 (July 26, 2007), 72 Fed. Reg. 42222 (Aug. 1, 2007).

[221] *See* rule 14a-3 under the Exchange Act ("householding" rules).

1. Remove Postage-Paid Reply Form Requirement and Permit Inclusion of Other Methods of Communication

Rule 30e-3 would require funds to provide on Initial Statements and Notices a toll-free phone number and enclose a pre-addressed, postage paid reply form that shareholders could use to contact the fund to express a preference for delivery of paper shareholder reports.[222]

We recommend that the Commission only require funds to provide shareholders with a toll-free phone number **or** a pre-addressed, postage paid reply form. Provision of a toll-free telephone number is sufficient to provide investors with a means to obtain paper copies of shareholder reports or to opt out of electronic delivery. Requiring a pre-addressed, postage paid reply form would be burdensome and expensive without a corresponding benefit for investors. Members have informed us that shareholders do not use postage paid envelopes, with rates of return as low as 2%. Given this low return rate, many members no longer have postage paid licenses and therefore no longer have the capability to provide postage paid envelopes.

Our recommended approach would align the proposed rules with the Commission's rules regarding online posting of proxy materials, as the Commission says it intended.[223] The notice requirements in those rules permit, but do not require, the inclusion of a postage-paid envelope.[224] The Commission also considered requiring a postage-paid envelope in the context of allowing shareholders to opt out of householding of proxy statements. In that case, the Commission determined that the notice that funds would need to send to shareholders for opting out of householding of proxy statements should contain a phone number **or** postage-paid reply form, rather than both.[225]

We also recommend permitting funds to inform shareholders of additional means of contact for paper report requests, including via fax, e-mail, or website (rather than just phone or U.S. mail, as proposed). This would provide shareholders with additional flexibility with respect to which method they can use to request paper reports. Many shareholders now communicate with funds electronically, via e-mail or a website, rather than strictly via telephone or the mail. Under our recommended approach, shareholders would be able to communicate their preferences using means that are more reflective of how shareholders communicate with funds today.

---

[222] *See* proposed rules 30e-3(c)(1)(iii) and (d)(1)(vi). Proposed rule 30e-3 generally would require funds to draft Initial Statements and Notices using plain English principles. Initial Statements and Notices also must contain a prominent legend in bold-face type and provide information about the availability of shareholder reports online, as well as information about how to request paper copies of reports. *See* proposed rules 30e-3(c)(1) and (d)(1).

[223] *See* Fund Reporting Proposal at 33629.

[224] *See* rule 14a-16 under the Exchange Act.

[225] *See* rule 14a-3 under the Exchange Act.

2. Permit Other Important Materials to Accompany the Initial Statement and Notice

The proposed rule would not allow other shareholder communications to accompany the Initial Statements or Notices (with the exception of the fund's current summary prospectus, statutory prospectus, statement of additional information, or Notice of Internet Availability of Proxy Materials under rule 14a-16 under the Exchange Act).[226] The SEC has requested comment on whether it should permit the Initial Statements and Notice to accompany one or more other documents.

We recommend permitting important account materials to accompany Initial Statements and Notices.[227] Investors would be more likely to read Initial Statements and Notices if accompanied by materials such as account statements, new account applications, new account welcome kits, Notices from other funds with the same fiscal year-end, or dividend checks. Investors would be more likely to attend to five Notices bundled together in the same envelope, for example, than five separate envelopes, each with its own Notice. We also recommend expanding the permissible accompanying materials to permit the inclusion of the relevant contract statutory prospectus in the context of variable insurance products.[228]

Ultimately, the requirement for any Initial Statement or Notice to contain a prominent legend stating its purpose should help ensure that investors comprehend its purpose. The Commission previously considered this issue when constructing the proxy statement and information statement householding rules. In that instance, the Commission concluded that companies could mail the householding notice with other communications, including account statements, dividend checks, or shareholder reports, as long as there was a prominent legend on both the notice and the envelope containing it (if the notice is mailed with other shareholder communications).[229]

---

[226] *See* proposed rules 30e-3(c)(1)(v)(3) and (d)(4). *See also* Fund Reporting Proposal at 33629.

[227] Our recommendation would be consistent with requirements for opting out of householding of proxy statements. *See supra* note 218.

[228] Consistent with our recommended approach, the SEC permits contract statutory prospectuses to accompany summary prospectuses. *See* rule 498(c)(2) under the Securities Act.

[229] The proposed proxy statement and information statement householding rules would have required companies to mail the notice of intent to household separately from other security holder communications. *See Delivery of Proxy and Information Statements to Households*, Release Nos. 33-7767, 34-42102, IC-24124 (Nov. 16, 1999), available at https://www.sec.gov/rules/proposed/33-7767.htm. The Commission's final rule relaxed that requirement to allow funds to mail those notices with other communications, such as, for example, account statements, dividend checks or security holder reports, and added a prominent legending requirement for additional clarity. *See Delivery of Proxy and Information Statements to Households*, Release Nos. 33-7912, 34-43487, IC-24715 (Nov. 1, 2000), available at https://www.sec.gov/rules/final/33-7912.htm.

We recognize the importance of alerting shareholders to the availability of a new electronic shareholder report. Although we view the Notices as an effective tool to raise investor awareness of such availability, we believe that shareholders would be more likely to review the Notices if coupled with other materials that interest an investor, such as account statements, new account applications, new account welcome kits, and dividend checks. In addition to likelihood of shareholder review, allowing funds to bundle the Initial Statement with other materials would create a substantial increase in net savings in the first year of adoption.[230] If the Commission permits this approach, we would not object to providing a prominent legend on the Notice and the envelope containing the Notice and accompanying materials, consistent with the householding rules.

3. Permit Consolidated Notice for Funds with Same Fiscal Year-End

We recommend that the Commission allow funds the option to create a single, consolidated Notice for funds with the same fiscal year-end. Under this approach, an investor would receive one Notice with the necessary information for five funds with the same fiscal year-end, with the option to request delivery of a paper report for any or all of the funds. Under the rule as proposed, this investor would otherwise receive five separate Notice mailings at the same time. A consolidated Notice option would increase the likelihood of investor review, while adding to shareholder cost savings.

4. Clarify the Role of Intermediaries

The SEC has requested comment on what impact, if any, the proposed rule would have on the transmission of reports to shareholders holding fund shares through financial intermediaries, including insurance companies with respect to variable insurance products,[231] or other omnibus type arrangements.[232] Proposed rule 30e-3 does not address if or how the Commission might permit intermediaries to act on behalf of the fund in satisfying a fund's obligation to deliver shareholder reports, Notices, or Initial Statements.[233]

We recommend that the Commission state in any final rule that funds or financial intermediaries, including insurance companies with respect to variable insurance products, are

---

[230] Separate mailing of the Initial Statement as proposed by the Commission is expected to cost fund shareholders an additional $127 million. For more detailed information, *see* Appendix B.

[231] Proposed rule 30e-3 also would extend to the transmission of reports to shareholders of UITs required pursuant to rule 30e-2 under the 1940 Act. The SEC has requested comment on what impact, if any, the proposed rule would have on the transmission of reports to these shareholders. In some cases, UITs are mutual funds that are available for investment as underlying investment options in variable annuity contracts. UITs sometimes also are referred to generally as "insurance funds" or "underlying funds."

[232] *See* Fund Reporting Proposal at 33631.

[233] The proposed rule has only one mention of intermediaries, requiring the fund or a financial intermediary to transmit paper shareholder reports upon request. *See* proposed rule 30e-3(f).

permitted to deliver Initial Statements and Notices. The final rule should permit intermediaries to act as an agent on behalf of funds as they are permitted to act with respect to other fund communications.[234] This approach is critically important given the role of intermediaries in communicating with fund shareholders who are their clients, and particularly for shares held in omnibus accounts. Our approach also is consistent with the aspect of the rule that requires the fund or the financial intermediary to transmit paper shareholder reports upon request,[235] as well as existing regulatory requirements.[236]

5. Permit Initial Statement and Notice to Include Option for Affirmative Consent to E-Delivery

The proposed rule would not permit the Notice to contain any information other than that required by the proposed rule.[237] The proposed rule, however, is silent as to whether the Initial Statement may contain additional information other than that required.[238]

The SEC requested comment on whether it should permit the Initial Statement and Notice to contain any additional information other than that specified in the rule.[239] Absent any requirement specified by rule, the SEC also sought comment on what other information funds generally would include in these documents. In addition to general information, the SEC specifically asked whether the Initial Statement and Notice should include the option to affirmatively consent to e-delivery.[240]

We strongly recommend allowing funds to add information to the Initial Statement and Notices alerting shareholders to the option to affirmatively consent to e-delivery. Doing so would permit funds to better satisfy investor preferences. The inclusion of this information also would generate additional cost savings for fund shareholders since investors who opt for e-delivery after receiving the Initial Statement in the mail would not receive paper Notices.

Given the evolving preferences and trends towards electronic receipt of information, in particular with regard to the delivery of financial information, this recommendation would serve

---

[234] *See, e.g.,* rule 14a-3 under the Exchange Act.

[235] *See* proposed rule 30e-3(f).

[236] *See supra* note 218.

[237] *See* proposed rule 30e-3(d)(3).

[238] *See* proposed rule 30e-3(c).

[239] *See* Fund Reporting Proposal at 33632.

[240] *Id.*

investors, by providing them with the option on the Initial Statement and Notices to affirmatively consent to e-delivery on a going forward basis.[241]

6. Permit "Householding" of Initial Statement

Similar to the Commission's rules on householding prospectuses, shareholder reports, and proxy statements and information statements,[242] proposed rule 30e-3 also would allow funds to send one Notice to shareholders who share an address so long as the fund addresses the Notice to the shareholders individually or as a group.[243] The SEC has sought comment on whether it also should permit funds to send the Initial Statement in a "householded" manner, as proposed for the Notice.

We recommend allowing funds to "household" the Initial Statement as proposed for the Notice. The Commission has deliberately constructed an appropriate regulatory framework for householding of prospectuses, shareholder reports, and proxy statements and information statements. We see no reason to treat Initial Statements differently.

C. Improve Cost Savings

The extent of net cost savings from reliance on proposed rule 30e-3, if adopted, is expected to vary among fund complexes based on length of shareholder report, unit print costs, and extent of shareholder accounts held at broker-dealers. In the aggregate, ICI estimates that the proposed rule

---

[241] Any e-delivery affirmative consent option would follow prior Commission guidance with respect to e-delivery notice, access and delivery (*i.e.*, appropriate scope and duration of consent). *See generally Use of Electronic Media for Delivery Purposes*, SEC Release Nos. 33-7233; 34-36345; IC-21399 (Oct. 6, 1995) (providing Commission views on the use of electronic media to deliver information to investors, with a focus on electronic delivery of prospectuses, annual reports to security holders and proxy solicitation materials under the federal securities laws); *Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information*, SEC Release Nos. 33-7288; 34-37182; IC-21945; IA-1562 (May 9, 1996) (providing Commission views on electronic delivery of required information by broker-dealers, transfer agents and investment advisers); *Use of Electronic Media*, SEC Release Nos. 33-7856; 34-42728; IC-24426 (Apr. 28, 2000) (providing updated interpretive guidance on the use of electronic media to deliver documents on matters such as telephonic and global consent).

More recently, the Division of Investment Management published guidance stating the staff's position that electronic delivery of a notice pursuant to rule 19a-1 under the 1940 Act, consistent with the Commission's electronic delivery guidance, would satisfy the purposes and policies underlying the rule. *See* Division of Investment Management, Securities and Exchange Commission, *Shareholder Notices of the Sources of Fund Distributions – Electronic Delivery*, IM Guidance Update No. 2013-11 (Nov. 2013), available at http://www.sec.gov/divisions/investment/guidance/im-guidance-2013-11.pdf.

[242] *See, e.g.,* rule 154 under the Securities Act (permitting householding of prospectuses); rules 30e-1 and 30e-2 under the 1940 Act (permitting householding of fund shareholder reports); rules 14a-3 and 14c-3 under the Exchange Act (permitting householding of proxy statements and information statements).

[243] *See* proposed rule 30e-3(d)(5).

would create additional costs of $38 million in the first year, due to the mailing of the Initial Statement, with annual net savings of $89 million thereafter, for a total of $140 million in net savings within the first three years of adoption.

Potential net savings for fund shareholders would more than triple to $465 million within the first three years of adoption if the Commission adopted the few minor modifications to rule 30e-3 that we recommend in Section VIII.B. For example, if the Initial Statement and Notice were modified slightly to eliminate the requirement to include a pre-addressed postage paid reply form, funds would then be able to mail a postcard to fulfill the Notice requirement. ICI estimates that this approach would produce estimated net savings for fund shareholders of $101 million in the first year and $182 million per year thereafter.[244] We expect this alternative, which we believe is fully consistent with the Commission's regulatory objective, to have a substantially higher adoption rate as it would be significantly more cost effective for more fund complexes than the proposed requirement.

In Appendix B to our letter, we provide more detailed analysis regarding the estimated net cost savings for rule 30e-3 as proposed, as well as for a modified version of the rule without the postage-paid reply form requirement.

Our analysis of cost savings assumes that NYSE rule-based processing fees would be lower for shareholder accounts that receive website delivery of shareholder reports as a result of adoption of proposed rule 30e-3. There are three fees under NYSE rules that are relevant to this discussion: a $0.07 blended rate per account "notice and access" processing fee,[245] a $0.10 per account "preference management" fee,[246] and a $0.15 per account "processing fee" for actually mailing shareholder reports.[247] The fees are paid for each broker-held fund shareholder account.

As a general practice, broker-dealers contract with third party mail houses to process and mail required fund documents, such as annual reports and prospectuses. NYSE Rules 451 and 465 have processing fees that apply to fees for these services. Ultimately, fund shareholders bear these costs through their ownership of fund shares.

Under NYSE rules, a fund pays a "notice and access" processing fee when the fund utilizes "notice and access" for a proxy distribution. The amount of the fee varies based on several factors. For our analysis, we estimate the fee to be about $0.07 per broker-held shareholder account.[248] ICI assumes

---

[244] Adoption of our other recommended modifications outlined in Section VII.B would provide additional, likely substantial savings.

[245] *See* NYSE rule 451.90(5).

[246] *See* NYSE rule 451.90(4)(b).

[247] *See* NYSE rule 451.90(3).

[248] *See* Appendix B, at n.13.

that funds that utilize the delivery mechanism provided under Rule 30e-3 will pay a similar "notice and access" fee because those funds will be required to mail notices of shareholder reports.

NYSE rules also prescribe a $0.10 per account "preference management" fee. This fee is for suppression of paper shareholder reports under current rules.

ICI assumes and seeks confirmation that this fee is not applicable to, and therefore would not be paid by, funds utilizing the disclosure mechanism under rule 30e-3. The NYSE's justification for this fee is the purported significant processing work involved in keeping track of the shareholders' election not to receive a paper report.[249] According to the NYSE, the broker-dealer (or, most likely, its vendor) needs to look at each account position relative to each shareholder meeting or proxy distribution event to determine whether a paper mailing has been eliminated. This fee is intended to compensate the broker-dealer or vendor for those efforts.[250]

This "preference management" fee assumes the need to deliver a paper copy of a shareholder report, an assumption that will change under rule 30e-3, except for any shareholders who affirmatively elect such delivery. Because website transmission of shareholder reports will be the operational default for those funds that operate under the rule, there will be nothing for the intermediary or its vendor to suppress. The "preference management" fee therefore is not applicable and should not be paid.

We strongly urge the Commission to confirm our understanding that the "preference management" fee will not be applicable to funds that elect the delivery mechanism under rule 30e-3, if adopted. Doing so is critical to preserving the proposed rule's cost savings for fund shareholders. Indeed, if funds were required to pay those fees, the unintended effect would be simply redirecting to third-party mail house vendors the very cost savings intended for the benefit of fund shareholders. As explained in our cost savings analysis, the total cost of NYSE processing fees for the Notice mailings would be more than double if the "preference management" fee applies. For the two annual Notice

---

[249] *See Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Proposed Rule Change Amending NYSE Rules 451 and 465, and the Related Provisions of Section 402.10 of the NYSE Listed Company Manual, which Provide a Schedule for the Reimbursement of Expenses by Issuers to NYSE Member Organizations for the Processing of Proxy Materials and Other Issuer Communications Provided to Investors Holding Securities in Street Name and to Establish a Five-Year Fee for the Development of an Enhanced Brokers Internet Platform*, SEC Release No. 34-68936 (Feb. 15, 2013), 78 Fed. Reg. at 12386.

[250] We previously have objected to the existing proxy distribution fee system, including questioning whether the overall level and structure of the fees reflected in the NYSE rules are 'reasonable' or an 'equitable' allocation of fees. *See* Letter to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, from Dorothy M. Donohue, Deputy General Counsel, Investment Company Institute, dated June 20, 2013, available at https://www.ici.org/pdf/27325.pdf; Letter to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, from Dorothy M. Donohue, Deputy General Counsel, Investment Company Institute, dated March 15, 2013, available at https://www.ici.org/pdf/27124.pdf; Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Ms. Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, dated October 20, 2010, available at http://www.ici.org/pdf/24637.pdf.

mailings, NYSE processing fee costs would increase from $16 million ($8 million per Notice mailing for "notice and access" fees) to $40 million ($16 million plus $24 million for "preference management" fees).[251] Funds that elect the proposed rule's delivery mechanism would, in fact, pay more under NYSE rules not to send the shareholder reports than they pay to actually send them—a nonsensical result.[252]

D. Permit Implied Consent to Cover Multiple Funds

Under the proposed rule, a fund must meet the notice requirement in order to obtain implied consent from an investor.[253] As currently proposed, a registrant offering multiple series would need to obtain a separate implied consent from a shareholder for each series held by the shareholder.[254] This means that an investor would receive a separate Initial Statement for each fund and each series within that fund in which he or she is invested.[255] The SEC requested comment on whether it should permit a shareholder's implied consent to cover multiple funds.[256]

The proposed rule does not describe clearly how it would apply to investments in new funds. However, it appears that whenever an investor purchases a new fund, the possibility exists that the fund would have to deliver a printed shareholder report, since the fund would not be able to rely on the proposed rule until at least 60 days after mailing the Initial Statement to the investor.[257] This issue would cause particular problems for investors in variable annuity products, which are structured so that shareholders can change investments frequently in funds over the course of their investment lifecycle. Receiving shareholder reports via mail for certain periods, while receiving shareholder reports via website delivery for other periods, would create needless confusion and create inconsistencies in investor expectations.

Provided immediately below is our recommended approach for obtaining consent from shareholders who hold funds directly with a fund complex and for shareholders who hold funds through an intermediary, with respect to both existing and new investments.

---

[251] This $24 million estimate assumes the $0.10 "preference management" fee multiplied by twice-yearly Notice mailings of 120 million Notices each ($0.10 x 240 million Notices). *See* Appendix B.

[252] Funds currently pay $0.15 in NYSE processing fees for each hard copy shareholder report mailed to a broker-held account. If the Commission views as permissible the charging of a "preference management" fee for "suppression" of paper shareholder reports for a fund electing to utilize rule 30e-3, a fund would pay $0.17 per account ($0.10 "preference management" fee + $0.07 "notice and access" fee). These fees add up.

[253] *See* proposed rule 30e-3(c).

[254] *See* Fund Reporting Proposal at 33632.

[255] In the context of variable insurance products, an investor may hold an insurance product that has a contract with 30-40 underlying funds.

[256] Fund Reporting Proposal at 33632.

[257] *See* proposed rule 30e-3(c)(1).

1. ***Direct holdings of funds in the same complex***. For shareholders who directly hold multiple funds in the same complex, we recommend permitting shareholders to provide implied consent as to all funds in a complex. Funds would accomplish this by mailing one consolidated Initial Statement that lists all of the shareholder's investments in the fund complex. This approach would permit shareholders to opt for paper delivery with respect to each fund.

   Shareholders' implied consent should carry through to any new fund investment in that complex, so that shareholders would not receive multiple Initial Statements from the same fund complex. This approach would not sacrifice a shareholder's ability to change its preference for the manner of delivery because the semi-annual Notice mailings would continue to alert shareholders of the availability of new shareholder reports and give them the ongoing option to request paper delivery.

2. ***Indirect holdings of funds through an intermediary***. For shareholders who hold funds through accounts with an intermediary (including an insurance company with respect to variable insurance products),[258] we recommend permitting the intermediary to send one consolidated Initial Statement that lists all of the shareholder's investments through that intermediary. We strongly urge the Commission to permit this approach given that investors are used to receiving consolidated communications from intermediaries.

   Shareholders' implied consent would carry through to any new fund investment through that intermediary, so that shareholders would not receive multiple Initial Statements from the same intermediary. The semi-annual Notice mailings would continue to alert shareholders of the availability of new shareholder reports and give them the ongoing option to request paper delivery.

In the absence of such a targeted approach, separate Initial Statements would inundate investors for each fund that they own. An investor receiving a dozen Initial Statements would be less likely to read any individual one. Moreover, separate Initial Statements for each fund investment inevitably would result in the confusion of some shareholders receiving an occasional paper report.

In addition to facilitating a consistent method of delivery, this consolidated approach also would allow investors who prefer hard copies to request paper delivery for all funds held at a complex or through an intermediary in only one consolidated response as opposed to requiring a separate response for each fund. Consolidated consent would not compromise investor protection because shareholders

[258] We believe that this is an important consideration for UITs given that UIT investors' primary relationship is with their insurance company.

still would receive annual and semi-annual Notices for each fund owned. Under our recommendation, for subsequent investments in new funds held at a complex or through an intermediary, the shareholder would receive Notices, allowing them to opt into paper delivery for that fund's shareholder reports if they choose. We believe that this is sufficient notice given that the information on the Initial Statement and Notices is virtually identical.[259]

E. Modify Filing Requirement for Form of Notice

Under the proposed rule, a fund must file a form of the Notice with the Commission, on a new EDGAR submission type, not later than 10 business days after it is sent to shareholders. The Commission has requested comment on whether it instead should require funds to file the form of Notice as an exhibit to Form N-CSR or Form N-CEN.[260]

Since the form of Notice is not likely to change frequently, we instead recommend that the Commission consider requiring a subsequent filing of the form of Notice only when there is a change to the form of Notice, similar to FINRA's approach to filing requirements for template for retail communications.[261] An alternative that we would not object to would be to permit funds to file the form of Notice as an exhibit to Form N-CEN. Either of these approaches would be less burdensome than the rule as proposed, while adequately permitting the Commission to monitor compliance.

F. Retain Existing E-Delivery Guidance

Although the proposed rule would not impact e-delivery, the Commission has requested comment on whether availability of the rule would impact current industry practices on transmitting shareholder reports electronically.[262] The Commission also is seeking comment on whether it should permit funds that rely on rule 30e-3 to continue to rely on prior electronic transmission guidance for shareholders who consent to e-delivery.[263]

We strongly support preserving funds' ability to rely on the Commission's electronic delivery guidance framework. This framework has been in place for approximately twenty years, and shareholders increasingly have shown their preference for e-delivery. In fact, for broker-held accounts, the percentage of shareholder reports processed via e-delivery has increased from 19% in 2010 to 43% in 2015, with a projected increase to 59% by 2018, according to Broadridge Financial Solutions, Inc.

---

[259] *See* proposed rule 30e-3(c)(1) and (d)(1).

[260] Fund Reporting Proposal at 33633.

[261] Under FINRA advertising rules, firms must file templates within 10 business days of *first* use rather than each time it is used without change. *See* FINRA rule 2210(c)(3)(C).

[262] Fund Reporting Proposal at 33631.

[263] Fund Reporting Proposal at 33632.

Therefore, removing the e-delivery option would be extremely ill-advised both from the perspective of cost and investor preference. Members have advised us that they likely will continue to deliver reports under the Commission's e-delivery framework to affirmatively consenting shareholders and will seek implied consent under the new Rule 30e-3 framework for other shareholders. Therefore, we believe it is imperative that all funds continue to be permitted to rely on the Commission's e-delivery guidance.[264]

G. Adopt Proposed Safe Harbor Provision

Rule 30e-3 as proposed would include a safe harbor provision that would allow a fund to continue relying on the rule even if it did not meet the posting requirements of the rule for a temporary period of time.[265] To rely on this safe harbor, a fund must to have reasonable procedures in place to ensure that the required materials are posted on its website in the manner required by the rule and take prompt action to correct noncompliance with these posting requirements.[266]

We strongly support this aspect of the rule and commend the SEC for taking steps to ensure that technical difficulties would not interfere with funds' ability to rely on the proposed rule. We agree with the Commission that events beyond a fund's control, such as system outages or other technological issues, natural disasters, acts of terrorism, pandemic illnesses, or other circumstances, may cause a fund to be temporarily unable to meet the Internet posting requirements of the rule.[267]

H. Retain the Summary Schedule of Holdings

The Commission's proposal would restrict funds relying on proposed rule 30e-3 from providing a summary schedule of portfolio investments[268] in their shareholder reports in lieu of a complete schedule.[269] The Commission has requested comment on whether the summary schedule is an important option for funds to provide portfolio holdings disclosures for reasons other than those

---

[264] See also Section VIII.B.5 (recommending allowing funds to add information to the Initial Statement and Notices alerting shareholders to the option to affirmatively consent to e-delivery).

[265] *See* proposed rule 30e-3(b)(6). The rule provides that the conditions in paragraphs (b)(1) through (b)(5) of the rule (*i.e.*, the posting requirements) shall be deemed to be met, notwithstanding the fact that the materials required by paragraph (b)(1) of the rule are not available for a period of time in the manner required by the posting requirements, so long as certain conditions are met. *See id.*

[266] *See id.*

[267] *See* Fund Reporting Proposal at 33628.

[268] This reliance is currently permitted under Instruction 1 to Item 27(b)(1) of Form N-1A (permitting the inclusion of Schedule VI – Summary schedule of investments in securities of unaffiliated issuers under rule 12-12C of Regulation S-X in lieu of Schedule 1 — Investments of securities of unaffiliated issuers under rule 12-12 of Regulation S-X).

[269] *See* proposed amendments to Item 27(b) of Form N-1A; Item 24, Instruction 7 of Form N-2; and Item 28(a), Instruction 7(i) of Form N-3. *See also* discussion in Fund Reporting Proposal at 33630-31.

relating to printing and mailing costs.[270] We believe that many investors find value in the summary schedule of investments, particularly when a fund has many holdings. The summary schedule can help investors focus on a fund's principal holdings, and thereby better evaluate the fund's risk profile and investment strategy. We therefore disagree with the Commission's assertion that investors seeking to access the fund's complete portfolio holdings may find use of the summary schedule unnecessary, confusing or cumbersome.[271] At the same time, we understand the Commission's concern that investors receiving shareholder reports via website delivery may have to take additional steps if they wish to access a fund's full schedule of portfolio holdings.[272]

We therefore do not object to requiring the posting of the full schedule, although we believe that shareholders also should have access to the summary schedule of portfolio holdings. In response to the SEC's request for comment on whether it should permit funds to continue to use the summary schedule in paper reports, we believe that the policy rationale remains the same as when the SEC originally implemented this approach. The summary schedule gives investors a clearer picture of a fund's risk profile and investment strategy.[273] We therefore strongly recommend retaining this approach.

IX. Proposed Amendments to Form ADV and Advisers Act Rules

In the Adviser Reporting Proposal, the Commission proposes amendments to Form ADV[274] and various rules under the Advisers Act.[275] The proposed amendments to Form ADV would collect additional information regarding investment advisers' separately managed account business and make clarifying, technical and other changes to certain Form ADV items and instructions. The proposed rules also would update the recordkeeping rule to require investment advisers to retain additional documentation of investment performance claims.

We generally support the SEC's proposed collection of separately managed account data on the basis that it should better equip the SEC to analyze whether specific activities or practices pose risks to the markets or the financial system, although we also urge the Commission to be mindful of the

[270] Fund Reporting Proposal at 33633.

[271] *See* Fund Reporting Proposal at 33631.

[272] *See* Fund Reporting Proposal at 33631, n.356.

[273] *Shareholder Reports and Quarterly Portfolio Disclosure of Registered Management Investment Companies*, Release Nos. 33-8393, 34-49333, IC-26372 (May 10, 2004), available at https://www.sec.gov/rules/final/33-8393.htm#IIB1 (adopting amendments to permit a registered management investment company to include a summary portfolio schedule of investments in its reports to shareholders). "These amendments are designed to streamline shareholder reports and help investors to focus on a fund's principal holdings, and thereby better evaluate the fund's risk profile and investment strategy." *Id.*

[274] Investment advisers use Form ADV to register with the Commission and with the states.

[275] *See* Adviser Reporting Proposal, *supra* note 2.

importance of reducing burdens and increasing efficiency wherever possible. We do not object to the Commission's proposed amendments to the recordkeeping rule.

X. Compliance Dates

The Commission proposes a tiered set of compliance dates based on asset size for Form N-PORT. Larger funds, specifically funds that together with other investment companies in the same "group of related investment companies"[276] have net assets of $1 billion or more as of the end of the most recent fiscal year, would have to file Form N-PORT 18 months after the effective date of the rule. Smaller funds, specifically those that together with other investment companies in the same "group of related investment companies" have net assets of less than $1 billion as of the end of the most recent fiscal year, would have an extra 12 months, or a total of 30 months after the effective date of the rule, to file.

The Commission proposes to provide funds with 18 months from the effective date to comply with Form N-CEN, and the related amendments to other rules and forms. The Commission proposes to provide funds with eight months from the effective date to comply with the proposed amendments to Regulation S-X.

A. Extend Compliance Dates for Forms N-PORT and N-CEN, and Amended Regulation S-X

We recommend that the Commission provide longer compliance periods for Form N-PORT, Form N-CEN, and amended Regulation S-X. Specifically, we recommend: (1) a compliance date of 30 months after the effective date, implemented on a rolling basis according to a fund's fiscal year-end, for Form N-PORT (for both large and small funds); (2) a compliance date of 30 months after the effective date for Form N-CEN; and (3) a compliance date of 18 months after the effective date for the proposed amendments to Regulation S-X. As described below, these implementation periods would better recognize the tremendous operational and resource challenges, both from a cost and personnel perspective, firms face in implementing the Commission's proposals simultaneously. These challenges are exacerbated by the fund industry's current efforts to implement major operational changes to comply with the recently adopted money market fund rule amendments.[277]

Our views on the necessary compliance periods are explained in more detail below.

First, we recommend for Form N-PORT that both large and small funds receive the benefit of a compliance date that is 30 months after the effective date. Implementation of Form N-PORT will

---

[276] The SEC would base this threshold on the definition of "group of related investment companies," as that term is defined in rule 0-10 under the 1940 Act.

[277] *Money Market Reform; Amendments to Form PF*, 79 Fed. Reg. 47736 (Aug. 14, 2014), available at http://www.gpo.gov/fdsys/pkg/FR-2014-08-14/pdf/2014-17747.pdf.

require firms, as well as third-party administrators and other service providers, to undertake significant systems development and operational updates and, in many cases, will require additional staffing. To provide the data the Commission requests in a tagged format, firms will need to coordinate data that currently resides in different systems or modify current systems. For example, even firms that are currently able to obtain the risk metrics data the Commission proposes will have to modify their systems to be able to capture and file that information appropriately. Rather than this process taking *less* time for large funds, we believe it will take at least as much time, if not more, due to the volume of data and the complexity of systems typical at large fund firms.

Even with a longer compliance period for Form N-PORT, we believe that both the fund industry and the SEC would benefit from a rolling compliance period. We recommend that the Commission provide for a phase-in period based on a fund's fiscal year-end, such that the Commission would require each fund to first begin filing its Form N-PORT as of its next fiscal year following the compliance date.[278] Our recommended approach will avoid the whole industry filing the significant volume of data required by Form N-PORT with the SEC at once on the compliance date. A rolling phase-in would provide a more manageable implementation period for both the industry and the SEC, and would provide an opportunity to address more easily any issues that may arise in the initial months of preparing and filing the new form.

Second, we recommend a compliance date that is 30 months following the effective date for Form N-CEN, rather than the 18 months proposed by the Commission. While we appreciate that some of the information on Form N-CEN is substantially unchanged from existing Form N-SAR, much of the information is new or has been revised, and now will be in an XML format. As with Form N-PORT, the implementation of Form N-CEN will require firms to undertake significant systems development and operational updates, as well as coordination of data that currently resides in different systems, to be able to prepare and file the form. In connection with these development and updates, funds will need at least six months from the release of the XML taxonomy for each form, and perhaps even more time based on the complexity of the taxonomy, to tag and test the data.

Third, we recommend a compliance date for the proposed amendments to Regulation S-X that is 18 months after the effective date, such that the Commission would require a fund to begin complying with the amendments as of the beginning of its next fiscal year following the compliance date. While we acknowledge that the proposed amendments are largely consistent with existing fund disclosure practices, they nonetheless will require a period of time to implement and test in a firm's financial accounting systems.

---

[278] We note that the Commission permitted a similar rolling phase-in period for the mutual fund summary prospectus. *See Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies,* 72 Fed. Reg. 67790 (Nov. 30, 2007), available at http://www.gpo.gov/fdsys/pkg/FR-2007-11-30/pdf/07-5852.pdf.

XI. Conclusion

We appreciate the opportunity to comment on the proposals. If you have any questions regarding our comments or would like additional information, please contact me at (202) 326-5815 or david.blass@ici.org, or Dorothy Donohue, ICI Deputy General Counsel – Securities Regulation, at (202) 218-3563 or ddonohue@ici.org.

Sincerely,

/s/ David W. Blass

David W. Blass
General Counsel

cc: The Honorable Mary Jo White
The Honorable Luis A. Aguilar
The Honorable Daniel M. Gallagher
The Honorable Kara M. Stein
The Honorable Michael S. Piwowar

David W. Grim, Director
Diane C. Blizzard, Associate Director
Division of Investment Management

Appendix A

Data Security: Suggested Features of Any Third-Party Examination

As discussed in Section II.E of our letter, we suggest that any third-party examinations of the SEC's information security processes take into account then current service industry information standards as security protocols for Form N-PORT data.

As an initial starting point, any third-party review should consider recommending that the Commission permit funds to encrypt and transmit Form N-PORT information via a secure File Transfer Protocol, or some other equally secure method. There is precedent for this approach. In the Commodity Future Trading Commission's ("CFTC") final large trader rule, the CFTC included a secure File Transfer Protocol feed as an alternative transmission option to the CFTC's web-based portal.[1] The CFTC determined to offer this alternative in response to commenters' concerns over the security of the web-based portal for transmitting confidential trade, position, and counterparty identifying information.[2]

Based on discussions with information security experts among our membership, we also have developed the following partial list of protective steps for the SEC and any third-party expert to consider, at a minimum.

1. Perform an assessment of readiness to hold and protect financial firm confidential data, consistent with the recently released Cybersecurity Assessment Tool issued by the Federal Financial Institutions Examination Council ("FFIEC"),[3] and adjust controls commensurate with the risk.[4] Among other aspects, this assessment would focus on the following areas:

---

[1] *Large Trader Reporting for Physical Commodity Swaps*, CFTC Final Rule, 76 Fed. Reg. 43851 (July 22, 2011).

[2] *Id.* at 43853.

[3] FFIEC Cybersecurity Assessment Tool (June 2015), available at http://www.ffiec.gov/pdf/cybersecurity/FFIEC_CAT_June_2015_PDF2.pdf ("Cybersecurity Assessment Tool"). The Cybersecurity Assessment Tool maps to the National Institute of Standards and Technology (NIST) Cybersecurity Framework, although the Cybersecurity Assessment Tool is more comprehensive and targeted towards financial institutions. *See* Cybersecurity Assessment Tool, Appendix B, at http://www.ffiec.gov/pdf/cybersecurity/FFIEC_CAT_App_B_Map_to_NIST_CSF_June_2015_PDF4.pdf.

[4] In addition to determination of cyber security maturity in various domains, the assessment also would identify areas of inherent risk such as (1) the volume, sophistication, and type of cyberattacks (attempted or successful) targeting the SEC; (2) the inherent risk profile of the SEC's technology and connection types, including the number of Internet service provider ("ISP") and third-party connections, whether systems are hosted internally or outsourced, the number of unsecured connections, the use of wireless access, volume of network devices, end-of-life systems, extent of cloud services, and use of personal devices; and (3) SEC organizational characteristics such as the number of direct employees and contractors, changes in security staffing, the number of users with privileged access, changes in information technology environment, locations of business presence, and locations of operations and data centers. *See* Cybersecurity Assessment Tool, at 3.

a. Management's development and implementation of an effective enterprise-wide cybersecurity program with comprehensive policies and procedures for establishing appropriate accountability and oversight.
b. Inventory to account for all hardware, software, and applications currently in use at the SEC.
c. Threat intelligence and collaboration capabilities, including processes to effectively discover, analyze, and understand cyber threats, with the capability to share information internally and with appropriate third parties.
d. Effective cybersecurity controls used to protect assets, infrastructure, and information by strengthening the SEC's defensive posture through continuous, automated protection and monitoring.
e. Appropriate external dependency management, which involves establishing and maintaining a comprehensive program to oversee and manage external connections and third-party relationships with access to the SEC's technology assets and information.
f. Effectiveness of cyber incident management, including establishing, identifying, and analyzing cyber events; prioritizing the SEC's containment or mitigation; and escalating information to appropriate stakeholders.[5]

2. Ensure that any system used to collect, store, and transmit data provided via Form N-PORT employs PKI (public key infrastructure) secure data infrastructure for both storage and transmission.
3. Employ internal monitoring controls, systems and methods designed to detect indicators of compromise and theft of data.
4. Control employee access to sensitive Form N-PORT data and establish enhanced surveillance of those employees' personal trading.
5. Agree to notify fund complexes of compromises or thefts of fund data; share breach communication protocols with member organizations including specific contacts at each organization before data collection begins; and develop a plan of response in case of a potential data breach.
6. For any agencies or parties with which the SEC shares fund data, ensure that those agencies or parties have taken similar protective steps.

As financial services firms currently are doing, we recommend that, in addition to these specific steps, the SEC continue to prioritize the development of information security capabilities, including through the increased use of encryption, state of the art monitoring software, and additional training of already highly skilled security personnel. In addition, the SEC should mirror firms' security programs' focus on continued improvement in areas including security policy, physical and environmental

[5] *Id*. at 7.

security, security operations management, access controls, incident management, business continuity management, and compliance.

Appendix B

Proposed Rule 30e-3: Analysis of Cost Savings

Proposed rule 30e-3 would, subject to conditions, permit funds to deliver shareholder report by posting the reports online. This regulatory change would generate significant savings for fund shareholders—we estimate $140 million in net savings within the first three years of adoption.[1] If the Commission adopts the few minor modifications to rule 30e-3 that we recommend in Section VIII.B, potential net savings for fund shareholders could more than triple to $465 million over a three-year timeframe.

The fund industry currently spends an estimated $344 million each year, or a little more than a billion over a three-year period, to print and mail shareholder reports.

ICI estimates that if the Commission adopts rule 30e-3 as proposed, funds would spend $382 million in the first year and $255 million each year thereafter for mailings notifying shareholders of the availability of the reports on the website. Funds would not save any money in the first year of adoption due to the cost of the proposed Initial Statement and two notices in that year, the cost of which outweighs the savings from no longer printing and mailing the shareholder reports. We estimate that funds will spend an additional $38 million in that first year. In the second year and annually thereafter, we expect net savings to funds of $89 million each year. Over the three-year period, funds would spend a total of about $892 million[2], or about $140 million less if than if rule 30e-3 is not adopted as proposed.[3]

The Commission can capture greater savings if it removes the postage paid reply form requirement from any final rule, thereby allowing funds to send Initial Statements and Notices as postcards. ICI estimates that this approach would cost funds $243 million in the first year and $162 million each year thereafter, totaling $567 million[4] over three years. Under this alternative, net savings for fund shareholders is expected to be $101 million in the first year following adoption, $182 million per year thereafter, and $465 million for the three-year period.[5] Our detailed analysis follows.

1. Estimated Costs of Print and U.S. Mail Delivery of Shareholder Reports

Based on information gathered from members and industry sources, ICI estimates that printing

[1] We chose to show savings over a three-year timeframe because the one-time cost of the Initial Statement, which is mailed only at the beginning of the implied consent process, reduces net savings in the first year.

[2] $892 million = $382 million +$255 million + $255 million.

[3] $140 million = $1.032 billion - $892 million.

[4] $567 million = $243 million + $162 million + $162 million.

[5] $465 million = $1.032 billion - $567 million.

and mailing of shareholder reports currently costs fund shareholders $344 million annually (Table 1).[6] This estimate is comprised of three parts—current print costs, mail costs, and New York Stock Exchange ("NYSE") processing fees applicable to accounts held at brokers-dealers. It assumes, solely for purposes of this analysis, that all funds would completely eliminate the printing and delivering via U.S. mail of shareholder reports. First, we multiplied the estimated cost to print and mail a shareholder report[7] ($0.70) by the estimated number of shareholder reports printed and mailed industrywide[8] (440 million) for a total of $308 million. We then added the NYSE hard copy report processing fee applied to shareholder accounts that are held through broker-dealers[9], which we estimate was $36 million in 2014.[10]

[6] We based our estimate on a limited sample of our larger members, representing 32 percent of total net assets and 13 percent of the number of money market funds, long-term mutual funds, 1940 Act registered exchange-traded funds, and closed-end funds (excluding funds that invest primarily in other funds) as of December 2014.

[7] Based on responses from a sample of members, the average cost to print a shareholder report is $0.25 and mailing costs an additional $0.45 per report. These estimates apply to both fund complexes that produce a shareholder report for each of their funds as well as fund complexes that combine shareholder reports for multiple funds in a single consolidated report.

[8] A definitive figure on the number of shareholders accounts is virtually impossible to ascertain because of the prevalence of omnibus accounting. ICI estimates that there were approximately 430 million shareholder accounts as of 2014. We derived this figure from applying a 5 percent annual growth rate to ICI's estimate of 290 million shareholder accounts at year-end 2006 (290 million x 1.05^8). We use the 2006 figure because the increase in omnibus accounting since then has caused a decline in the reported number of shareholder accounts. The use of more recent shareholder account figures therefore would understate significantly the true number of beneficial shareholder accounts. ICI's estimate of approximately 430 million shareholder accounts implies 860 million shareholder reports (430 million x 2). We reduce the 860 million estimate by 10 percent for householding (860 million x 0.9 = 774 million). We believe there is not as much opportunity for householding of shareholder reports as there is for shareholder statements because fund complexes often stagger funds' fiscal year-ends throughout the year to more efficiently manage work flow. We reduce the 774 million figure by 43 percent to account for e-delivery (774 million x 0.57 = approximately 440 million shareholder reports printed and mailed). According to Broadridge Financial Solutions, Inc. ("Broadridge"), 43 percent of shareholder reports for broker-held accounts are processed via e-delivery. We assumed the same e-delivery rate of 43 percent for accounts that investors hold directly at a fund complex based on an informal sampling of some of our members with direct-at-fund business that showed an average e-delivery rate of about 40 percent. We do not take into consideration suppression of shareholder reports for 401(k) accounts because we have no information on the percentage of shareholder reports that are, or are not, delivered to 401(k) participants.

[9] *See* NYSE rule 451.90(3). As a general practice, broker-dealers contract with third-party mail houses to process and mail all required fund documents (*e.g.*, annual reports, prospectuses). NYSE rules 451 and 465 provide the processing rates, which fund shareholders ultimately bear.

[10] The $36 million figure is calculated by multiplying the number of hard copy fund shareholder reports processed for broker-held accounts by the unit processing fee (240 million x $0.15 = $36 million). In 2014, Broadridge processed 240 million hard copy fund shareholder reports for broker-held accounts. The NYSE report processing fee is $0.15 per hard copy shareholder report.

Table 1: Estimated Costs of Print and Mail Delivery of Shareholder Reports*

Estimated total cost of print and mail delivery	**$344 million**
Estimated total print and mail costs	$308 million
Print cost per shareholder report	$0.25
Mail cost per shareholder report	$0.45
Total unit print and mail cost	$0.70
Total number of shareholder reports printed and mailed	440 million
Estimated NYSE shareholder report processing fees	$36 million
NYSE report processing fee for broker-held accounts	$0.15
Number of paper shareholder reports processed for broker-held accounts	240 million

*Figures rounded to the nearest million.

2. Estimated Costs of Website Delivery of Shareholder Reports

a. The Commission's Proposed Approach

Proposed rule 30e-3 would provide funds with an optional method to satisfy shareholder report delivery requirements by posting such reports online if they meet certain conditions. To rely on the proposed rule, the Commission would require the fund to mail an Initial Statement to each shareholder from whom the fund is seeking implied consent. Thereafter, the Commission would require funds to mail two Notices annually to each shareholder who has provided implied consent, one in connection with the publication of each fund report. The proposed rule requires a postage-paid return envelope and reply form to accompany each Initial Statement and Notice. As a result, in the initial year, funds would be required to conduct three mailings to shareholders—the Initial Statement and two Notices. For subsequent years, we assumed funds would conduct two mailings (one Notice per report) to shareholders.

As shown in Table 2, ICI estimates that funds would spend $127 million for each mailing under proposed rule 30e-3. This estimate is comprised of three parts—current print costs, mail costs, and NYSE "notice and access" processing fees.[11] ICI estimates that print and mail costs for each mailing would be $119 million ($0.54 x 220 million).[12] ICI anticipates that NYSE "notice and access"

[11] In the context of proxy solicitations, NYSE rules permit member organizations to charge a $0.10 "preference management" fee in connection with suppression of paper shareholder reports. *See* NYSE rule 451.90(4)(b), "Schedule of approved charges by member organizations in connection with proxy solicitations – Preference Management Fees." We do not include this "preference management" fee in our Table 2 cost estimate because we do not believe that this fee is permissible in the context of proposed rule 30e-3. *See* further discussion in Section VIII.C of our letter.

[12] Based on responses from a sample of members, the average cost for a letter, reply form, and two envelopes (one envelope to contain the packet and one return envelope) is $0.12. The cost of $0.42 per unit mailed is the pre-sorted first class mail rate. Table 1 presents the number of shareholder reports mailed annually (*i.e.,* two mailings per year). In contrast, Table 2 presents the number of Notices sent in a single mailing to shareholders. Because the Notices would be sent semi-annually,

processing fees for broker-held shareholder accounts would apply, similar to the "notice and access" processing fees currently applied in connection with proxy solicitations. ICI estimates that these NYSE "notice and access" processing fees would amount to $8 million per mailing ($0.07 x 120 million).[13]

ICI anticipates that the proposed rule 30e-3 will be more cost effective for those complexes that have relatively high print and mail costs for their shareholder reports either because they have small volumes, which tend to have higher unit print costs, or they bundle their individual funds' shareholder reports into a single consolidated report. Also, funds that are sold through intermediary channels would pay lower NYSE processing fees since the $0.15 per hard copy shareholder report fee would not apply to shareholders who no longer receive a paper shareholder report in the mail.[14] Funds with higher print volumes, less lengthy shareholder reports, and larger direct-at-fund business would not experience as much cost savings under the SEC proposal.

b. Alternative Approach 1

As discussed more fully in Section VIII.B.1 of our letter, we believe that the reply form and postage-paid return envelope requirement is burdensome and unnecessary as shareholder response rates to return reply requests are extremely low. If the Commission follows our recommendation and eliminates the proposed requirement to provide a reply form and postage-paid return envelope, the estimated cost to shareholders for one mailing would decline from $127 million to $118 million for firms that choose to provide a letter and envelope.[15] The savings stem from a lower estimated print cost for a letter and envelope only ($0.08) versus the packet proposed by the SEC ($0.12).

c. Alternative Approach 2

Removal of the reply form and postage-paid return envelope requirement effectively would permit funds to use postcard mailings to satisfy the conditions of the proposed rule. ICI estimates that funds would spend $81 million per mailing to send the Initial Statement and Notices as postcards.

---

the estimated number of Notices for one mailing (220 million) is one-half the estimated number of shareholder reports printed and mailed in a year from Table 1.

[13] NYSE has tiered pricing for "notice and access" processing fees that is based on the number of broker-held accounts. The $0.07 "blended" rate assumes that the third party processes notices for 2 million broker-held shareholder accounts. We also assume that NYSE hard copy shareholder report processing fees and "preference management" fees do not apply. The $0.15 flat rate charge for processing a hard copy shareholder report (shown in Table 1) no longer applies because the hard copy reports would no longer be processed, except where a shareholder requests delivery of a paper shareholder report. We also assume that the NYSE $0.10 "preference management" fee would not apply to broker-held shareholder accounts that have consented to delivery of shareholder reports via the fund's website. *See supra* note 11 as well as further discussion in Section VIII.C of our letter. If the Commission views as permissible the charging of a "preference management" fee, then estimated NYSE transaction processing fees under the SEC proposal for one mailing would increase from $8 million to $20 million (sum of $8 million from Table 2 and ($0.10 x 120 million notices)).

[14] *See* NYSE rule 451.90(3).

[15] The $118 million estimate is calculated as (($0.50 x 220 million) + ($0.07 x 120 million)).

This is substantially less than the estimated $127 million per mailing cost under proposed rule 30e-3.[16] The additional savings stem from a lower estimated print cost for a postcard ($0.05)[17] versus the packet proposed by the SEC ($0.12), and a lower postage cost for pre-sorted first class mail—$0.28 for a postcard compared to $0.42 for a letter. Under this alternative, virtually all funds would experience significant net cost savings.

[16] The $81 million estimate is calculated as (($0.33 x 220 million) + ($0.07 x 120 million)).

[17] This estimate reflects ICI's view that a control number or account identifier is unnecessary in this context because there will be no need for the postcard to be tracked or returned. Shareholders would be able to request any desired paper copies of their shareholder reports by calling the toll-free number provided on the Initial Statement or Notice.

Table 2: Estimated Costs of One Mailing for Website Transmission of Shareholder Reports*

SEC proposal: Letter, envelope, and postage-paid reply form Estimated total cost	**$127 million**
Estimated total print and mail costs	$119 million
Print cost per letter, envelope, reply form, and postage-paid return envelope	$0.12
Mail cost per letter, envelope, reply form, and postage-paid return envelope	$0.42
Total unit print and mail cost	$0.54
Number of notices	220 million
Estimated total NYSE "notice and access" processing fees	$8 million
Blended NYSE processing fee for broker-held accounts	$0.07
Number of notices to broker-held accounts	120 million
Alternative 1: Letter and envelope only Estimated total cost	**$118 million**
Estimated total print and mail costs	$110 million
Print cost per letter and envelope	$0.08
Mail cost per letter and envelope	$0.42
Total unit print and mail cost	$0.50
Number of notices	220 million
Estimated total NYSE "notice and access" processing fees	$8 million
Blended NYSE processing fee for broker-held accounts	$0.07
Number of notices to broker-held accounts	120 million
Alternative 2: Postcard only Estimated total cost	**$81 million**
Estimated total print and mail costs	$73 million
Print cost per postcard	$0.05
Mail cost per postcard	$0.28
Total unit print and mail cost	$0.33
Number of notices	220 million
Estimated total NYSE "notice and access" processing fees	$8 million
Blended NYSE processing fee for broker-held accounts	$0.07
Number of notices to broker-held accounts	120 million

*Figures rounded to the nearest million.

3. Estimated Initial and Ongoing Annual Net Savings of Mailings for Website Transmission of Shareholder Reports

Over a three-year timeframe, ICI expects that proposed rule 30e-3 would save fund shareholders a total of $140 million on a net basis (Table 3).[18] In the initial year of adoption, funds would be required to conduct three mailings (Initial Statement and two Notices) at an estimated industry cost of $382 million—$381 million for printing and mailing and $1 million for postage-paid

[18] The three-year $140 million estimate is calculated as (-$38 million + $89 million + $89 million).

licensing.[19] As a result, shareholders would expect to incur additional costs (negative savings) of $38 million in the first year following adoption of proposed rule 30e-3. In the second year and annually thereafter, funds that choose to rely on proposed rule 30e-3 would conduct two Notice mailings, creating an estimated annual net savings of $89 million.[20] Fund complexes with low unit print costs and more direct-at-fund business, however, do not anticipate as much cost savings from adoption of the rule as proposed.

We recommend in Section VIII.B.1 that the Commission remove the postage-paid reply form requirement from any final rule, thereby allowing funds to satisfy the rule's conditions through a postcard mailing. ICI estimates that this modification to the proposed rule would produce estimated net savings for fund shareholders of $101 million in the first year and $182 million per year thereafter. Adoption of our recommendation would more than triple potential net savings to $465 million over a three-year period—a dramatic increase in cost savings, even for fund complexes with low unit print costs and more direct-at-fund business.[21]

[19] Many fund complexes currently do not send materials that have postage-paid returns to shareholders. Therefore, to comply with the SEC requirement for a postage-paid envelope, fund complexes would have to pay annual licensing fees to the United States Postal Service. The roughly $1 million figure is estimated by multiplying 867 fund sponsors by the annual licensing fee of $950. *See 2015 Investment Company Fact Book, 55th edition*, Investment Company Institute, at 16, available at https://www.ici.org/pdf/2015_factbook.pdf. The $950 annual fee is the sum of the annual permit fee ($225) and the annual account maintenance fee ($725) for business reply mail. Also, our members tell us that return reply response rates by fund shareholders are quite low, and they receive few requests for printed statutory prospectuses. As a result, we anticipate requests for print and mail delivery for shareholder reports also will be quite low, and we do not take into consideration this additional cost.

[20] If the Commission adopts our recommendation to allow the Initial Statement to be bundled with other materials (thus reducing the total number of mailings from three to two), the first-year costs of proposed rule 30e-3 would no longer be larger than annual ongoing costs. First-year estimated net savings therefore would increase from (-$38 million) to $89 million in the initial year of adoption.

[21] The three-year $465 million estimate is calculated as ($101 million + $182 million + $182 million).

Table 3: Estimated Net Savings of Mailings for Website Transmission of Shareholder Reports[1]

	Initial Year[3]	Annual Ongoing[4]
SEC proposal: Letter, envelope, postage-paid return form Estimated net savings	**($38 million)**	**$89 million**
Estimated print and mail delivery[2]	$344 million	$344 million
Less estimated cost of SEC proposal	($381 million)	($254 million)
Less estimated cost of postage paid licensing	($1 million)	($1 million)
Alternative 1: Letter and envelope only Estimated net savings	**($10 million)**	**$108 million**
Estimated cost of print and mail delivery[2]	$344 million	$344 million
Less estimated cost of Alternative 1	($354 million)	($236 million)
Alternative 2: Postcard only Estimated net savings	**$101 million**	**$182 million**
Estimated cost of print and mail delivery[2]	$344 million	$344 million
Less estimated cost of Alternative 2	($243 million)	($162 million)

1. Figures rounded to the nearest million.

2. Estimated costs of printing and mailing of shareholder reports from Table 1.

3. Estimated costs of specified mailing method for website transmission of shareholder reports from Table 2 multiplied by three for delivery of Initial Statement and two Notices in first year.

4. Estimated costs of specified mailing method for website transmission of shareholder reports from Table 2 multiplied by two for delivery of two Notices in each year thereafter.