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The Honorable Alexander Acosta
Secretary of Labor
200 Constitution Avenue, NW
Washington, DC 20210

Dear Secretary Acosta:

As one of the leading sponsors of closed-end funds and a subsidiary of TIAA, we write in connection with the Department's regulation defining investment advice fiduciary and the exemptions accompanying that final rule. We are appreciative of the Department's transition period and its proposal to extend that transition period until July 1, 2019.

While the extension is welcome in many ways, we strongly believe that it works an injustice on products that are sold as principal. In 2015, when the exemptions were proposed, both the BIC exemption and the principal transaction exemption contained very narrow lists of permissible products that could be bought and sold under the exemptions. The Department received almost uniformly negative comments on these "legal lists" of investments, characterizing them as patronizing, restrictive, and contrary to the principle of investor choice. In response to those comments, the Department eliminated the restrictive list from the BIC exemption but not from the principal transaction exemption. Thus, a variety of investments that have historically been sold to plans and IRAs in principal transactions, including Initial Public Offerings ("IPOs") of closed end funds, municipal bonds, currency, and financial institution debt, and IPOs of equity offerings would no longer be available to these retirement accounts. We are asking for interim relief so that retirement investors may continue to have the ability to invest in IPOs of closed end funds (subject to impartial conduct standards) during this extended review period (until July 1, 2019) while the matter is under the Department's further consideration for a longer term solution.

We were heartened by your comments immediately after your confirmation where you disagreed with the prior Administration's approach to severely restrict investor choice. We urge you to amend the principal transaction exemption, as many commenters asked you to do in the RFI comments, to permit investment products that were generally available for sale on a principal basis prior to June 9, 2017, particularly IPOs of new closed end funds.

Some Background on Closed End Funds

Given their strong focus on generating high returns and high cash flow, closed end funds ("CEFs") offer an important choice for long-term investors in IRAs and tax-deferred accounts.

Because of the way these funds are offered, restricting purchases in IPOs hurts retirement investors – as well as all other investors and the capital markets – in ways that cannot be remedied simply by allowing plans and IRAs to purchase these funds in the secondary market. We believe there are adverse effects on retirement investors and on the market generally if IRA and fiduciary accounts are not permitted to invest in CEF IPOs.

CEFs are one of three general types of investment companies identified in the Investment Company Act of 1940 ('40 Act); the other two are open-end funds (OEFs) and unit investment trusts. Exchange-traded funds are a newer investment company structure, which some describe as a hybrid of an OEF and a CEF. There are many similarities between these four investment company types. Each is a pooled investment vehicle that offers shares almost exclusively through a public offering registered under the Securities Act of 1933, with all applicable fees, expenses, and offering costs fully disclosed in an initial prospectus. CEFs differ, in that they are generally not offered continuously like open-end mutual funds, and typically have a fixed number of shares issued during the IPO. CEFs generally do not issue redeemable shares; after the IPO investors buy and sell shares on a national stock exchange at prices established through market trading. The exchange and market participants provide investors with price transparency and liquidity throughout the trading day. The non-redeemable nature of CEF shares allows full investment of all capital rather than reserving significant amounts of cash, especially in funds with less liquid investments, to meet redemptions.

The majority of CEFs are designed and managed to offer strong income and cash flow. Thus, the estimated $44 billion of current CEF assets in IRAs and tax-deferred accounts play an important role in helping to fund retirement needs. Unlike continuously offered funds, CEFs generally have a limited opportunity to raise investment capital through a brief IPO offering period – typically 20 or so business days. While we do not believe the Department meant to significantly affect the investment product, we think it is clear that excluding IRA investors from the initial offering, or 25% of a fund's investor base, would significantly reduce the scale of future CEFs. This exclusion creates a number of certain and potential disadvantages for all fund shareholders, including IRA investors who purchase shares after the IPO. For example, let's assume that today there is public interest of $250 million in a particular new CEF IPO and its asset class and investment strategy. Under the new DOL rule, because of the IPO exclusion, the fund will be 25% smaller. That means less diversification, higher fund expense ratios, reduced efficiency and investment choice in managing a fund's portfolio, reduced or absent CEF analyst coverage (CEF analysts generally do not evaluate or publish information about smaller funds), and lower secondary market volume, leading to potentially wider bid/ask spreads. These diseconomies of scale affect current and future shareholders, taxable and retirement alike, as well as the capital markets being served by that asset class. Ultimately, the IPO exclusion results in reduced income and return potential to all investors over time.

As an example, consider the Build America Bond funds that were launched by many fund companies, including us, as part of the American Reinvestment and Recovery Act in 2009. Under the new rule, the amount of CEF capital available to finance such infrastructure spending through CEFs is reduced by 25%, the diversification of the bond portfolio may be reduced, fund expenses are higher, and the retirement investor, who now can only purchase this fund in the secondary market, has a less attractive and less advantageous product when he is able to buy. Since the IPO is the only time a CEF investor can buy a known quantity of fund shares at a certain known price, forcing interested IRA investors into purchasing shares on the secondary market introduces price and quantity execution risk to those investors. Under the new rule, the share price set in the secondary market is likely to be higher once the retirement investor enters, given increased demand is chasing smaller supply.

We appreciate that the Department has concerns about the risk of underwriters dumping shares on investors during the IPO process. But, given the nature of CEF IPOs, we believe those concerns are not present here. In a typical operating company equity IPO, the issuer consults with its underwriters and sets a specific capital target the offering must raise. That capital goal is prominently featured on the front of the red herring prospectus for the offering. In contrast, the assets raised in a CEF IPO depend solely upon investor demand discerned during the initial offering period, not a pre-determined capital goal. For the CEF IPO, the underwriting syndicate members are committing only to the shares needed to fill their clients' indications of interest. Beyond that, the underwriters hold little or no additional inventory. Additionally, the CEF IPO process includes another protection: syndicate members track aftermarket activity and will impose a claw-back of the sales concession in the event an advisor engages in 'flipping' shares purchased during the offering. This can serve to remove the financial incentives for a broker to dump the shares after the pricing of the CEF offering.

In summary, we believe that the Department's restriction on IPOs in the CEF setting actually hurts the product for all investors, including retirement investors, and adversely affects the overall market by impeding capital raised through a CEF IPO. It makes the product less attractive, less diversified, and more costly for all investors. Including IRAs and tax-deferred investors in a CEF's initial public offering will help ensure the largest possible fund scale, benefiting all shareholders and the assets and projects being financed over time. Finally, the IPO process for CEFs differs from that of operating companies, with pricing that is known at the outset, continued high transparency and liquidity opportunities after launch, additional regulations and protection from the '40 Act and FINRA, and a capital raise that is strongly aligned with investor demand, not issuer and syndicate goals.

We urge you to provide interim relief during this extended transition and review period by making changes in the principal transaction exemption to permit all securities and other investment products typically sold as principal so as to avoid disruption and continue current markets during this period while the matter is under the Department's further consideration for a longer term solution. We would welcome the opportunity to meet with you at your convenience.

Sincerely yours,

Kevin J. McCarthy
Senior Managing Director, General Counsel
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