COVE STREET CAPITAL

VIA E-MAIL: rule-comments@sec.gov

October 8th, 2015

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-10

RE: **File Number: S7-16-15**
Open-End Fund Liquidity Risk Management Programs

Dear Mr. Fields:

I am writing as the Lead Principal and Portfolio Manager of Cove Street Capital, LLC, an SEC- registered investment advisor with approximately $1 billion in assets. Our core strategy is small cap value investing, an approach we offer to clients through separate accounts as well as through our mutual fund, the Cove Street Capital Small Cap Value Fund. I will start generally and then get into some specifics, although by no means are my specific objections to this certain issues in the proposal wholly contained within this letter.

The fatal flaw here is that the commission is attempting to blanket all funds under an impossibly complex set of rulemaking that simply has little to do with what I call "classic" equity mutual funds—hereby defined as being long-only with little or no use of derivatives or leverage. These rules will create a hellacious set of compliance requirements to generate near useless information to fix something that cannot rationally be considered broken. The commission should correctly be focusing its attention on the looming disaster areas of ETF management and any number of well-marketed alternative structures that are bringing highly priced, illiquid and poorly understood strategies to retail investors. (As if that is what they have been missing all these years.) Not to properly differentiate between the "classic" and the "new" is simply terrible policy that will hurt investors and capital formation, as I will discuss below.

But there is another crucial flaw at play here that is important to understand before I go into specifics. "Liquidity" is not the 11th Commandant that somehow got lost in the desert, nor is it the missing chapter from Newton's or Einstein's collected works. It comes from a fragile ecosystem where counterparties either warily or obliviously interact and its presence is utterly at the whim of its deeply flawed participants—just as with any endeavor that involves the noncompulsory cooperation of elements of mankind. Liquidity is as ephemeral as youth or clouds; it cannot be mandated to a "level" and behind each grinding piece of potential compliance recordkeeping listed in the Commission's proposal is a lack of appreciation of this issue.

Specifically, we would note the following and again, these points primarily concern pools of assets that are managed in a long-only fashion and do not use leverage or derivatives:

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1. We run a small cap value fund. The innate premise of our investment philosophy is to do careful work and restrict our assets to a manageable level so that we can take advantage of exactly the issue at hand: we want to be buyers of people's fear of illiquidity! To tell a small cap fund that they are subject to the same liquidity rules as a US Treasury Fund or a $50 billion large cap fund is almost to deny the right for us to exist as a mutual fund. The last thing the investment world and its clients need is more funds hugging indices and only buying the most liquid stocks.

2. Every measure suggested by the Commission, and I will add, every measure that we use internally to guestimate liquidity, is by definition backward looking. What was average volume, spread, number of market makers etc., etc. yesterday, last week, last quarter? That is a terribly unhelpful analysis when it comes to estimating future liquidity. There is zero academic work that suggests that liquidity has linear properties. Liquidity spikes up and down on investment-specific news, general market news or geopolitical news. It fluctuates subject to regulatory changes, such as penalizing investment banks—from a capital standpoint—for making markets. It changes seasonally. (Try to get a decent execution in size on a Friday in July.) It is there simply because a portfolio manager is fired and the new manager tells the desk to sell every share regardless of price. It is there and then it's not as Michael Lewis writes another book about market structures. Under this proposal, our fund could be in compliance on day 1, not do a single trade for 30 days, and then be out of compliance simply because the market in that stock quieted down and a very liquid week dropped out of the calculation. This is indicative of an impossible and unhelpful process if implemented as suggested by the Commission.

3. The last I checked, the United States has the deepest and widest capital markets in the world. What is a particular wonder is our ability to fund new ventures, which has translated into thousands of publicly traded small cap companies. Mutual funds are the single largest holder of equities. Who may I ask is going to buying these companies if we are going to be looking over our shoulders on every trade to see if we are running up against a completely arbitrary target of liquidity? And eventually, mutual fund managers will tire of arguing with compliance officers and just toe the line. (That's when we will close our fund and open an LP to arbitrage a great opportunity.) I am sure the Commission would agree with me that less capital and less transparent capital looking to invest in smaller companies is not a good thing for this country.

4. Less liquidity means a higher cost of capital which means less funding on the margin. Is this the same Commission that was all in favor of the Jobs Act that in my opinion allows near fraud to masquerade as a public company by removing a number of legitimate protections against loss that could result from accounting fraud and lack of disclosure? That is how you really lose money; not by taking a haircut in trying to sell stock into a down market.

5. It is correct for the Commission to ask registered advisors: "What are your guidelines for assessing liquidity." Our answer is that we have been doing it since day 1, but our measures focus on 30, 60 and 90 day liquidity measures, not "days or hours" We review it weekly, on an internal basis, and monthly with the compliance, trading and investment teams. I thought the Commission is part of the crowd decrying short termism?

6. Like Dodd Frank, which is crushing smaller banks under huge reporting requirements whose expenses in time, people, lawyering and outside services are easily absorbed by the largest financial institutions, this proposal will grossly overburden small-to-midsize funds and investment managers.

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What is also not considered here is that many of these funds use so called Series Structures, whereby we, the midsize manager, outsource all the administration and structure to a third party—thus becoming part of a Series in order to achieve back office scale. Large funds have enough scale to do this in house. The practical point is that our experience suggests that the Series provider will simply "lawyer up" and across the board push standard practices for liquidity that are the most restrictive interpretation possible, thus making a mockery of the suggestion in the Proposal that rules will largely be principle-based and the manager will have the ability to create different standards for different types of funds. It's naive to suggest otherwise.

7. While the Commission argues that "liquidity reporting" will give investors more information and thus by definition they will be able to make more informed decisions, I will take the other side. Just as federally insuring bank deposits has eliminated the generation of any brain waves in the direction of whether or not a financial institution is an acceptable credit risk, I would argue this proposal gives the average investor an illusion that they have will have liquidity at will in asset classes where they should not have that expectation. An investor HAS to understand that non-money market funds involve risk and one of those risks is getting your head handed to you when you try to sell large amounts in a down market.

8. It is frankly my job, not the Commission's, to manage liquidity. If I do it poorly, my performance will be poor and I will lose assets and die the death of many unsuccessful managers before me. My clients will rightfully be unhappy and have learned their own lesson. And history marches on.

9. So let's say "liquidity" should be mandated. How should we measure it? The Commission's rules are arbitrary at best and I have looked for the academic premise and don't see it:

   a. No more than 15% in investments that can't be sold in 30 days?
   b. Defining investments into 6 liquidity buckets?
   c. Do we really think it's a valuable use of time to actually subdivide holdings into "I can sell 30% in 30 days so that counts as liquid, but 70% of a stock is "illiquid"?

10. The Proposal reads on page 176:

    In addition, the proposed categorization requirement also would provide the foundation for the requirement for a fund to invest a prescribed minimum percentage of its net assets in "three day liquid assets" (that is, any cash held by a fund and any position in an asset, or portion thereof, that the fund believes is convertible to cash within three business days at a price that does not materially affect the value of that asset immediately prior to sale.

    So with all the whining about active managers not being able to beat an index, the Commission is mandating a head start for the index by requiring minimum cash holdings? An existing and very popular pastime to get around this consists of holding an ETF that is similar to the strategy that you are running, the premise being that it can be liquidated in bulk more efficiently than selling individual securities in a panic. The proposal seems to encourage this practice.

    Let's think this through: the Commission wants to encourage the holding of ETFs to enable a three day liquidity rule, but the ETF itself will be subject to liquidity rules in the same stocks that we might be trying to sell? I also do not see how a large increase in the use of ETF's to maintain

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compliance with this proposed rule-making assists general market liquidity. If anything, it is another drain of liquidity from the pool of assets that are most in need of a liquid market.

11. While the Commission thinks it's an elegant solution to not to "require" funds to divest less liquid assets to meet the 3 day liquidity rule, in reality it is the rules that prevent a manager from buying them until the 3 day hurdle is restored that completely hobbles the market mechanism that enables liquidity. Furthermore, the Proposal creates restrictions on buying the exact assets that are most likely to be sold in a market meltdown and thus makes the overall mess worse.

12. What if I have 40% cash and yet 20% of my holdings are smaller and illiquid? I would be exactly the guy in the "invisible hand" world who would be putting in bids to effectively stabilize markets. Under this proposal, my compliance officer would prohibit me because I am over the 15% hurdle as narrowly defined by the proposal?

13. Literally on page 104, is it the domain of the federal government to mandate a "what if I die" stress test?

I could go on. There are any number of very important issues on which the SEC is and should be focusing their attention in regard to market liquidity, but I would sincerely and severely encourage the commission NOT to further burden participants in "classic" mutual funds with complex and unnecessary regulations to address a problem that plagued investors for millennia and won't be fixed in 415 pages: "sell to whom?"

Best Regards,

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