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Mr. Brent J. Fields
Secretary
Securities and Exchange
Commission
100 F Street, NE
Washington, D.C. 20549-1090

File Reference: File Nos. S7-16-15 and S7-08-15: Open End Mutual Fund Liquidity Risk Management Proposal; Swing Pricing; and Reopening of Comment Period for Investment Company Reporting Modernization Release

Dear Mr. Fields:

MFS Investment Management (MFS)[1] appreciates the opportunity to comment on the Securities and Exchange Commission's ("SEC's" or "the Commission's") Proposed Rules relating to Open End Mutual Fund Liquidity Risk Management Practices (the "Liquidity Risk Management Proposed Rule"), Swing Pricing (the "Swing Pricing Proposed Rule"), and Re-Opening of Comment Period for Investment Company Reporting Modernization Release (the "Reporting Modernization Proposed Rule").[2] The Liquidity Risk Management Proposed Rule, the Swing Pricing Proposed Rule and the Reporting Modernization Proposed Rule are referred to collectively as the "Proposed Rules".

Overview of the Proposed Rules

Liquidity Risk Management

The Liquidity Risk Management Proposed Rule would require open-end funds other than money market funds (“funds”) to adopt a liquidity risk management program that is reasonably designed to assess and manage a fund's liquidity risk. While the proposed rule generally provides funds with flexibility in designing its liquidity risk management program, the proposed rule mandates that every risk management program include a requirement to categorize each portfolio investment into one of six liquidity buckets (the "6 Bucket Requirement"), each fund consider its cash and cash equivalent holdings, as well as its borrowing arrangements and other funding sources, in assessing its liquidity risk and that each fund determine the percentage of the fund's assets that can be converted to cash within three business days without materially affecting the price of the security based upon the fund's cash flow projection, which in turn is based on, among other factors, the size, frequency and volatility of historical subscriptions and redemptions (the "Three Day Requirement"). As daily redeemability is a key characteristic of a fund, a properly managed fund should account for its redemption liability and structure its portfolio consistent with that redemption obligation. MFS supports the elements of the Proposed Rules that require funds to adopt a written and board approved liquidity risk management program that is reasonably designed to manage the fund's liquidity risk. MFS does

[1] MFS Investment Management traces its history to 1924 and the creation of the Massachusetts Investors Trust. Today MFS is a global investment manager managing approximately $420 billion in assets through a variety of collective investment vehicles and separate account, including approximately $218 billion managed in registered open end investment companies for which MFS serves as the primary investment adviser and approximately $35 billion managed in UCITS funds organized in Luxembourg that utilize swing pricing.
[2] Investment Company Act Rel No. 31835 (Sept. 22, 2015), 80 FR 62273 (Oct. 15, 2015).

not support the 6 Bucket Requirement and the Three Day Requirement. MFS also recommends that the definitions of liquidity risk and the criteria for a three day asset not include, respectively, no material affect to the fund's net asset value and no material market impact to the price of the security; that the principal amount of an undrawn committed line of credit should count as a three-day asset; and that each fund's internal assessment of each portfolio security's liquidity score not be made public.

A requirement that funds have a liquidity management program, that it be reviewed and approved by its board of directors, that it be disclosed in offering documents and that disclosure around liquidity risks in offering documents be enhanced should be sufficient to accomplish the Commission's stated goal of investor protection. Small retail investors have benefitted greatly from the mutual fund, a key aspect of which is the mutualization of the costs of investing. It should not be a goal of the Commission to completely immunize investors from liquidity risks, which certainly includes the risk that a mutual fund will have to sell portfolio securities at a price below the price at which the security was marked the night before in order to satisfy redemption obligations. A well-managed fund should be obligated to identify and manage its liquidity risk. A rule that dictates how that risk must be managed is inherently flawed because the prescriptive elements cannot be well suited to every investment strategy of every fund and because they are premised on the Commission's assessment of current best practices which are likely to be dated by the time that they become effective. In the fund space, however, the mandated elements of the proposed rule will likely stultify innovation and lock the funds into what will become an antiquated process.

When the Commission engages in rulemaking where there is no specific statutory directive to be implemented like that of the Proposed Liquidity Risk Management Program, the Commission must decide whether to mandate specific activity or to mandate development of a program based on specified principles. There should be strong evidence of a real risk of harm to investors to justify the Commission ordering a specific activity absent a statutory requirement. If that evidentiary base is not present MFS believes that the Commission should opt for a principles based approach because it is adaptable to the extraordinarily diverse group of registrants to which the requirements are applicable and better able to adapt to evolving market practices over time. The ICI Research Comment Letter persuasively makes the case that funds have historically managed their liquidity obligations well and that there is not a factual basis to support the requirement that all funds adhere to specific types of liquidity management practices.

Swing Pricing

MFS supports authorizing registered investment companies to use so-called “swing” pricing. In fact, MFS recommends that the SEC authorize funds to use swing pricing whenever a fund has net subscriptions or redemptions and not require that the net redemptions or subscriptions exceed a specified threshold. Swing pricing has the benefit of at least reducing and perhaps eliminating the so called "first mover" advantage that some bank regulators believe is inherent to the mutual fund structure. It has the additional value of allocating the costs of investing the proceeds of subscriptions or raising cash to pay for redemptions to the shareholders that trigger the need to incur such costs. This is an additional way to protect investors form the dilutive impact of subscriptions and redemptions. Unfortunately, the way transactions are currently processed in the United States, particularly in the retirement space and with variable annuities and variable life insurance policies, there is not sufficient information available at the time a US registered investment company is required to strike its net asset value per share (“NAV”) to determine with a sufficient level of confidence whether the NAV should be swung. MFS urges the Commission to work with industry to modify its transaction processing practices to enable swing pricing to be practical. In the meantime the necessary exemptions and authorizations should be adopted to allow funds to use swing pricing.

Investment Company Reporting

MFS does not support the proposed requirement that reports submitted to the Commission concerning the liquidity categorization of fund securities be made public. The information is too granular to be of assistance to investors and will only enhance funds' litigation risks related to their liquidity risk management programs.

Except as otherwise indicated elsewhere in this comment letter and except with respect to swing pricing, MFS supports the comments included in the comment letters of the Investment Company Institute and the Asset Management Group of the Securities Industry and Financial Markets Association.

Specific Comments

Liquidity Risk Management Program

MFS supports adoption of a rule that funds be required to adopt a written liquidity risk management program that is reasonably designed to assess and manage the liquidity risks of a fund and that such program be subject to approval of the fund's board of directors, including by a majority of the independent directors. If the Commission believes that it would be helpful to include in the adopting release a discussion of the types of factors that well designed liquidity risk management programs currently include MFS would not oppose inclusion of such a discussion provided it makes clear, as it presently does, that not all of the factors discussed may be relevant to a particular fund and that there may be other factors that are not discussed that may be relevant.

Liquidity risk management is a complex multi factored assessment that has changed and will continue to change over time. It is not advisable that the Liquidity Risk Management Rule carve into law a laundry list of practices that are assessed to be worthy in 2016.[3] The Liquidity Risk Management Rule should not mandate the factors that every liquidity risk management program must consider. Instead, similar to the compliance program rule, the Commission should specify the type of program that must be implemented (assessment and management of liquidity risk) and then rely on the advisers and directors to develop the specifics of the program that are suitable to the particular facts and circumstances of each fund.

In a different, but analogous context, the SEC staff recently issued a risk alert for investment companies that rely on out sourced compliance programs (Volume V, Issue 1, November 9, 2015). In that alert the staff observed that outsourced compliance programs are too generic and fail to account for the particulars of the investment company to which the program applies, noting that "some standardized risk checklists utilized by outsourced CCO's were generic and did not appear to fully capture the business models, practices, strategies, and compliance risks that were applicable to the registrant." The Liquidity Risk Management Proposed Rule creates the risk of creating a "checklist" approach to liquidity risk management. While the proposed rule states that not all identified factors may be relevant, the reality is that the factors will become a checklist.

A principles based liquidity risk management requirement coupled with enhanced prospectus disclosure of the fund's liquidity risk management program and liquidity risks of the fund will better serve investors overall than will a rule that puts liquidity risk ahead of all other risks. The Proposed Liquidity Risk Management Program Rule will increase the risk that a fund will underperform its benchmark or not meet its investment objective, particularly because of the Three Day Requirement. There is no analysis of the cost of this negative consequence of the Liquidity Risk Management Proposed Rule or why liquidity risk should be put ahead of all other risks. The requirement of the proposed Liquidity Risk Management Rule

[3] *Cf. Mutual Fund Distribution Fees; Confirmations*, Investment Company Act Rel. No. 29367 (July 21, 2010), 75 FR 47063, 47067-68 (Aug. 4, 2010) ("the factors enumerated in our adopting release reflected an expectation that a fund would use the rule in order to address particular distribution problems, such as periods of net redemption . . . . however, the rule ultimately resulted in distribution practices that we did not originally anticipate."

is to manage liquidity risk, not eliminate it. Each fund's disclosure will reflect the choices the fund has made in balancing the liquidity risks of the fund against the fund performance risks and other risks. Investors should be given the choice, within the parameters that all funds must prudently manage their liquidity risk, the risks into which they decide to invest.

Six Buckets

The Proposed Liquidity Risk Management Rule requires that each portfolio asset that is not a Standard Asset or a portion thereof be classified in one of six buckets based on the Fund's assessment of the number of days that it would take to convert that asset (or portion of that asset) to cash without materially impacting the price of the asset. The Commission states that "it recognizes that a fund whose ownership is relatively concentrated, and that has an investment strategy requiring it to hold a significant portion of unlisted securities that do not trade frequently, would likely establish a different liquidity risk management program than a fund whose portfolio assets consist mostly of exchange-traded securities with a very high average daily trading volume."[4] However, the actual rule proposed by the Commission applies to all asset classes and fails to recognize the reality that different asset classes trade very differently and that what might be sensible for large liquid equity assets is not a workable framework for fixed income assets. While it is conceivable that a six bucket categorization scheme might work for equity assets using generally available trading volume data and categorizing based on some rolling period of average daily volume, there is the paradox that in times of market stress trading volumes tend to rise. A consequence of this phenomenon would be that equity funds that rely on average daily trading volume to bucket the liquidity of their assets will be more liquid in stressed market conditions. Such a methodology is even more problematic for fixed income securities as there is far less reliable trading data and the significance of that data as it relates to the liquidity of a fixed income security is very uncertain. In MFS' professional view, there are many fixed income securities that may not have traded for a number of days but which MFS believes are liquid and could be sold in three or fewer days.

While it is the case that many liquidity models available in the marketplace as well as proprietary liquidity management approaches in fact bucket the relative liquidity of portfolio assets for purposes of analysis, that is different from there being a regulatory requirement to do so and the implication that the bucketing is a prediction that a particular asset can be converted to cash in a specified number of days for a specified amount – a prediction made in a document filed with the Commission and subject to filing liability. Liquidity management does not lend itself to that type of definitive assessment. Not only does the mandated bucketing give a false sense of precision as to the knowledge of how long it will take to convert certain portfolio securities to cash, when coupled with the requirement to make the classifications public in a document filed with the Commission, the Proposed Liquidity Risk Management Rule becomes a recipe for litigation. The fact that liquidity scoring is likely to be an element of any rigorous liquidity management program does not support mandating the liquidity scoring framework for every liquidity management program.

In stressed market conditions it is a certainty that however the fund's assets were classified for liquidity they will not turn out to have the predicted liquidity security by security, even though in the aggregate the fund is able to capably manage its liquidity requirements. Some assets might be saleable sooner than expected and others will take longer than expected.

For these reasons, MFS urges that the Commission not mandate a liquidity classification scheme at the individual portfolio security level, much less assessing whether a security should be classified in two or more buckets. A liquidity assessment based on asset type and key characteristics is a legitimate approach to liquidity management. If, however, the SEC insists on an individual security level assessment of liquidity, MFS urges that the Commission acknowledge that "matrix liquidity" is an appropriate way – but not the sole appropriate way – to assess liquidity at the individual security level. Of course if there are

[4] *Proposed Rule*, 80 FR at 62288.

circumstances specific to a particular issuer that could affect liquidity of securities issued by that issuer, the fund would need to account for those issuer specific circumstances.

No Material Impact on Net Asset Value or Price

The Proposed Liquidity Risk Management Rule defines liquidity risk to mean the risk that a fund could not meet expected redemptions under normal market conditions and reasonably foreseeable redemptions in stressed market conditions without materially affecting the fund's net asset value and provides that the liquidity of a portfolio security must be assessed on the basis that its sale does not materially impact the price. MFS recommends that the material impact to NAV and price components of these definitions be deleted. Liquidity risk is a risk inherent to investing regardless of whether an investor invests directly in a security or in a fund. Fund managers' incentives to carefully manage liquidity are well aligned with the interests of shareholders as a material impact to NAV will adversely affect performance.

Including a no material impact standard in both definitions is problematic because it will be unclear whether the impact to NAV or price is a function of the fund's activity or a function of the market – not to mention whether the no material impact standard could effectively prevent a fund from applying a swing factor when it deems such an action to be in the best interests of fund shareholders. For equities there are a variety of service providers and analytical frameworks that try to predict the impact that transactions are likely to have on price. In our experience those models are reasonably reliable – but not perfect – predictors of impact cost in normal market conditions when trading less than 20% of average daily volume. For transactions in excess of 20% of average daily volume or in stressed market conditions the models do a poor job of predicting impact costs, both over- and under-estimating expected costs. On the fixed income side there are far fewer tools available to predict market impact. It is mostly trader judgment and skill. It is also possible that in times of market stress even a small volume transaction could have an outsized impact on price due to market imbalances. Indeed, in a severely falling market how can a fund be certain that any sale of a portfolio asset will not materially affect the price?[5] The no material impact on price standard is unrealistic, arguably inconsistent with the Commission's Swing Pricing proposal and is trying to protect shareholders against dilution caused by illiquidity when in fact liquidity risk is inherent to the market and cannot be eliminated. The no material impact to price standard should be eliminated from the final rule.

Three Day Requirement

The Proposed Liquidity Risk Management Rule requires each fund to determine the portion of its fund's assets that are required to be invested in "three day assets" based on the fund's cash flow projection which requires the fund to estimate, among other things, the amount of reasonably foreseeable redemptions it will experience in normal and stressed market conditions. The proposal does not indicate the period of time over which the estimate of foreseeable redemptions is to be calculated. Many liquidity models currently assess adequacy of liquidity over a 30 day period and assess the entity's ability to raise cash during a thirty day period to meet liabilities. Does the Proposed Liquidity Risk Management Rule require that a fund estimate its reasonably foreseeable redemptions over a 30 day period in stressed market conditions and maintain assets that can be converted to cash within three days without affecting market price? Why should a fund be required to have so many three day assets when the projected redemptions will occur over a 30 day period? Such a requirement unduly constrains legitimate portfolio management discretion. If the Three Day Requirement is to be assessed on a rolling basis as of each day during the cash flow projection period, the Commission should clarify this point in the Adopting Release. Even with such a clarification the Three Day Requirement is likely to interfere with portfolio management that is consistent with sound liquidity risk management practices. A portfolio manager should be allowed to adjust his or her fund's liquidity based on current market conditions and not maintain a liquidity buffer

[5] If the Liquidity Risk Management Proposed Rule is adopted as proposed, it could well adversely affect overall market liquidity in periods of stress because funds may be prohibited from purchasing assets that cannot be converted to cash within three business days without materially affecting the price of that security.

against reasonably forseeable redemptions in stressed market conditions when stressed market conditions are not reasonably foreseeable. This more balanced approach will better serve investors over time by avoiding a mandated cash drag to performance. This "cash drag" will over time adversely affect performance in rising markets and may have the unintended consequence of causing portfolio managers to make riskier bets than they otherwise would, simply to counteract the cash drag.

While history should not be the only guide for what may happen in the future it should not be ignored. Historically, to the extent there have been "runs" on a fund (other than a Money Market Fund with a stable NAV) the run takes place over a period of months, not days and is unlikely to have been foreseen by historical redemptions and subscriptions (see, for example the recent events surrounding Third Avenue Trust, Release No. IC-31943; 812-14593, December 16, 2015). The Three Day Requirement would not adequately manage liquidity risk resulting from a long steady stream of redemptions. Rather, if a fund is well constructed using sound principles of liquidity risk management, disruption caused by persistent redemptions can be managed and redemption obligations honored. Witness the difference between the massive outflows that the PIMCO Total Return Fund suffered and honored without material disruption to the market in 2014 or to that fund versus the Third Avenue situation in which assets that were inappropriate for a significant portion of a fund represented a large portion of the fund. Even if that fund had cash equal to its reasonably foreseeable redemptions such a cash buffer would not have protected it from the level of redemptions the fund suffered in light of the assets in which it was invested. The Commission should rely on a principles based approach rather than trying to identify a single number which if satisfied provides the illusion that liquidity risk has been addressed.

Lines of Credit

The Proposed Liquidity Risk Management Rules does not provide for consideration of lines of credit available to a fund to pay redemptions in constructing its cash flow projection or establishing the Three Day Requirement. The Proposing Release on the other hand acknowledges that lines of credit, interfund lending and other sources of borrowing may be an appropriate consideration in determining the fund's Three Day Requirement. The Proposing Release, however, does not contemplate that a committed line of credit can be treated as a three day asset. A contractual commitment from a bank to lend is an asset, although it does not have a balance sheet value and is not relevant to the calculation of a fund's NAV. As an asset, a committed line of credit from an institution that is determined by the advisor to be creditworthy and that does not include conditions to borrowing that the fund cannot satisfy at the time of calculating its three day assets should be included in the amount of three day assets available to satisfy the Three Day Requirement. Other potential sources of borrowing such as interfund lending and uncommitted lines of credit should continue to be relevant to the determination of the Three Day Requirement.

Public Reporting of Liquidity Classifications

If the Commission decides to include the 6 Bucket Requirement in the final rule, MFS urges the Commission to not make the classification data public. Such information would be of little value to retail investors as it is too granular to be useful without further expert analysis. Moreover, different funds may legitimately classify the same holdings differently, for reasons ranging from the overlap among two of the Commission's buckets to holdings by other funds to differences in trading strategies and differences in the amount of liquidity provided by broker-dealers utilized by different funds. The Commission suggests that "third party analyzers" would find the information useful in assessing funds' liquidity risk. However, to the extent third party analyzers will actually analyze a fund's liquidity and not merely report on how a fund has scored its portfolio holdings, the portfolio holdings disclosure without the liquidity scoring is sufficient information to allow third party analyzers to analyze. Publicly disclosing liquidity scoring, in our view, merely provides third parties with a means of second-guessing decisions reached by different fund groups – third parties who do not have the benefit of the frequently-difficult analysis performed by fund advisers and who have no liability under the federal securities laws for any false or misleading statement that they may make. Balanced against the little value that public disclosure would bring and the harms

such disclosure would cause as described in Section IVE.2 of the ICI Comment Letter the Commission should not include a fund's liquidity scoring in the publicly available records.

Instead, MFS would urge that such data be provided to the Commission on proposed Form N-CEN. In particular, we would propose that each fund be required to file its liquidity risk management program as an exhibit to Form N-CEN.[6] We would propose that each program be accompanied by data about its program, filed in a structured format, to facilitate the Commission's aggregation and analysis of such data. Of course, we recognize that the Commission could supplementally request a fund to provide additional information about its liquidity risk management program over and above what would be provided through Form N-CEN.

Swing Pricing

As indicated above MFS generally favors the adoption of amendments to Rule 22c-1 under the Investment Company Act of 1940 to permit funds to adopt swing pricing. MFS has successfully used swing pricing for its Luxembourg based funds and believes that it has been beneficial to shareholders by allocating the cost of liquidity to the shareholders that are demanding it. It would have the same beneficial effect for shareholders of MFS' US mutual funds.

Swing pricing would also be responsive to the concerns that have been expressed by certain bank and systemic risk regulators that mutual funds create a "first mover advantage" that encourages fund shareholders to be early redeemers and therefore exacerbates the systemic risk posed by funds. While there is no historical data to support this thesis, swing pricing's allocation of the cost of liquidity to the shareholder demanding it should mitigate, if not eliminate, this concern.

Because swing pricing serves two beneficial purposes, liquidity management and externalization of transaction costs related to managing cash flow, MFS recommends that funds be permitted to swing their NAVs whenever they are in net subscriptions or redemptions and not only in circumstances where the net transaction activity exceeds a specified threshold.

While MFS would support the adoption of swing pricing in concept, MFS notes two issues that would inhibit the adoption of swing pricing by funds even if Commission rules authorized funds to do so. First, current practices for processing shareholder transactions for US mutual funds would make adoption of swing pricing very challenging. MFS receives less than a majority in principal amount of shareholder transactions as of the time the MFS Funds' NAV is required to be determined. With that amount of unknown transactions, MFS does not believe that it could reliably determine whether to swing its NAV. Significant changes would be required to provide enough information about flows early enough to enable funds to make informed swing decisions. That said, MFS believes that the US processing practices that delay receipt of transactions can be changed in a manner consistent with protection of investors, efficiency, competition and promotion of capital formation. MFS recommends that the Commission work with industry to make the necessary changes to processing transactions so that swing pricing becomes operationally feasible in the US.

Second, any decision to swing a fund's NAV carries with it the risk that a plaintiff with the benefit of hindsight could challenge any decision that a fund made in good faith at the time. As the Commission is aware, funds have shied away from taking advantage of past regulatory initiatives intended to benefit investors because of liability fears. In particular, the Commission recognized that funds generally failed to utilize fund profiles because of liability issues associated with those documents.[7] We believe that unless the Commission creates a safe harbor insulating funds from liability for swing pricing decisions that are

[6] *Cf.* Proposed Form N-CEN, Item 79.a.ii. (requiring registrants to disclose when they receive financial support).
[7] Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Investment Company Act Rel. No. 28584 (Jan. 13, 2009), 74 FR 4545, 4570-71 (Jan. 26, 2009).

not grossly negligent, reckless or intentionally fraudulent, few funds, if any, will adopt swing pricing, even if the shareholder processing issues can be solved.

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We appreciate the opportunity to comment on the Proposed Rules. If you have any questions regarding this comment letter I would be happy to discuss. I can be reached at [redacted].

Sincerely,

Mark Polebaum

cc: The Honorable Mary Jo White
Chair
Securities and Exchange Commission

The Honorable Kara M. Stein
Commissioner
Securities and Exchange Commission

The Honorable Michael S. Piwowar
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