PIMCO

April 30, 2020

Vanessa Countryman
Secretary, Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Proposed Rule Regarding Use of Derivatives by Registered Investment Companies and Business Development Companies; Required Due Diligence by Broker-Dealers and Registered Investment Advisers Regarding Retail Customers' Transactions in Certain Leveraged/Inverse Investment Vehicles (File No. S7-24-15)

Dear Secretary Countryman:

Pacific Investment Management Company LLC ("PIMCO") appreciates the opportunity to respond to the U.S. Securities and Exchange Commission's ("SEC" or "Commission") proposed rule regarding the use of derivatives by registered investment companies and business development companies (collectively, "funds"), and required due diligence by broker-dealers and registered investment advisers regarding retail customers' transactions in certain leveraged/inverse investment vehicles (the "Proposal").[1] PIMCO supports the Commission in its efforts to address the investor protection concerns underlying Section 18 of the Investment Company Act of 1940 ("Section 18"), as amended ("1940 Act") and to provide a more comprehensive approach to the regulation of funds' use of derivatives and certain other transactions.

PIMCO is registered as an investment adviser with the SEC and as a commodity trading advisor and a commodity pool operator with the U.S. Commodity Futures Trading Commission ("CFTC"). As of March 31, 2020, PIMCO managed approximately $1.78 trillion in assets on behalf of millions of individuals and thousands of institutions in the U.S. and globally, including state retirement plans, unions, university endowments, corporate defined contribution and defined benefit plans, and pension plans for teachers, firefighters and other government employees. PIMCO manages funds registered under the 1940 Act, separately managed accounts in accordance with specific investment guidelines and objectives specified by our clients, and private funds that are offered to institutional and individual investors, including funds that are Undertakings for Collective Investments in Transferable Securities ("UCITS"). In the case of all of these management services, PIMCO is engaged in long-term investment management of our clients' assets as a fiduciary.

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PIMCO is a leading provider of investment management services to fixed income funds, as well as funds investing in other asset classes such as equities and commodities, and employs a broad range of portfolio management tools in seeking to manage risk, capitalize on market inefficiencies and execute alpha-seeking strategies consistent with a fund's investment objective. Derivatives are an important tool in the

1 Use of Derivatives by Registered Investment Companies and Business Development Companies; Required Due Diligence by Broker-Dealers and Registered Investment Advisers Regarding Retail Customers' Transactions in Certain Leveraged/Inverse Investment Vehicles, Investment Company Act Release 33704, 85 Fed. Reg. 4446 (proposed Nov. 25, 2019) (to be codified at 17 C.F.R. pts. 239, 240, 249, 270, 274, 275) ("Proposing Release").

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management of investment portfolios and are used for various purposes, including: (i) as a more attractive substitute in terms of price, liquidity, or other factors for comparable physical securities; (ii) for managing portfolio risk (*e.g.*, adjusting portfolio duration, buying credit protection, hedging tail risks, downside risk mitigation and reducing currency exposure), particularly during periods of high market volatility; (iii) to target specific areas of yield curve exposure; (iv) to gain exposures that may not be possible through physical instruments; (v) to purse "theta" strategies that profit from the time decay of selling options; and (vi) to put cash to work and to maintain exposures during periods of redemptions. PIMCO also offers a line of "enhanced index" funds, which seek benchmark returns through the use of derivatives (such as S&P 500 futures contracts), while seeking alpha in an unrelated asset class (*i.e.*, fixed income). If the return on the invested asset exceeds the financing rate embedded in the derivatives instrument, the combination of the derivatives instrument and the invested securities can enhance the portfolio's return potential.

In light of the current market conditions and the recent extreme volatility in the market, we believe it is extremely important to stress the value and importance of derivatives for liquidity management and efficient portfolio management. During times of market stress or volatility, managers rely heavily on the numerous tools available to them, including the ability to access high quality, liquid instruments in derivative form. As described in more detail below, derivatives provide an alternative and often important substitute to the purchase of a comparable physical security. In times of market volatility this optionality is crucial and something that any rule that seeks to govern derivatives should encourage. Therefore, we believe certain changes would be warranted which can preserve the positive aspects of setting a common regulation of derivatives while not adversely impacting funds' ability to use derivatives.

Finally, we would note that in our view a prudent investment and liquidity management program should consider the use of derivatives. Therefore, although we agree and support the Commission's efforts in this area we continue to stress the need for prudent regulation. To the extent a derivatives rulemaking has the effect of curtailing a fund's ability to appropriately use derivatives we believe that could have a negative impact on shareholders and a manager's ability to seek risk adjusted returns.

I. Executive Summary

PIMCO generally supports the Commission's efforts to provide an updated and more comprehensive approach to the regulation of funds' use of derivatives transactions and agrees with many of the provisions of the Proposed Rule. However, we wish to offer several recommendations that would reduce the negative impact to fund investors, while still addressing the Commission's goal of protecting investors. Each of these recommendations is summarized below, and addressed in greater detail further in this letter.

- *The SEC should modify the proposed value-at-risk ("VaR") testing framework in certain respects.*
    - *Funds should be permitted flexibility to comply with the absolute value-at-risk ("VaR") test.* The Commission should permit fund managers to select whether absolute or relative VaR testing is most appropriate for a particular fund based on the fund's risk profile and disclosed investment strategy.

- *Additional guidance regarding the use of blended indexes should be provided.* The SEC should provide additional guidance with respect to construction of a blended index and under what circumstances a fund could determine to change the composition of such an index as the lack of specific guidance with respect to these items could lead to disparate and conflicting practices across the industry.

- *The SEC should clarify that an unlevered benchmark with derivatives would qualify as a designated reference index under the Proposed Rule.* Certain indexes include derivatives that do not have the effect of increasing the index's leverage, and thus appropriate funds should be permitted to utilize such indexes as designated reference indexes under the Proposed Rule, notwithstanding the fact that the index composition includes derivatives.

- *The SEC should modify the proposed VaR tests in certain respects.*

  - *The percentage limits under both VaR tests should be increased.* The SEC should adopt limits of 200% as the relative VaR test limit and 20% as the absolute VaR test limit, rather than the respective 150% and 15% limits set forth under the Proposed Rule.

  - *The restriction on new derivatives transactions that would be imposed in the event of a VaR test breach should be eliminated.* Restricting the ability of a fund to enter into certain derivatives transactions for the remediation period proscribed in the Proposed Rule has the potential to disrupt a fund's portfolio and risk management. If the SEC determines not to remove the restriction, we request that the Proposed Rule be modified to permit funds to enter into derivatives transactions during the remediation period for purposes of (1) responding to abnormal market conditions or events, (2) rolling current holdings, (3) meeting liquidity and redemption needs, and (4) mitigating risks within the fund's portfolio more generally (even if individually or in the aggregate, such risk mitigating transactions do not decrease the fund's VaR).

  - *The VaR test limits should be modified for closed-end funds.* A closed-end fund should be permitted to either (i) comply with VaR limits of 200% or greater under the relative VaR test and 20% or greater under the absolute VaR test, or (ii) use as its designated reference index a leveraged index that is leveraged in an amount corresponding to the amount of structural leverage disclosed by the fund.

- *The SEC should modify the treatment of reverse repurchase agreements and similar financing transactions in certain respects.*

  - *Funds should be permitted flexibility to segregate assets to cover these types of transactions similar to what is allowed under the current framework (i.e., asset segregation regime under Release 10666).* The SEC should adopt a limited asset segregation regime for reverse repurchase agreements and similar financing transactions, which would allow a fund to cover its obligations under these transactions with an amount of assets classified as "highly liquid investments" or "moderately liquid investments," as defined under Rule 22e-4 under the 1940 Act, equal to the fund's obligations to return assets under the transactions.

- *Closed-end funds engaging in such transactions should be treated differently than open-end funds.* If the SEC determines to adopt the requirements for reverse repurchase agreements and similar financing transactions as set forth in the Proposed Rule, we request that the SEC provide that closed-end funds may use the limited asset segregation regime for reverse repurchase agreements and similar financing transactions described in the above bullet point.

- *Securities lending transactions and reinvestment of cash collateral thereunder should be treated in a manner consistent with current no-action letters and SEC guidance.* The SEC should include guidance in this regard in connection with adopting any new rule.

- *We support the SEC's overall aim to eliminate the current asset segregation regime, with the limited exceptions we have noted for reverse repurchase agreements and similar financing transactions.*

- *The SEC should modify the proposed derivatives risk management program requirements in certain respects.*

  - *Funds should not be required to publicly disclose risk guidelines.*
  - *Funds should be permitted to conduct stress testing on a monthly basis.*
  - *Funds should be permitted to conduct back testing on a weekly basis.*

II. Comments Regarding the Limit on Fund Leverage Risk and Related Requirements

A. The Proposed VaR-Based Testing Framework Should be Modified in Several Respects

i. The Proposed Rule Should Allow for Flexibility to Comply with the Absolute VaR Test

The Commission should modify the Proposal to permit a fund manager to select whether absolute or relative VaR testing is most appropriate for a particular fund based on the fund's risk profile and disclosed investment strategy.[2] PIMCO supports the use of VaR as a means to limit funds' leverage risks and would anticipate that the relative VaR test will be appropriate for some of our funds, while the absolute VaR test would be a more appropriate measure of leverage for other funds. The framework proposed in the Proposal places an inappropriate burden on a fund's derivatives risk manager by forcing the manager to affirmatively determine that they are "unable" to identify a designated reference index that is appropriate for the fund. We strongly believe that this determination is both unnecessary and could subject the derivatives risk manager to second guessing by the SEC examination staff. As a result, the absolute VaR test would only be available in limited circumstances, which could negatively impact certain types of funds. We interpret the role of the derivative risk manager as ensuring that fund risk-taking through entering into derivatives transactions is appropriate and consistent with the fund objectives communicated to investors. In addition, as discussed further below, we do not see a compelling policy

[2] PIMCO is generally supportive of VaR-related limits, but we would like to highlight that VaR testing considers volatility across a portfolio irrespective of whether a fund holds derivative positions. As a result, a fund's VaR and the associated VaR-related limits may serve as a limit on a fund's volatility rather than a limit on a fund's ability to hold derivatives.

reason to require that the relative VaR test be the default method for testing a fund's compliance with the limit on fund leverage risk.

Accordingly, we strongly believe that with appropriate disclosure, including with respect to the risks a fund may be subject to as a result of investments in derivatives, the Proposed Rule should permit a fund flexibility to determine whether to comply with the relative VaR test or the absolute VaR test, without requiring the fund's derivatives risk manager to determine that it is unable to identify a designated reference index that is appropriate. We would propose that the Proposed Rule instead allow for the choice between absolute and relative VaR tests and provide guidance that states that (1) the choice be made in light of the fund's risk profile and investment strategy; (2) a fund not change between tests solely due to a failure to comply with a selected VaR test; (3) a fund should disclose in its prospectus the specific risks it may face in connection with derivatives investments and how the fund manages such risks; and (4) the derivatives risk manager's annual report to the fund's board include information regarding the VaR test with which a fund has decided to comply, including narrative discussion of the differences between relative and absolute VAR tests.

We also note that the relevant percentage limit on fund leverage risk would be complemented by the derivatives risk management program (including required stress testing and backtesting) and would be reviewed by the fund's board. In this regard, this approach would be analogous to the approach that the SEC adopted for setting a "highly liquid investment minimum" under Rule 22e-4 under the 1940 Act, under which the liquidity risk manager, which is in the best position to assess a fund's liquidity risk, sets a fund's highly liquid investment minimum under the supervision of the fund board.

ii. There is No Policy Basis to Require That the Relative VaR Test be Used as the Default

We believe that analogizing the relative VaR test percentage limit to the hypothetical VaR of a fund engaging in bank borrowings demonstrates only a loose connection to Section 18. Under the proposed limit on fund leverage risk, the relative VaR test would include the leverage effects from instruments outside of derivatives and potential losses that could arise from non-leverage variables. This lends further support to the rationale for why a derivatives risk manager should be free to determine whether absolute or relative VaR testing is more appropriate for a particular fund.[3] Accordingly, we do not believe that the relative VaR test, as compared to the absolute VaR test, more closely resembles Section 18's limits on leverage risk but rather serves as a limit on volatility relative to a benchmark, which should not be the regulatory required default.[4]

In addition, the Commission states in the Proposing Release that reliance on the absolute VaR test "may be inconsistent with investors' expectations where a designated reference index is available." The Commission highlighted as an example of such an instance that a fund that invests in short-term fixed income securities using the absolute VaR test could "substantially leverage its portfolio" beyond the VaR

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3 Further, since the VaR test focuses on volatility and is not limited to derivative usage, a fund with limited or no derivative usage could surpass the absolute or relative VaR limits with no repercussions.

4 PIMCO currently uses tracking error relative to a benchmark in our risk management program. We believe that tracking error relative to a benchmark is an important tool in managing risk; however, we do not believe that all instances VaR relative to a benchmark is synonymous and therefore, we believe that there should not be a regulatory presumption that VaR relative to a benchmark is a preferable test and more closely aligned with investor expectation than an absolute VaR test.

of a hypothetical designated reference index of short-term fixed income securities. As discussed above, we note that while investor expectations with respect to a fund's leverage risk may be based on the volatility of the asset classes in which the fund invests, which generally could be represented by the fund's performance benchmark, a fund may experience more volatility than its performance benchmark depending on the specific investments it makes, irrespective of whether those investments are in derivatives. We believe that a fund can address this investor expectation issue by including appropriate registration statement disclosures indicating the nature of the level of risks that an investor should expect that the fund's investments may create. Additionally, we believe that public disclosure of which VAR test is being utilized, including explanatory discourse of the difference between relative and absolute VAR, should mitigate investor expectation concerns. Accordingly, we believe that clear and appropriate disclosure should sufficiently set investors' expectations.

Therefore, we propose that the Proposed Rule require that a fund select an appropriate VaR test based on its risk profile and investment strategy, clearly disclose such selection and not change between tests solely due to a failure to comply with a selected VaR test.

By permitting certain funds that are "unable" to designate an index to then use the absolute VAR test, which could give such funds greater flexibility, the Proposed Rule could give funds an incentive to market themselves as absolute return funds even where investors may have preferred funds that are managed relative to an index.[5] Similarly, funds could have an incentive to conclude that they are "unable" to choose a designated index, which may lead to certain funds being more aggressive than others in making their "inability" determination. In either case, certain similar funds in the industry may conclude differently whether they are "unable" to designate a benchmark, which could lead to similar funds utilizing different VAR tests.

The discussion of the SEC's economic analysis in the Proposing Release notes that allowing a choice between the tests depending on the derivatives risk manager's preference "may result in less uniformity in the outer limit on funds' leverage risk across the industry" and that certain funds could obtain significantly more leverage under an absolute VaR test, causing investors in such funds to be less protected from leverage-related risks than under the structure set forth in the Proposed Rule. As noted above, under the proposed construct, there likely will not be uniformity even among similar types of funds. Additionally, we believe that the SEC has not made a convincing case or provided any meaningful data-driven analysis showing that such optionality between VAR tests in fact creates significant risks or that such risks outweigh the benefits of the use of derivatives under the absolute VaR test. We also note that the Proposing Release does not discuss any specific benefits to funds and investors that would be gained from establishing the relative VaR test as the default limit on fund leverage risk.

We also note that the leverage risk a fund may be permitted to take under a relative VaR test may vary materially with the selection of the designated reference index itself, and even within similar strategies, funds' risk limits may diverge based on the selected index. Nor does the Proposing Release make a

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5 We also note that there may be certain incongruous results among funds with similar investment strategies that may arise from the VaR test formulation in the Proposed Rule. For example, an absolute return fund that invests in short-term fixed income securities could appropriately determine to comply with the absolute VaR test, whereas a fund that invests in short-term fixed income securities that does not describe having an absolute return investment focus or objective would likely have to comply with the relative VaR test.

convincing case or provide a quantitative, data-driven cost-benefit analysis evidencing that the relative VaR test will prevent harm to investors.

Each of the absolute and relative VaR tests can serve as an appropriate metric to help assess and limit the extent to which a fund's derivatives transactions create leverage and therefore both can serve to address the concerns underlying Section 18. We also note that, in addition to the new requirements we are proposing, the limit on fund leverage risk would be complemented by the derivatives risk management program that would manage asset sufficiency and other types of risk that may be posed by a fund's use of derivatives that may not be addressed by either VaR test.

iii. The Proposed Rule Creates Inherent Challenges in Selecting - or Determining that the Fund Cannot Identify - an Appropriate Designated Reference Index

The Proposed Rule and the Proposing Release provide generally that the selection of a designated reference index would have to be based on "the markets or asset classes in which the fund invests." However, there is no standard for, or substantive instruction on, what type of index may be an appropriate designated reference index for a particular fund. Further, the Proposed Rule and the Proposing Release do not provide guidance on how a derivatives risk manager should make a determination that it is unable to identify a designated reference index.[6] We are concerned that the lack of guidance on how to make the determination may create the risk that the SEC examination staff will issue negative examination findings (or raise the potential for an enforcement action) regarding the related determinations of a fund's derivatives risk manager.

To the extent the SEC is unwilling to provide more flexibility and allow a derivatives risk manager to reasonably determine and disclose whether a fund will comply with the relative VaR test or the absolute VaR test, we believe that the current standard laid out in the Proposal (*i.e.*, that the derivatives risk manager is unable to identify a designated reference index for a fund) is too high a bar and will result in a very limited universe of funds eligible to utilize the absolute VaR test. Therefore, we would propose revising the standard for when a fund may use an absolute VaR test. In our view, the choice of which VaR test to use should be at the discretion of the risk manager, taking into account the fund's risk profile and investment strategy, subject to related reporting to the Board and disclosure in fund shareholder reports and prospectuses.

In performing relevant testing on certain PIMCO funds, we have found that certain strategies may be better suited for absolute VaR testing as compared to relative VaR testing, such as short-term bond funds that currently utilize performance indexes with low volatility. For example, a short-term bond fund with an investment strategy of producing positive returns over longer periods of time may choose a performance benchmark of US government short-term Treasury bills. At times, the fund may invest a portion of its assets in short-term Treasury bills, but given the active management of the fund, we would generally expect that the short-term Treasury bill index would have a much lower risk and volatility profile than the fund. As such, we would not view such an index as an appropriate designated reference index for the fund. PIMCO manages such short-term bond funds with the expectation of having a certain

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6 The Proposing Release discusses only "multi-strategy funds" that "implement a variety of investment strategies, making it difficult to identify a single index (even a blended index)," as the sole example under which it would be appropriate for a derivatives risk manager to conclude that it is unable to identify an appropriate designated reference index.

amount of tracking error as compared to the relevant performance benchmark. The tracking error noted above is what allows our portfolio management team to deliver returns that deviate from the benchmark and are the hallmark of active portfolio management. However, as a result of this active management and deviation from the benchmark, such funds could exceed the VaR of the relevant Treasury bill index by more than 150%. Therefore, we would be forced to either: (i) change the strategy and reclassify it as an absolute return strategy which would allow us to utilize the absolute VaR limit or (ii) select another index with a higher volatility profile which may not be a better representation of the fund or its investments. In our view, these choices are sub-optimal and a better, more sensible option would be to allow the flexibility for a manager to choose between relative or absolute VaR tests and clearly disclose such selection and the risks associated with such selection to shareholders.

Further, we believe that the absolute VaR test may be appropriate for any actively-managed strategy that does not explicitly disclose an investment strategy to limit or tie its risk levels to an index. When engaging in active management (as compared to passive management), a manager is not directly constrained by a fund's benchmark index. Therefore, active management allows for the flexibility to take advantage of certain changes in the market which may periodically move a fund's risk profile farther away from a benchmark index without necessarily representing any concern for shareholders or inappropriate risk taking. For these reasons, we do not think that shareholder expectations change when comparing an absolute return fund to other actively-managed funds in a similar asset class.

iv. The SEC Should Provide Additional Guidance Regarding the Use of Blended Indexes

The Proposed Rule would permit a fund to use a blended index for purposes of the relative VaR test as long as each component index is not administered by an organization that is an affiliated person of the fund, its investment adviser, or principal underwriter, or created at the request of the fund or its investment adviser, unless such component index is widely recognized and used. The Proposing Release notes that this "would give some flexibility in identifying or constructing a designated reference index that provides an appropriate baseline for the relative VaR test," and provides as an example a balanced fund that "may determine that a blended index of an unleveraged equity index and an unleveraged fixed income index would be an appropriate designated reference index." However, we believe that the lack of specific guidance from the SEC with respect to the circumstances under which a fund could appropriately determine to use a blended index could lead to disparate and conflicting practices across the industry with respect to blended index construction. For example, it is unclear if a fund could only use a pre-blended index (for which an independent party has already determined the blend of indexes comprising such index) or if the fund could use a self-blended index.[7] In addition, changing macroeconomic and market conditions or changes in a fund's investment strategy or portfolio exposures could require a fund to frequently alter the composition of a blended index over time in order to ensure such index continued to reflect the markets or asset classes in which the fund invests. The constant monitoring and evaluation that would be necessary to ensure a blended index remained appropriate for a particular fund could be impracticable and cause a fund to incur significant operational costs. Accordingly, we would request that the SEC provide additional guidance with respect to construction of a blended index and under what circumstances a fund could determine to change the composition of such an index.

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7 We note that the Proposed Rule and Proposing Release are also unclear on whether there is a limit on the number of indexes that a blended index may be comprised of.

v. The SEC Should Clarify that an Unlevered Benchmark with Derivatives would Qualify as a Designated Reference Index

We also believe that the SEC should clarify that a fund could use an unlevered index that includes derivatives as the fund's designated reference index. For example, certain commodity indexes include commodity futures that do not have the effect of increasing the index's leverage, and thus appropriate funds should be permitted to utilize such indexes as designated reference indexes under the Proposed Rule, notwithstanding the fact that the index composition includes derivatives. The Proposing Release notes that "[c]onducting a VaR test on a designated reference index that itself is leveraged would distort the leverage-limiting purpose of the VaR comparison by inflating the volatility of the index that serves as the reference portfolio for the relative VaR test." We believe that permitting a fund to use an index that includes derivatives within its composition, but that do not have the effect of leveraging the index, would be in line with the "leverage-limiting purpose" of the Proposed Rule and would permit a fund to select a designated reference index that better reflects the fund's volatility and risk characteristics.

B. The Proposed VaR-Based Tests Should be Modified in Several Respects

i. The Percentages Should be Increased for Both VaR Tests

For the reasons set for below, we believe that the SEC should adopt an approach that sets the VaR limits at 200% as the relative VaR test limit and 20% as the absolute VaR test limit, rather than the respective 150% and 15% limits set forth under the Proposed Rule.

As discussed above, we believe that analogizing the relative VaR test percentage limit to the hypothetical VaR of a fund engaging in bank borrowings demonstrates only a loose connection to Section 18. The Proposed Rule's leverage limits would restrict a fund's ability to utilize leverage more severely than the Section 18 limits on bank borrowings because the fund's VaR calculation would account for losses created by many different variables other than leverage solely from the use of derivatives. The extension of the analogy to Section 18 to justify the 15% limit under the absolute VaR test likewise is problematic. In this regard, the Proposing Release states that the SEC's Division of Economic and Risk Analysis ("DERA") staff analysis of the VaR of the S&P 500 index over time found that the historical mean VaR of that index was approximately 10.4%. The Proposing Release goes on to state a view that, based on this finding, setting the absolute VaR test at 15% of a fund's net assets would provide comparable treatment for funds that rely on the absolute VaR test and funds that rely on the relative VaR test and use the S&P 500 as their designated reference index (*i.e.*, allowing the fund to have roughly 1.5 times the historic mean VaR of the S&P 500 index). The Proposing Release also suggests that many investors, including investors in funds that are not broad-based large capitalization equities funds, may understand the risk inherent in broad-based large capitalization equities indexes as the level of risk inherent in the markets generally. We are concerned that this line of reasoning is flawed with respect to funds that are not broad-based large capitalization equity funds and that the selection of the 15% limit appears to be arbitrary. In addition, we note that an applicable VaR test limit may be impractical for a fund to apply and comply with at any given time due to increases in market volatility that may occur.

Accordingly, the rationale for the proposed 150% relative VaR test limit and 15% absolute VaR test limit based on an analogy to the Section 18 borrowing limits for open-end funds does not justify the negative impact that the proposed percentage VaR test limits would have on certain funds.

Further, we do not believe the SEC has demonstrated justification for the proposed significant distinction from corresponding thresholds under the UCITS Guidelines.[8] Fund managers such as PIMCO that sponsor registered investment companies in the U.S. and UCITS funds using similar strategies would face significant issues with managing such strategies under similar regulatory structures that impose different percentage limits. The increased VaR test limits we are proposing have already been successfully implemented and tested through a variety of markets for UCITS funds, and U.S. funds (and their shareholders) could suffer from competitive disadvantages as a result of having to comply with more restrictive VaR tests. Fund managers may need to change a fund's use of derivatives in the U.S. and maintain a different portfolio compared to the corresponding UCITS fund in order to comply with the more limiting VaR tests under the Proposed Rule. This could reduce efficiency for a U.S. fund compared to the corresponding UCITS fund and be detrimental to fund return potential, risk controls and investor risks/returns. In addition, portfolio management, risk management, and compliance functions could be forced to adopt even more complex systems, and funds may be subject to greater technology and operational costs in order to manage compliance under both regulatory regimes.

ii. The Limitation on New Derivatives Transactions Has the Potential to Significantly Disrupt a Fund's Portfolio and Risk Management, and Should be Eliminated

Under the Proposed Rule, if a fund determines that it is not in compliance with its VaR test, the fund would have to come back into compliance within three business days. In such event, if the fund is not in compliance with its VaR test within three business days, among other things, the fund could not enter into any derivatives transactions (other than derivatives transactions that, individually or in the aggregate, are designed to reduce the fund's VaR) until the fund has been back in compliance with its VaR test for three consecutive business days. We strongly believe that restricting the ability of a fund to enter into certain derivatives transactions for this period of time could be very disruptive to a fund's investment strategy if the fund obtains significant amounts of its investment exposure through the use of derivatives transactions, and may have a negative impact on such a fund, including on its liquidity management, in periods of increasing market volatility. This argument is not theoretical in today's environment as asset managers are currently dealing with unprecedented volatility. We cannot stress how important our ability to access the derivative market is in these times of stress. If under a new regulatory regime, we were limited or restricted from using the derivatives market our shareholders would be negatively impacted. We remain supportive of prudent regulation but caution that over-regulation in this area may have a significant and harmful effect on funds and shareholders. Therefore, we request that the Commission reconsider this provision and strongly consider eliminating it from the final rule.

A fund's VaR is not a static calculation and, under the Proposed Rule, a fund's VaR calculation model would potentially have to account for periods of lower market volatility. However, as market volatility may change and increase over time, a fund's potential forward-looking VaR could also increase. During periods of increased market volatility, it is often prudent for a fund to increase the liquidity of its portfolio. Funds could achieve increased liquidity by replacing settled cash positions with derivatives instruments, while increasing the amount of available cash buffer that may be utilized to meet investor redemption requests. In modeling the VaR risk of funds, PIMCO explicitly considers the potential basis

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8 The UCITS Guidelines provide that a UCITS fund should always set the maximum VaR limit according to its defined risk profile. Under the relative VaR approach, the VaR of the UCITS fund's portfolio must not be greater than 200% of the reference portfolio. Under the absolute VaR approach, the VaR of a UCITS fund cannot be greater than 20% of its net asset value.

risk presented by replicating cash securities with synthetic instruments. Consequently, taking this basis risk into account could increase the ex-ante VaR on the margin when a fund is attempting to improve its liquidity profile. In addition, if a fund was prevented from reacting to changing asset liquidity or market dislocations by not being able to enter into derivatives transactions during the relevant period, the restriction in the Proposed Rule could adversely impact a fund's performance and harm the fund's shareholders.

In addition, this restriction could create additional risk for shareholders. For example, prohibiting a fund from rolling positions during the period until such breach is cured for three consecutive business days, and accordingly decreasing fund's investment exposure obtained through investments in derivatives or increasing a fund's exposure to currency risk, in a volatile market could lead to capital loss and exacerbate liquidity risk.

Another potential consequence of an overly restrictive set of rules around the use of derivatives is that it may create an incentive for fund sponsors to offer products that avoid derivatives but utilize structural leverage in the portfolio through the use of other investments that have embedded volatility, in order to generate returns. Investors, seeking exposure to leveraged investment products and the expected higher levels of returns, may drive the demand to invest in funds that utilize structural leverage. In our experience, these types of funds may be more susceptible to market volatility and therefore subject to higher levels of portfolio risk and greater risk of permanent impairment of capital than funds using certain derivatives to obtain comparable investment exposures higher up in the underlying capital structure. For example, a fund may invest in credit risk transfer securities, which provide leveraged exposure to agency mortgage-backed security pools at the lower levels of the pools' capital structure, and would not be derivatives transactions under the Proposed Rule. Credit risk transfer securities have experienced significantly magnified levels of losses and volatility under recent extreme market conditions compared to higher-rated forward-settling mortgage-backed security pools, which may be derivatives transactions under the Proposed Rule. Accordingly, it is important that the final Rule not disincentivize funds' use of derivatives by imposing overly restrictive VAR limits or by restricting the ability of funds to effectively and responsibly implement new derivatives positions after exceeding the VAR. These proposed requirements may have the unintended consequence of potentially encouraging investors to invest in funds that, despite their lack of investment in derivatives, could pose potentially greater risk of loss through exposure to other types of leverage than funds that invest in derivatives.

In addition, in our experience, it is practically difficult and complex to test and definitively determine whether a particular derivatives transaction will reduce a fund's VaR prior to or at the time the fund enters into such transaction. Certain abnormal market conditions, such as market volatility or fund-specific events, such as the departure of a portfolio manager, may also require funds to respond rapidly and make different investments on a time-sensitive basis, and derivatives may provide the most efficient means for making prudent investments in such circumstances. For example, liquidity events, which may be sparked by different market or fund-related events, could create significant issues for a fund's portfolio construction and necessitate a fund making investments that could temporarily increase the fund's VaR. In addition, we note that under the Proposed Rule, a fund would not be prohibited from entering into non-derivatives transactions during the three-business day period and until such breach is cured for three consecutive business days, which may have the effect of increasing a fund's VaR. This result would not appear to be in line with the Proposed Rule's risk-limiting aims and we would urge the SEC to reconsider whether the prohibition on entering into new derivatives transactions is actually protective of shareholders.

Accordingly, we request that the SEC remove the restriction on entering into certain new derivatives transactions from the Proposed Rule.

iii. At a Minimum, the Limitation on New Derivatives Transactions Should be Revised to: (i) Allow for Derivative Usage Under Certain Abnormal Circumstances and (ii) Permit Certain Derivative Strategies

If the SEC determines not to remove the restriction on entering into derivatives transactions during the remediation period following a VaR test breach, we request that the Proposed Rule be modified to permit funds to enter into derivatives transactions during the remediation period for purposes of (1) responding to abnormal market conditions or events, (2) rolling current holdings, (3) meeting liquidity and redemption needs, and (4) mitigating risks within the fund's portfolio more generally (even if individually or in the aggregate, such risk mitigating transactions do not decrease the fund's VaR). These bases for entering into derivatives transactions reflect significant concerns for certain funds, and funds should not be restricted from entering into derivatives transactions for these purposes for any period of time. We would propose that in such circumstances the derivatives risk manager report on such occurrence at the next regularly scheduled board meeting.

In addition, there are certain circumstances under which a fund could breach its VaR test without entering into a new transaction (*i.e.*, a passive breach). A passive breach of a VaR test may occur as a result of a change in market conditions or other general, industry-wide trends. We believe that a fund's passive breach of its VaR test would not necessarily be indicative of the fund bearing too much leverage arising out of its derivatives holdings and that a fund experiencing a passive breach of its VaR test should not be subject to the same remediation requirements as applicable to other VaR test breaches that occur in connection with a fund's active portfolio management or investment decisions. Accordingly, if the SEC determines not to remove the restriction on entering into derivatives transactions during the remediation period following a VaR test breach, we request that the SEC provide a carve-out from the prohibition on entering into certain derivatives transactions in the event of a passive breach.

iv. The Proposed Rule's VaR Limits Should be Modified for Closed-End Funds

We strongly believe that the SEC should raise the VaR test limits for closed-end funds beyond the limit for open-end funds that are subject to the Proposed Rule. Closed-end funds are permitted to simultaneously obtain structural leverage in the form of borrowing or issuing preferred stock or debt, which increases a fund's total assets, and portfolio leverage in the form of investments in derivatives, reverse repurchase agreements and tender option bonds (among other things). Section 18 imposes asset coverage requirements of different levels for different types of closed-end fund structural leverage (*i.e.*, 200% for preferred stock and 300% for debt), and affords closed-end funds to thus obtain greater overall levels of leverage than open-end funds.[9] Such closed-end funds typically disclose the level of structural leverage that they utilize. We believe that closed-end funds' ability to obtain structural leverage and greater overall levels of leverage generally supports certain differing treatment for closed-end funds under the Proposed Rule.

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[9] BDCs are subject to different percentage asset coverage requirements.

Accordingly, we believe that a closed-end fund should be permitted to either (i) comply with VaR limits of 200% or greater under the relative VaR test and 20% or greater under the absolute VaR test[10], or (ii) use as its designated reference index a leveraged index that is leveraged in an amount corresponding to the amount of structural leverage disclosed by the fund. With respect to the request in item (ii), we note, for example, that a closed-end fund that discloses it is 50% leveraged should be permitted to use a designated reference index that is similarly 50% leveraged.

III. Reverse Repurchase Agreements and Similar Financing Transactions

We are concerned with the Proposed Rule's treatment of reverse repurchase agreements and similar financing transactions as the equivalent of borrowings under the asset coverage test. We instead believe that the SEC should retain the flexibility for funds to segregate assets to cover these types of transactions similar to what is allowed under the current framework (*i.e.*, asset segregation regime under Release 10666[11]), as an alternative approach to that included in the Proposed Rule. As described below, reverse repurchase agreements are one of several tools which PIMCO uses in managing its portfolios and often raise in importance during more systemic risk periods, such as we are seeing in today's market. To the extent the Proposed Rule limits PIMCO's ability to access reverse repurchase agreements, it may increase the costs to shareholders and negatively impact liquidity and returns by increasing a fund's reliance on securities lending, which is treated differently under the Proposed Rule. We strongly believe that asset managers and shareholders are better served when a portfolio manager has a choice of multiple tools and instruments for achieving similar results. Therefore, we recommend that the Commission allow a fund to access both securities lending and reverse repurchase agreements in a similar manner.

Further, the current asset segregation regime protects shareholders from the potential risks associated with these instruments which are different than other types of derivatives transactions. Therefore, in light of

10 We would also request that in the event the SEC determines to increase the VaR limits for open-end funds to 200% under the relative VaR test and 20% under the absolute VaR test, the VaR limits should be further increased for closed end funds to at least 250% under the relative VaR test and 25% under the absolute VaR test, to account for the increased amounts of leverage closed-end funds are permitted to obtain. Both closed-end funds and open-end funds are required to maintain 300% asset coverage for senior securities representing indebtedness. Closed-end funds also are able to issue preferred stock that is subject to 200% asset coverage for senior securities representing indebtedness and preferred stock. With the addition of preferred stock, closed-end funds therefore are permitted to incur considerably more leverage as open-end funds. As such, it is consistent with investor expectations for closed-end funds to be more levered.

11 Under the SEC's long-standing guidance in Release 10666 and related SEC staff guidance, a fund may engage in reverse repurchase agreements and "all comparable trading practices" to the extent the fund segregates certain liquid assets equal to the fund's obligations arising under the agreement. The value of the account would have to equal the value of the proceeds received from any sale subject to repurchase plus accrued interest, or if the reverse repurchase agreement has a specified repurchase price, an amount equal to the repurchase price, which price will already include interest charges. If a fund complies with the asset segregation condition, it is not required to count the obligation created under the reverse repurchase agreement toward its Section 18 asset coverage requirement for borrowings. The Proposed Rule would significantly change the approach for determining compliance with Section 18 with respect to reverse repurchase agreements and similar financing transactions, and allow a fund to enter into such transactions only if the fund complies with the asset coverage requirements of Section 18 and combines the aggregate amount of indebtedness associated with the reverse repurchase agreement or similar financing transaction with the aggregate amount of any other senior securities representing indebtedness when calculating the asset coverage ratio.

the benefits of the use of these transactions and the potential costs to changing the approach under Section 18 with respect to these transactions, we believe that there is no policy reason that the SEC should create a disincentive for funds to utilize reverse repurchase agreement transactions by adopting different rules with respect to these transactions.

Reverse repurchase agreements are generally viewed as short-term financing transactions, which are economically similar in many ways to securities lending, which is exempt under the Proposed Rule from the Section 18 asset coverage requirements. Therefore, we believe reverse repurchase agreements are appropriately treated differently than "derivatives" as defined by the Proposed Rule. To the extent that a fund is limited in its ability to use reverse repurchase agreements, certain PIMCO funds may instead choose to rely more heavily on securities lending[12] which may increase costs to shareholders or, at a minimum, reduce flexibility for the portfolio management team. Reverse repurchase agreement transactions provide a means for funds to obtain shorter-term financing in a manner that is more efficient than a traditional secured borrowing under a credit facility, involve high quality collateral and serve as important sources of liquidity for funds. In our experience, a fund's ability to have options for financing beyond securities lending provides better results for shareholders without increasing the risk to shareholders.

Based on our analysis of the use of reverse repurchase agreements and similar financing transactions by the PIMCO funds, the SEC's economic analysis is flawed and the proposed change in approach to these transactions would have a significant limiting impact on certain PIMCO funds' operations. The proposed approach would require extensive changes to the way in which such funds use reverse repurchase agreements and other similar transactions. In this regard, the PIMCO funds have built strategies and fund products based on the Release 10666 asset segregation framework and the distinction thereunder for the treatment of reverse repurchase agreements and similar financing transactions from traditional secured borrowings.

The current asset segregation model is sufficient as reverse repurchase agreements are covered with liquid assets equivalent to the notional amount of exposure.[13] The SEC has not identified any reason that the current asset segregation framework does not adequately address the undue speculation and asset sufficiency concerns underlying Section 18.[14] In addition, we are not aware of any issue within the fund

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12 The Proposed Rule treats securities lending differently than reverse repurchase agreements. The SEC would not view the obligation to return securities lending collateral as a similar financing transaction "so long as the obligation relates to an agreement under which a fund engages in securities lending, the fund does not sell or otherwise use non-cash collateral received for loaned securities to leverage the fund's portfolio, and the fund invests cash collateral solely in cash or cash equivalents."

13 We are not proposing to increase flexibility beyond the current framework for funds to obtain leverage through the use of reverse repurchase agreements. Our proposed treatment of reverse repurchase agreements is consistent with the current asset segregation regime under Release 10666 and no-action relief issued by the SEC staff (*i.e.*, a fund could not use the securities underlying reverse repurchase agreements to meet its asset segregation requirements).

14 We note that the SEC's 2015 rulemaking effort regarding the use of derivatives (the "2015 Proposed Rule") included reverse repurchase agreements in the definition of "financial commitment transactions," and the related proposing release (the "2015 Proposing Release") noted that such transactions, if covered fully, do not raise concerns related to compliance with Section 18. In addition, the 2015 Proposing Release noted that "requiring a fund to maintain qualifying coverage assets sufficient to cover its full obligations under a financial commitment transaction may effectively address many of the risks that otherwise would be

industry nor have any PIMCO funds encountered issues in their use of reverse repurchase agreements that would suggest that the current asset segregation framework does not adequately protect funds and their investors.

A. There is No Policy Basis to Change Treatment of Reverse Repurchase Agreements and Similar Financing

The SEC's policy judgment to change the treatment of reverse repurchase agreement transactions and similar financing transactions is not founded on a clear cost-benefit analysis that demonstrates the benefits outweigh the costs created by this change. In its cost-benefit analysis, the SEC noted the number of funds it anticipates will need to adjust their operations in response to this change and concluded that the change could decrease fund use of reverse repurchase agreements which in turn could reduce capital formation. The SEC did not provide any data or analysis addressing the degree to which funds use reverse repurchase agreements and similar financing transactions to obtain leverage. The SEC also did not address the lost efficiency from limiting funds' ability to obtain short-term liquidity or leverage through using these transactions.

To address the SEC's perceived asset sufficiency concerns, we propose that the Proposed Rule modify the current framework to allow only for a limited asset segregation regime for reverse repurchase agreements and similar financing transactions, which would allow a fund to cover its obligations under these transactions with an amount of assets classified as "highly liquid investments" or "moderately liquid investments," as defined under Rule 22e-4 under the 1940 Act, equal to the fund's obligations to return assets under the transactions.[15]

B. Closed-End Funds Engaging in Reverse Repurchase Agreements and Similar Financing Transactions Should Be Treated Differently than Open-End Funds

Based on our analysis of the use of reverse repurchase agreements and similar financing transactions by the PIMCO closed-end funds, the SEC's analysis of the impact of the Proposed Rule is flawed and the proposed change in approach to these transactions would have a significant limiting impact on numerous PIMCO closed-end funds' operations. The proposed approach would require extensive changes to the way in which such funds use reverse repurchase agreements and other similar transactions.

As previously noted, closed-end funds are permitted under Section 18 to issue preferred stock to obtain structural leverage (subject to a 200% asset coverage requirement) and also issue debt to obtain structural leverage (subject to a separate 300% asset coverage requirement). Closed-end funds also are not subject to the daily liquidity concerns that are relevant for exchange-traded funds ("ETFs") and open-end funds.

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managed through a risk management program." We believe our proposal with respect to reverse repurchase agreements is consistent with this rationale and note that our proposal would be more restrictive than the 2015 Proposed Rule (which would have permitted funds to cover obligations with securities that were less liquid than "highly liquid investments" or "moderately liquid investments," as defined under Rule 22e-4 under the 1940 Act). *See* 2015 Proposed Rule at 80949.

15 To be clear, to the extent that a fund enters into an offsetting repurchase agreement transaction, no asset segregation would be necessary.

For the reasons noted in Section II.A, above, and in recognition of the differences in the statutory restrictions on the issuance of structural leverage under the statutory restrictions and concerns applicable to closed-end funds, as compared to open-end funds, if the SEC determines to adopt the requirements for reverse repurchase agreements and similar financing transactions as set forth in the Proposed Rule, we request that the SEC provide that closed-end funds may use a limited asset segregation regime for reverse repurchase agreements and similar financing transactions. As with our proposal above, we are proposing to allow such a fund cover its obligations under these transactions with an amount of assets that would be classified as "highly liquid investments" or "moderately liquid investments," as defined under Rule 22e-4 under the 1940 Act (as if that rule were applicable to a closed-end fund), equal to the fund's obligations to return assets under the transactions.

C. Securities Lending Transactions and Collateral Should be Treated Consistently with Current No-Action Letters and SEC Guidance

We believe that securities lending transactions and the collateral thereunder should be treated consistently with current no-action letters and guidance issued by the SEC and its staff under the Proposed Rule.

The Proposing Release notes that "currently, funds that engage in securities lending typically reinvest cash collateral in highly liquid, short-term investments, such as money market funds or other cash or cash equivalents, and funds generally do not sell or otherwise use non-cash collateral to leverage the fund's portfolio. We believe a fund that engages in securities lending under these circumstances is limited in its ability to use securities lending transactions to increase leverage in its portfolio." However, the Proposing Release goes on to state that a fund's securities lending collateral return obligation would not constitute a "similar financing transaction" so long as, among other things, "the fund invests cash collateral solely in cash or cash equivalents." U.S. GAAP defines cash equivalents as "short-term, highly liquid investments that are readily convertible to known amounts of cash and that are so near their maturity that they present insignificant risk of changes in value because of changes in interest rates." Generally, only investments with original maturities of three months or less qualify under that definition.

Funds presently reinvest cash collateral in certain other highly liquid instruments that may not necessarily constitute cash or cash equivalents. These practices are consistent with current SEC staff no-action relief and the conditions of SEC orders providing exemptive relief to certain funds.

We are concerned that the guidance in the Proposing Release would potentially treat funds that reinvest securities lending cash collateral in non-cash equivalents as similar financing transactions under the Proposed Rule and subject funds to requirements that would other otherwise not apply to these securities lending transactions under the current SEC and staff orders and guidance. We believe that the rationale discussed in the Proposing Release regarding funds' limited ability to use securities lending transactions as a source of leverage similarly applies to securities lending transactions under which a fund reinvests cash collateral in these types of highly liquid instruments.

Accordingly, we believe that securities lending transactions and reinvestment of cash collateral thereunder should be treated in a manner consistent with current no-action letters and guidance, and that the SEC should include guidance in this regard in connection with adopting any new rule.

We note that we generally support the SEC's overall aim to eliminate the current asset segregation regime, with the limited exceptions we have noted above for reverse repurchase agreements and similar financing transactions. We appreciate the SEC's efforts to provide clarity to the industry in this area, particularly in light of varying asset segregation practices across fund complexes, and believe that our limited recommendations would be in line with the SEC's broader goals.

IV. Comments Regarding Proposed Requirements for Derivatives Risk Management Programs

Under the Proposed Rule, a fund would be required to adopt and implement a written derivatives risk management program including policies and procedures that are reasonably designed to manage the fund's derivatives risks and to reasonably segregate the functions associated with the program from the portfolio management of the fund ("Program"). The fund's Program would also be required to include the following elements: (1) risk identification and assessment, (2) risk guidelines, (3) stress testing, (4) backtesting, (5) internal reporting and escalation, and (6) periodic review of the Program by the derivatives risk manager and the fund's board.

A. Public Disclosure of Fund Guidelines Should Not Be Required

In the request for comment 31 in the Proposing Release, the SEC requested comment on whether it "should require that a fund publicly disclose the guidelines it uses and the quantitative levels selected." We believe that a fund's guidelines should not be required to be publicly disclosed.

Public disclosure of guidelines may involve potential disclosure of proprietary information (particularly with respect to quantitative models and the like) that would harm competitive interests of funds and would not provide meaningful or significant information to investors. In addition, public reporting of guidelines could incentivize funds to set guidelines that would not be useful for purposes of risk monitoring and management (*i.e.*, restrictions that are too loose or too strict). It is likely that funds will use complex and divergent methodologies for setting guidelines and this information would inherently be subjective, hypothetical and based on estimates. For these reasons, we believe that funds should not be required to publicly disclose their guidelines.[16]

B. The Proposed Rule Should Require Funds to Perform Stress Testing on a Monthly Basis

Under the Proposed Rule, a fund's Program would be required to provide for stress testing of the fund's portfolio to evaluate potential losses to the fund's portfolio in response to extreme, but plausible, market changes or changes in market risk factors that would have a significant adverse effect on the fund's portfolio, taking into account correlations of market risk factors and resulting payments to derivatives counterparties. The Proposing Release notes that market risk factors commonly considered for this purpose include liquidity, volatility, yield curve shifts, sector movements or changes in the underlying instrument's price, and should include payments to counterparties.

The Proposed Rule would permit a fund to determine the frequency with which stress tests are conducted, provided that the fund must conduct stress testing at least weekly. In determining testing frequency, a fund must take into account the fund's strategy and investments and current market conditions. The selected frequency should "best position" the derivatives risk manager "to appropriately administer, and the board to appropriately oversee, a fund's derivatives risk management, taking into account the

[16] We have similar concerns regarding the Proposed Rule's requirements regarding public disclosure, on Form N-PORT, of a fund's aggregate derivatives exposure and the number of exceptions that the fund identifies from backtesting its VaR model. We do not believe public disclosure of such information is necessary or appropriate for the protection of investors.

frequency of change in the fund's investments and market conditions." The SEC noted that the weekly testing minimum is intended to balance the benefits of frequent stress testing against the burdens of conducting stress testing.

We are concerned that requiring weekly stress testing may be too frequent, burdensome and costly for funds to implement, and we believe that such frequency is not necessary for a fund to benefit from an overlay of stress testing to the VaR-based limits on fund leverage risk.[17] We believe that the SEC could adopt a monthly stress testing frequency requirement without sacrificing a fund's ability to assess its risk of potential loss in a timely manner. A fund would still be able to assess multiple sets of testing results throughout a year and observe trends and changes over time. Also, a fund would be subject to a general obligation to increase frequency of testing if necessitated by market conditions or for other reasons under the guidance provided in the Proposing Release.

C. The Proposed Rule Should Require that Funds Perform Backtesting of the VaR Calculation Model on a Weekly (Not Daily) Basis and Provide for Scaling of Confidence Levels

We are concerned that requiring VaR backtesting testing to be carried out each business day will be too frequent and will not yield productive results. Daily VaR backtesting will be too burdensome and costly for funds to implement, and we believe that testing on a daily interval is not necessary to use VaR backtesting as an effective tool to monitor the effectiveness of a fund's VaR model.[18] We note that daily backtesting could also be problematic due to misalignment in pricing times between various pricing sources. For example, our testing results have shown, including for certain UCITS funds we manage, that daily VaR backtesting exceptions would arise due to a fund's net asset value being struck at 4:00 p.m. ET on a given day, whereas the fund's performance benchmark conducts pricing at 3:00 p.m. ET on the same day.[19] If the SEC adopts a weekly backtesting requirement with retroactive comparison of the VaR measure generated by the VaR model compared to a fund's actual VaR for each business day, a fund could still monitor the accuracy and performance of its VaR calculation model, and make appropriate adjustments over time, without incurring the significant costs of daily testing and without incurring as many exceptions that may have otherwise arisen due to the effects of pricing time misalignments between pricing sources.

In addition, we are concerned that daily testing with a one-day horizon (using one year of historical data) would not provide enough data points for purposes of model validation. VaR backtesting could provide more meaningful results if smoothed by a longer period of data points.

We would also recommend that the SEC permit funds to scale confidence levels for purposes of VaR backtesting. Scaling confidence levels is a technique that risk professionals use often to avoid using overlapping periods and to combat small sample bias in estimating VaR at higher confidence levels. This

17 For a point of comparison, the UCITS Guidelines require at least monthly stress testing for UCITS funds, with more frequent stress testing to be carried out whenever a change in the value or the composition of the UCITS fund, or a change in market conditions, makes it likely that the test results will significantly differ.

18 In this regard, the UCITS Guidelines require monthly backtesting to monitor the accuracy and performance of a UCITS fund's VaR model, with retroactive comparison of the VaR measure generated by the VaR model compared to the UCITS fund's actual VaR for each business day.

19 We note that certain PIMCO fixed income fund benchmarks typically conduct pricing at 3:00 p.m. ET on a given day rather than 4:00 p.m. ET.

allows funds to account for a relatively wider set of negative outcomes in the VaR calculation instead of being limited to the most extreme and unlikely losses. The Proposing Release does not explicitly prohibit risk professionals from using confidence level scaling, but we ask the SEC to clarify that it would be considered an acceptable practice in calculating and backtesting VaR, when appropriate, much like the SEC considers time-scaling to be acceptable. We note that UCITS funds are also required to use a VaR model with a 99% confidence level, but are permitted flexibility to scale VaR outputs from models using 95% confidence levels.[20] We believe aligning the Proposed Rule's relevant requirements with the UCITS requirements would enable funds to leverage already existing global compliance mechanisms. Any variations from this approach could add more compliance and operational burdens for U.S. funds.

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We thank the SEC for allowing us to comment on the Proposal and appreciate in advance the SEC's diligent consideration of our comments. Please feel free to contact us if we can provide any assistance to you in the further evaluation of these very important issues.

Sincerely,

E. Roman

Emmanuel Roman

Chief Executive Officer

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20 *See* UCITS Guidelines at Section 3.6.1 (Calculation Standards).