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

Submitted via rule-comments@sec.gov

February 14, 2023

Dear Ms. Countryman,

Proposed amendments to Open-End Fund Liquidity Risk Management Programs and Swing Pricing [File Number S7-26-22]

The Alternative Investment Management Association ("AIMA")[1] welcomes the opportunity to comment on the Securities and Exchange Commission ("SEC") proposal to amend its open-end fund liquidity risk management programs, swing pricing and the associated changes to Forms N-PORT, N-CEN and N-1A (the "Proposal").[2]

Liquidity risk management is a key component in the effective and fair risk management program for funds. As a matter of principle, AIMA welcomes any increase in the ability of investment advisers to make greater use of liquidity risk management tools ("LMTs") to allow them to manage liquidity flows more effectively and ensure fairness between different classes of shareholders in a fund.

However, any such changes should be as flexible as possible, within the limits of the Investment

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[1] The Alternative Investment Management Association (AIMA) is the global representative of the alternative investment industry, with around 2,100 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2.5 trillion in hedge fund and private credit assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 250 members that manage $600 billion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). For further information, please visit AIMA's website, www.aima.org.

[2] "Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting", SEC Rel. No. 33-11130 (Nov. 2, 2022) (the "Proposing Release").

The Alternative Investment Management Association Ltd (New York Branch)

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Company Act of 1940 and avoid any unnecessary prescription. Funds and their managers have spent a great deal of resources to comply with the current requirements. In setting out its proposals, the SEC has not provided compelling reasoning as to why the current requirements are insufficient.

The proposals as they stand have the potential to:

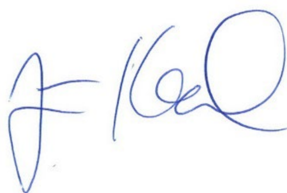
- reduce investor choice, disrupt existing investments, reduce funding to the real economy and require forced sales at artificially low prices;
- force investment advisers to adhere to formulaic requirements that may be harmful to their investors best interests and create the kind of pro-cyclical behavior SEC says it wants to prevent; and
- increase the already substantial and frequently changing reporting requirements.

The annex sets out in detail AIMA's concerns.

This consultation document is 444 pages long and contains over 230 detailed questions which themselves often embed further questions. We believe that the 60-day consultation period provides an insufficient period of time for interested parties to be able to analyze fully and respond to the Proposal in a meaningful way. The Proposal is not the only lengthy and detailed consultation SEC is currently addressing to the same audience of potential respondents and places considerable strain on the resources available to reply to this Proposal and the others, as we, and other trade associations, have recently respectfully submitted to you.[3]

We would be happy to elaborate further on any of the points raised in this letter. For further information please contact James Hopegood, Director of Asset Management Regulation at .

Yours sincerely,



Jiří Król
Deputy CEO, Global Head of Government Affairs

[3] Letter from Elliot Ganz, General Counsel, Co-Head Public Policy, Loan Syndications and Trading Association et al. (Nov. 16, 2022).

ANNEX

AIMA has confined its response to the three key areas mentioned in the covering letter. They are addressed in the order they have been asked. All other questions have been omitted.

Question 16. As proposed, should we eliminate the less liquid investment category and amend the illiquid investment definition to include an investment that a fund reasonably expects can be sold within seven calendar days without significantly changing the market value but is not convertible to U.S. dollars within that period (i.e., investments that are currently classified as less liquid under the rule)? What effect would these proposed amendments have and how would those funds that significantly invest in such less liquid investments likely change?

We are deeply concerned that the proposal to abolish an entire liquidity categorization could lead to a range of undesirable outcomes. This will restrict investor choice, reduce investment in the affected asset classes and therefore the overall liquidity of those asset classes. This may also create unnecessary losses for existing investors to the extent that it triggers the mass disposal of particular asset classes as funds whose investment objectives rely on those assets are forced to liquidate.

Much of the SEC's justification for removing this category relates to the experience of bank loans over the March 2020 Covid crisis and its concerns over how readily they can be redeemed within the existing rules. But the logic for this major change is perverse. The Proposing Release states that bank loans constituted a mere 2% or $100 billion of fixed income assets held by relevant funds in December 2019.[4] That amount declined to $70 billion by March 2020.[5] This is a small amount of overall assets upon which to base such a significant policy change compared to the total assets of open-end funds (excluding ETFs) for the same period of $13.5 trillion.[6]

This logic becomes yet harder to follow given that Proposing Release goes on to state that, "bank loan funds were able to meet redemption requests during March 2020, a period of significant outflows", but then says that the SEC is concerned that "they may not be able to meet shareholder redemptions in future stressed conditions, especially as investments in this asset class increase."[7]. But the Proposing Release also notes that such assets had decreased from £70 billion in March 2020 to $68 billion by December 2020 compared to the total assets of open-end funds (excluding ETFs) for the same period of $24 trillion.[8]

Many of the SEC's hypothetical concerns over banks loans and associated assets such as collateralized loan obligations ("CLOs") and leveraged loans do not withstand scrutiny. Proprietary research carried out in June 2019 by the Alternative Credit Council shows that such assets have low levels of default, are transparent and are tradeable and more liquid than the Proposing Release implies.

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[4] *See* Proposing Release, *supra* note 2, at 23.
[5] *See* Proposing Release, *supra* note 2, at 24.
[6] *Id*.
[7] Proposing Release, *supra* note 2, at 62.
[8] *See* Proposing Release, *supra* note 2, at 29.

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For example, both leveraged loans and CLOs are traded, and experience has shown that in times of market stress there is a deep pool of sophisticated investors who have raised significant amounts of capital and so can provide liquidity. CLOs are actively managed throughout their life spans with all the risk management focus that implies and they are notably more transparent than assets in many other private markets.

This is borne out by the Government Accountability Office ("GAO") assessment of the behavior of leveraged loans and CLOs published in December 2020 and whether they posed any risks to financial stability over the March 2020 period.[9] The GAO found:

- "Based on regulators' assessments, leveraged lending activities had not contributed significantly to the distress of any large financial entity whose failure could threaten financial stability. Large banks' strong capital positions have allowed them to manage their leveraged lending exposures, and the exposure of insurers and other investors also appeared manageable.

- Mutual funds experienced redemptions by investors but were able to meet them in part by selling leveraged loan holdings. While this may have put downward pressure on already-distressed loan prices, based on regulators' assessments, distressed leveraged loan prices did not pose a potential threat to financial stability.

- Present-day CLO securities appear to pose less of a risk to financial stability than did similar securities during the 2007–2009 financial crisis, according to regulators and market participants. For example, CLO securities have better investor protections, are more insulated from market swings, and are not widely tied to other risky, complex instruments."[10]

We are surprised that the SEC has not taken account of the GAO assessment in the Proposing Release.

Further, these non-bank loans have become more popular as banks have withdrawn from some lending activities. These assets represent a key line of funding to main street and other businesses unable to secure loans from banks. Reducing their availability will inevitably mean there is less real economy funding available, which we can only assume is an unintended consequence of the Proposal.

The Bank of England's recently published research, "Non-bank lenders as global shock absorbers: evidence from US monetary policy spill overs"[11] supports this position. The research is clear that far from being a financial stability risk, non-bank lending plays a key role in supporting and substituting for banking activities, stating: "Overall, our results suggest that nonbank lenders act as shock absorbers from US monetary policy spillovers, and that having more diversified funding providers

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[9] U.S. Government Accountability Office Report to Agency Officials, "Financial Stability: Agencies Have Not Found Leveraged Lending to Significantly Threaten Stability but Remain Cautious Amid Pandemic", GAO-21-167 (Dec. 2020).

[10] Id. at GAO Highlights on page 2.

[11] D. Elliott et. al., "Nonbank lenders as global shock absorbers: evidence from US monetary policy spillovers", Staff Working Paper No. 1,012 (Jan. 13, 2023).

(nonbanks in addition to banks) reduces the volatility in capital flows and economic activity resulting from the global financial cycle."

As a broader point, the ability of investors to choose the instruments they use to allocate their capital based on appropriate disclosure of the risks they may carry underpins the success of capital markets investment. The proposal to remove an entire investment category will reduce the ability to offer funds specializing or investing predominantly in such assets. This will lessen investors' ability to diversify their portfolios in a way they think best suited to themselves.

The recategorization of assets in existing funds, such as those investing in leveraged loans and CLOs, may well mean that the 15% limit on illiquid assets is breached. This may very well create fire sales, creating unnecessary losses for investors who had made a knowing decision to invest in them. This is acknowledged in the proposal when it says:

> "As a result of the proposed amendments, more bank loan funds may contract for expedited settlement, which would involve costs. Alternatively, advisers with strategies that have 15% or more of assets in investments classified as less liquid and illiquid may change those strategies, close funds, or consider using a closed-end fund or other investment vehicle structure that is not subject to rule 22e-4."[12]

We respectfully submit that such an outcome or the associated costs to existing fund investors is not justified by SEC's arguments in favor of the proposed amendments.

Question 53. Should we adopt swing pricing as a default tool, with a requirement that an open-end fund, other than an excluded fund, implement swing pricing unless certain conditions are met? For example, should a fund be required to implement swing pricing unless its board of directors makes certain determinations (e.g., that the fund and its shareholders are unlikely to experience significant dilution in connection with investor purchases and redemptions) and the fund maintains records of such determinations? Should a fund be required to report information about the reasons for such a determination publicly?

The thrust of the proposals to enhance investment advisers' ability to ensure they treat all classes of shareholders equally by facilitating the wider use of liquidity management tools ("LMTs") has merit. But the overly prescriptive and inflexible nature of the detailed proposals will create significant barriers to the effective and proportionate use of LMTs. The SEC appears to have taken inspiration in part from the LMT mechanisms that have been in use in a range of European jurisdictions for some time but proposes to mimic them in a flawed way.

For example, the Proposing Release refers to the joint UK Bank of England and Financial Conduct Authority work on the beneficial effects of swing pricing.[13] A key to achieving these beneficial effects was that the swings were done at the investment adviser's discretion, having considered all relevant factors and this could only be done if the ability to do so was written into the fund prospectus. The

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[12] Proposing Release, *supra* note 2, at 63.
[13] Proposing Release, *supra* note 2, at 31-32.

Proposal will not achieve this it removes this all-important discretion and imposes a template for the use of swing pricing regardless of a fund's investment strategies and whether swing pricing is appropriate in the circumstances.

European experience over the Covid market stress in 2020 and before then demonstrates that swing pricing and other LMTs are not used by funds in a uniform manner as they have widely varying risk profiles, investments strategies and redemption terms[14]. The proposal to insist that all funds use swing pricing and the imposition of a standardized methodology for triggering the swing is likely to be counterproductive. It will force its use in situations where it may not be appropriate. In such a scenario it may increase rather than reduce any unfair treatment between shareholders. For example, it may be more appropriate to use a different LMT, such as an anti-dilution level.

Enforcing a rigid methodology and trigger for the use of swing pricing would appear to increase rather than reduce the risk of so-called first mover advantage. More informed investors may use the methodology to assess when a trigger is likely to be pulled to start to swing prices and withdraw their funds before then.

We also note that the Proposal threatens to change the concept that underpins the successful use of swing pricing: it is a tool to ensure on-going fair treatment of all classes of shareholders in a fund. The proposed mechanistic approach could have the effect of turning swing pricing into a penalty to be levied automatically against shareholders who want to redeem. This would amount to a major change in the way in which investment advisers have to apply this tool and may conflict with the duty to treat shareholders fairly.

The Proposal appears to front run the Financial Stability Board ("FSB") policy position that there should be greater and more uniform use of swing pricing as a tool to reduce the perceived risk from investment funds to financial stability. We fully appreciate the SEC's wish to influence the direction of global standards setting work. But that should not come at the cost of rushed and poorly thought through domestic policymaking as seems to be the case in places here.

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[14] FSB Assessment of the Effectiveness of the FSB's 2017 Recommendations on Liquidity Mismatch in Open-Ended Funds. https://www.fsb.org/wp-content/uploads/P141222.pdf see pp 17/18.