

INDEPENDENT TRUSTEES OF THE BOARD OF TRUSTEES OF PIMCO FUNDS
650 Newport Center Drive
Newport Beach, California 92660

Via Electronic Submission

February 14, 2023

Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting, File Number S7-26-22

Dear Secretary Countryman:

The Independent Trustees of PIMCO Funds, PIMCO Variable Insurance Trust, PIMCO ETF Trust, PIMCO Equity Series and PIMCO Equity Series VIT (collectively, the “PIMCO Funds”) appreciate the opportunity to comment on the U.S. Securities and Exchange Commission’s (“SEC” or “Commission”) proposed rule amendments regarding open-end fund liquidity risk management and swing pricing (the “Proposal”).¹ We oversee over 150 series across the PIMCO Funds, with approximately \$320 billion in assets, as of December 31, 2022. Many of the funds we oversee invest primarily in fixed income securities. We recognize that the PIMCO Funds’ adviser, Pacific Investment Management Company LLC (“PIMCO”), is submitting a comment letter addressing many aspects of the Proposal; however, the Independent Trustees believe it is important to submit this letter to highlight important issues for the Board of Trustees.

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I. Open-End Funds’ Existing Liquidity Risk Management Policies, Procedures and Practices Have Successfully Navigated Periods of Market Volatility, and the Proposal Would Be Unnecessary and Harmful to the Industry and Shareholders

A. Clarity on the March 2020 Market Turmoil

March 2020 was a period of market volatility from which the fixed income markets were not immune. As the SEC notes in the Proposing Release, fixed income markets experienced significant volatility and markedly widened bid-ask spreads. However, the SEC appears to misinterpret these events and incorrectly takes aim at the fixed income markets in much of the Proposing Release. The Commission has proposed

¹ See Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting, SEC Rel. No. IC-34746 (Nov. 2, 2022) (“Proposing Release”).

significant, fundamental rule changes targeted at products and processes for managing heightened market volatility that, from our perspective, functioned as intended during the March 2020 turmoil.

We respectfully submit that the inferences the Proposing Release draws from the market turmoil that funds experienced in March 2020 do not seem adequate to justify the restructuring of a fund and intermediary ecosystem that performed as designed through this same period and over the past decades. In our experience, during the March 2020 period of market volatility, the funds we oversee were able to fully meet redemption requests. Our experience is consistent with statements from the SEC staff that concerns about bond funds' ability to meet redemption requests during periods of market stress "did not materialize" during March 2020.² Accordingly, we believe that the existing rules and management tools were more than adequate to allow funds to be managed effectively during that time period.

In our view, the SEC's observations from the March 2020 period are unpersuasive at demonstrating failures of the existing structure or regulation of open-end fixed income funds. For example, the SEC cites emergency relief it issued to facilitate interfund lending and other short-term funding solutions to help funds meet redemptions; however, the Proposing Release acknowledges that "funds generally did not use" this relief.³ We believe that the SEC's other observations – that fund managers held discussions with the SEC regarding various forms of relief (*e.g.*, for the imposition of redemption fees or actions to facilitate swing pricing), that the Federal Reserve intervened, that the SEC views many funds' liquidity classification and reclassification processes as having been inadequate and slow during the March 2020 period, and that "more than a dozen" funds made Form N-RN filings during March 2020 ("most" of which related to 15% illiquid limit breaches)⁴ – fall far short of justifying the SEC's costly and disruptive proposal, which would rewrite open-end fund liquidity risk management and anti-dilution regulation.

B. The Proposal Would Have Significant Unintended Consequences

We believe the Proposal, though well-intentioned, would have significant unintended consequences, including driving open-end fund investors to alternatives such as private funds, collective investment trusts ("CITs") and separately-managed accounts ("SMAs") that lack the protections afforded to registered funds, reducing market liquidity in many cases and reducing investor access to important segments of the U.S. capital markets. For example:

- The Proposal is likely to lead to more constrained investment strategies and potentially more limited distribution channels for open-end funds, which will diminish an important category of trades in fixed income securities and a source of market liquidity. Fund investors may be forced to choose other vehicles, such as private funds, CITs and SMAs, that lack the oversight of an independent board. We believe an independent board is one of the most significant benefits of the registered fund model.
- The problematic impacts of certain aspects of the Proposal would seem likely to reduce market liquidity and would be magnified in stressed environments. For example, the proposed changes to classification mechanics seem likely to result in an unreasonable downward bias in fund

² See Division of Economic and Risk Analysis, U.S. Securities and Exchange Commission, "U.S. Credit Markets Interconnectedness and the Effects of the COVID-19 Economic Shock" (Oct. 2020), *available at* https://www.sec.gov/files/US-Credit-Markets_COVID-19_Report.pdf ("DERA Study") at 38.

³ See Proposing Release at n.57 and accompanying text ("Although the Commission provided this relief for a period of time, we understand funds generally did not use it.").

⁴ See Proposing Release at 29 – 30, 32 – 33.

liquidity profiles, which would only be amplified in stressed markets. This would appear to hinder, rather than facilitate, market liquidity. As more securities may be considered illiquid as a result of the Proposal (in some cases unreasonably), a fund's ability to act as a buyer for such assets – a source of market liquidity in stressed environments – is further constrained.

- The proposed elimination of the less liquid investment classification category would significantly curtail investor access to certain markets through registered open-end fund products. In the long run, fewer participants in these markets will translate to a higher cost of capital, and reduced market liquidity and transparency.
- The hard close component of the swing pricing proposal also would favor certain financial intermediary business models over others because certain intermediaries may not have the operational capacity to communicate trade information as of a 4 p.m. ET hard close or the resources to undertake the complete reconfiguration of all necessary systems. Further, the Proposal could make it more difficult for investors to move from one fund or intermediary to another, thereby limiting investor choice. We fear that, as a result, the Proposal may eliminate entire populations of potential investors who wish to invest in mutual funds, but would be unable to if they invest through a channel that is unable accommodate the mechanics of the swing pricing proposal.

Ultimately, we believe the Proposal will result in increased cost of capital for drivers of our economy, reduced market liquidity, and fewer options for investors to participate in income and growth opportunities.

II. Recommendations for a Different Approach

We believe that shareholders and the open-end fund industry would be better served by the SEC replacing the Proposal with a concept release in order to better facilitate broader stakeholder engagement.⁵ The SEC should play a central role in working with the industry to identify key issues and challenges in the liquidity risk management and swing pricing / anti-dilution areas, such as by organizing roundtables and working groups with broad representation. These groups and discussions should help to identify practical challenges and possible solutions.

We also believe that coordinated regulatory efforts aimed at reinforcing market strength and resiliency would be more effective at reducing the risk of market disruptions similar to those experienced in March 2020. The SEC's focus in this regard should be on assisting in facilitating more efficient trading venues and systems.

We urge the Commission also to consider options, such as Commission guidance, exemptive relief or rulemaking, which would permit fixed income holdings to be cross tradeable under Rule 17a-7 under the Investment Company Act of 1940. The SEC's recent Rule 2a-5 rulemaking foreclosed this useful portfolio and liquidity management tool for fixed income funds.⁶

If the SEC decides to proceed with the Proposal, we encourage the SEC to take an approach that differs in kind, not just degree. Any final rule amendments should reflect targeted, principles-based considerations for liquidity risk management and anti-dilution mechanisms. For example, to the extent the SEC believes

⁵ See *e.g.*, Use of Derivatives by Investment Companies under the Investment Company Act of 1940, SEC Rel. No. IC-29776 (Aug. 31, 2011).

⁶ See Good Faith Determinations of Fair Value, SEC Rel. No. IC-34128 (Dec. 3, 2020) at nn.358, 362, 493 and accompanying text.

certain funds' liquidity risk management programs failed to operate as required, the SEC should consider focused guidance targeting those particular perceived shortfalls rather than rewriting the foundations of the liquidity risk management rule for all funds. To the extent the SEC determines to require swing pricing, we believe the Proposal should be replaced with principles-based guidelines that better recognize the need to balance precision with funds' and intermediaries' ability to operationalize swing pricing in a timely and efficient manner.

III. Critical Steps if the SEC Determines to Proceed with the Proposal in its Current Form

A. Avoiding Regulatory Arbitrage

The SEC should coordinate closely with other relevant regulators, as well as market participants, to seek to ensure that open-end mutual funds are not placed at a competitive disadvantage as a result of the Proposal. We note Chair Gensler's recent comments regarding coordination with other regulators "to mitigate possible regulatory arbitrage between" open-end funds and CITs in connection with the Proposal,⁷ and we urge the SEC not to adopt the Proposal until other regulators have acted to impose similar requirements on investment products within their regulatory purview.

B. Better Alignment with the Realities of Fixed Income Market Data

Underlying much of the Proposal are assumptions that do not accurately reflect key characteristics of fixed income investments and related market data. For example, we understand that the salient information when anticipating how a fixed income instrument will trade is not the information about how that instrument has traded but information about how other instruments with similar characteristics have traded. Although the SEC recognizes these characteristics at times in the Proposal, ultimately it fails to appropriately account for them. This is evident in the proposal to eliminate asset class classification as well as the proposed value impact definition for fixed income instruments and the proposed requirement to consider market impact in the swing pricing context.

We are concerned that this disconnect from the realities of fixed income investments and markets will disproportionately adversely impact fixed income mutual funds. Thus, in our view, the SEC should preserve funds' ability to utilize asset class classification. Moreover, at least for fixed income investments, the SEC should not adopt the proposed value impact definition under the liquidity risk management rule or the proposed requirement to consider market impact in establishing a swing factor. If the SEC determines to proceed with either element of the Proposal, it should instead adopt a principles-based approach that better recognizes and reflects the nature of fixed income markets and data.

C. Swing Pricing, Hard Close and the Mutual Fund Product

The SEC should carefully consider the impact of the proposed swing pricing and hard close amendments on the competitive positioning of mutual funds relative to other investment products and investor confidence in the mutual fund product. We are concerned that the proposed approach, coupled with mutual fund flow data issues discussed in other comment letters from industry participants, is likely to result in inaccurate, and potentially directionally incorrect, net asset value swings. In our view, this could undermine investor confidence in the mutual fund product. If the SEC determines to proceed with the swing pricing portions of the Proposal, it should consider ways to make the swing pricing requirements more resilient and less susceptible to such issues. The SEC could consider, for example, flexibility in establishing the relevant

⁷ See Gary Gensler, Chair, SEC, Prepared Remarks Before the Financial Stability Oversight Council: Annual Report (Dec. 16, 2022).

parameters (e.g., permitting funds to set their own net outflow swing thresholds) and simplifying the swing factor calculation requirements.

IV. Conclusion

The Independent Trustees believe that the existing toolkit available to mutual funds and their boards is robust and has supported open-end funds' successful navigation of stressed markets, including in March 2020. This toolkit includes: Rule 22e-4's existing compliance tests (*i.e.*, the highly liquid investment minimum and 15% limit on illiquid investments); the use of lines of credit, interfund lending, reverse repurchase agreements and dollar rolls, in-kind redemptions, redemption fees, and cross trades; and other items such as advance notification procedures, board reporting under Rule 22e-4 and annual liquidity risk assessments under Rule 22e-4. We, therefore, believe that material and prescriptive amendments to this well-functioning framework are not necessary at this time. Moreover, as described above, we have substantial concerns about the impact of many elements of the Proposal.

We thank the Commission for the opportunity to provide comment on the Proposal and respectfully request that the Commission consider our recommendations and suggestions. We would be pleased to provide further information or to answer any questions at the convenience of the Commission's Staff.

Sincerely,

/s/ Ronald C. Parker

Lead Independent Trustee

cc: George E. Borst, Independent Trustee
Jennifer Holden Dunbar, Independent Trustee
Kym M. Hubbard, Independent Trustee
Gary F. Kennedy, Independent Trustee
Peter B. McCarthy, Independent Trustee
Kimberly G. Stafford, Trustee
Peter G. Strelow, Chair and Trustee

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