Morgan Stanley

INVESTMENT MANAGEMENT

February 14, 2023

VIA EMAIL

Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street
Washington, DC 20549-1090
rule-comments@sec.gov

Re: Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting (File No. S7-26-22)

Dear Ms. Countryman:

Morgan Stanley Investment Management Inc., together with Eaton Vance Management ("Eaton Vance"), Calvert Research and Management ("Calvert") and certain other advisory affiliates (collectively, "MSIM"), manage a wide range of US-registered investment companies. We appreciate the opportunity to provide feedback on the proposal ("Proposal") of the Securities and Exchange Commission ("SEC") to amend the rules under the Investment Company Act of 1940, as amended ("Investment Company Act"), that govern open-end fund liquidity risk management and mutual fund swing pricing. We agree with the SEC that managing liquidity risk in open-end funds is important, and we appreciate the SEC's attention to the potential for dilution of shareholder interests that can arise from mutual fund inflows and outflows.

Although we support the SEC's objectives of promoting effective liquidity risk management and investor protection, we nonetheless have significant concerns with the Proposal. Not only would the Proposal dramatically alter the rules for liquidity risk management when experience has demonstrated current rules and practices to be effective, but its mandatory hard close and swing pricing requirements for mutual funds would cause, in our view, more harm than the shareholder dilution and fund resiliency considerations the Proposal seeks to address. As we detail below, these proposed changes would have consequences, both contemplated and unintended, that would be harmful to fund investors. We believe these changes would also be severely disruptive and impose costs on funds and shareholders that the Proposal has not adequately identified or quantified. In each case, we respectfully submit that the Proposal does not articulate benefits to funds and their shareholders that would justify these changes.

We believe that evidence from the market turmoil of March 2020 does not support the Proposal's wide-ranging interventions. In the midst of one of the most significant public health crises in history, that period witnessed elevated market stress as participants sought to reprice assets in the face of incredible uncertainty. The Proposal suggests that this episode exposed fundamental liquidity weaknesses in open-end funds that justify transformative regulatory changes but cites little evidence to support this view. Given the scale of impacts, we believe more evidence would be necessary to justify what would amount to a reinvention of the entire fund ecosystem, the

implicit banning of certain open-end fund strategies and the wholesale disadvantaging of mutual funds and their shareholders. We respectfully submit that the Proposal is not responsive to evidence from March 2020 nor otherwise an advance in fund regulatory policy.[1]

I. Executive Summary

As discussed in greater detail below, we strongly oppose the Proposal because it would make dramatic and unjustified changes to funds that have proven resilient through periods of significant stress and does not articulate convincing reasons or evidence to justify the harm to fund investors that would result from the proposed changes. In particular:

- MSIM believes the proposed amendments to Rule 22e-4 under the Investment Company Act ("liquidity rule") are neither necessary nor justified by the reasoning presented in the Proposal and would harm fund shareholders by lowering their returns and reducing the investment options available to them. The elimination of the "less liquid" category, in particular, would effectively prevent investors from accessing certain strategies through open-end funds, harming both investors and capital formation. Additionally, the uniform 1% value impact standard that funds would be required to apply in determining the liquidity of investments that are not exchange-listed may actually result in diminished market liquidity in stressed conditions. If the SEC proceeds with any of the proposed amendments to the liquidity rule, we urge it to adopt more flexible, data-driven requirements that could be adaptable to each open-end fund rather than strict, fixed parameters applicable across all open-end funds.

- MSIM strongly opposes the proposed requirement for mutual funds (other than money market funds) to adopt a hard close and to limit eligible purchase and redemption orders such that many fund shareholders could no longer rebalance their holdings across multiple funds in transactions executed on the same day. We also view swing pricing as a fundamentally flawed anti-dilution mechanism that funds should not be required to implement. Moreover, we believe the Proposal does not fully account for the harm these changes would impose on investors or sufficiently explore alternatives that could be fairer, more efficient and more effective. In this way, the Proposal has not made the case for adopting mandatory swing pricing or a hard close.

    - As an alternative to swing pricing, we believe daily variable liquidity fees with the right features could address the fundamental flaws of swing pricing. We are prepared to assist the SEC in further study of this alternative and have identified below certain of the key systems requirements and structural features that would be necessary for daily variable liquidity fees to realize the benefits that the

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[1] See also *MSIM Comment Letter on Money Market Fund Reforms (SEC Release No. IC-34441)* (Apr. 8, 2022), available at https://www.sec.gov/comments/s7-22-21/s72221-20122831-279202.pdf ("MSIM MMF Proposal Comment Letter"). As we noted in that comment letter, and as the SEC acknowledged in the 2021 money market fund proposing release, it was the link between weekly liquid assets and the possible imposition of fees and gates that contributed most to investors' decisions to redeem their shares in money market funds in March 2020. The SEC created this link in a previous round of revisions to Rule 2a-7 that the SEC intended to improve the resiliency of money market funds. The history of revisions to Rule 2a-7 counsels against regulatory interventions without extensive study and coordination because the unintended consequences of policymaking can be significant.

Proposal aims to achieve. The next steps in exploring daily variable liquidity fees as an alternative to swing pricing must include: (1) significant coordination and advance planning among the SEC, mutual fund sponsors and intermediaries to ensure that liquidity fees imposed on transacting shareholders would be priced accurately and that implementation could be achieved in a cost-effective manner; and (2) conditioning any requirement for funds to adopt liquidity fees on a determination that the benefits to a fund's shareholders would measurably justify the costs involved.

- In addition, MSIM strongly opposes the proposed amendment to increase the required frequency of portfolio holdings reporting on Part F of Form N-PORT, the proposed amendment requiring public availability of Form N-PORT filings each month, rather than only the third month of each quarter, and the proposed requirement to report publicly every month aggregate liquidity classifications. We believe the proposed change mandating more frequent public disclosure of portfolio holdings would require some funds to take actions contrary to existing disclosure policies adopted in the best interest of shareholders, and the proposed change to require the public reporting of aggregate liquidity classifications would prove misleading to shareholders.

- If the SEC proceeds in the face of the strong opposition and serious concerns that we and other commenters have expressed, a longer implementation period than proposed is critical. Given the broad and fundamental nature of the proposed changes, we believe that an implementation period of even three years after the effective date would be insufficient to implement the proposed changes without material harm to funds and their shareholders.

II. Proposed Changes to the Liquidity Rule

The Proposal would make a number of significant changes to the liquidity rule just four years after much of that rule became effective. We respectfully submit that these changes are not supported by events since adoption of the liquidity rule.

Above all, we are concerned that the individual and cumulative effects of these changes would be harmful to fund shareholders. In particular, many aspects of the Proposal eliminate judgment currently available and important to appropriate and effective liquidity risk management in favor of fixed, draconian parameters imposed uniformly across different types of funds and markets. The analysis the Proposal presents in support of these changes appears to amount to little more than identifying standards that are stricter than current practice. These changes would force open-end funds to systematically underestimate the liquidity of their investments, interfere with the ability of many funds to implement their investment strategies and cause funds to avoid certain high-potential investments to remain in compliance with the liquidity rule's 15% illiquid investment limit. Although the Proposal posits that these changes would reduce the risk that open-end funds cannot meet redemptions, MSIM believes these changes would instead reduce shareholder returns and restrict investment choice by forcing funds to maintain unnecessarily restrictive liquidity positions. We believe that the Proposal does not present sufficient evidence that these changes are necessary, let alone optimal. In contrast, the significant costs to shareholders of a liquidity rule that systematically underestimates the liquidity of investments are evident. Moreover, the Proposal would reduce or eliminate the ability of investors to access certain strategies through open-end funds and increase the cost of capital to businesses, impeding capital formation.

Accordingly, we believe that the SEC should not adopt the proposed changes to the liquidity rule.

a. Elimination of the "Less Liquid" Category

The liquidity rule prohibits open-end funds from acquiring any illiquid investment if, immediately after the acquisition, the fund would have invested more than 15% of its net assets in assets that are illiquid. Under the Proposal, all investments currently classified as "less liquid" would be reclassified as "illiquid investments." According to the Proposal, bank loans make up the majority of the investments in the less liquid category.

MSIM strongly opposes the elimination of the "less liquid" category. This change would dramatically reduce investor choice by effectively banning open-end bank loan funds, a well-established investment category with approximately $105 billion in net assets as of December 31, 2022.[2] We agree with other commenters that this change is unwarranted and would operate to the detriment of fund investors and capital formation. As an alternative to eliminating the less liquid category, we support amending the liquidity rule to require open-end bank loan funds to maintain a highly liquid investment minimum ("HLIM") of 10%.

The Proposal Would Harm Fund Investors and Capital Formation

The proposed change would likely eliminate the ability of investors to access bank loan strategies using open-end funds. Open-end bank loan funds provide fund shareholders, including retail investors, with exposure to an asset class with a distinctive and highly valuable investment profile, generating floating rates of income from underlying income investments that are typically most senior in the capital structure of the issuing corporations and secured by a first claim on corporate assets. No other asset class available to retail investors has similar investment characteristics. Over multiple market cycles, open-end bank loan funds have demonstrated favorable risk-adjusted returns, providing income investors with the opportunity to earn attractive rates of income without exposing fund investors to the interest rate risk that accompanies longer-duration fixed income assets.

In addition to providing retail investors with a distinctive and highly valuable profile of investment returns, open-end bank loan funds serve an important role in capital formation, helping to direct capital from investors to the businesses that turn borrowed funds into jobs, goods and services to benefit our economy. The proposed change to the liquidity rule would likely meaningfully reduce the number and variety of market participants who are able to participate in the loan market, which will increase the cost of doing business for companies who access the syndicated loan market for their financing needs. Open-end bank loan funds also contribute significantly to liquidity and price discovery in the bank loan market.

Other types of funds would not be able to fill the void that elimination of open-end bank loan funds would create. Listed closed-end funds trade at varying discounts (and sometimes premiums) to their current net asset value per share ("NAV"), adding price volatility that may deter demand from investors otherwise attracted to bank loan investments. For closed-end interval funds and similar closed-end funds, the concentration of liquidity demand at periodic repurchase dates can be more disruptive to a loan fund's investment program than managing liquidity on an ongoing daily basis, as happens with open-end funds. On an overall basis, we believe the Proposal is likely to reduce,

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[2] Estimate of category assets represents the assets under management held by open-end bank loan funds (including ETFs) in the Morningstar Bank Loan Category as of December 31, 2022.

not improve, the overall resiliency of the loan funding markets by removing a valuable source of capital and liquidity and by reducing the number and variety of market participants.

The Proposal Discounts Important Facts About Bank Loans

We believe the Proposal underestimates the liquidity of bank loans by focusing on average settlement times in normal conditions. Settlement times tend to be longer in normal conditions because loans are idiosyncratic, and fast settlements are typically not necessary during such periods. However, when open-end funds need faster settlements (to meet redemptions or for other purposes), shortened settlement times have proven to be reliably available. For example, our experience in March 2020 showed that bank loan trading volumes grew and open-end funds were reliably able to obtain shorter loan settlement times.[3] Accordingly, simply looking at average settlement times under normal conditions fails to properly account for the available liquidity in the bank loan market.

While the Proposal requests comment on whether elimination of the less-liquid classification may lead to changes in the contractual terms of bank loan transactions to shorten normal settlement times, the Proposal does not adequately account for the current ability of open-end bank loan funds to use loan participation agreements to achieve shorter settlement times. Because borrower and administrative agent consent is generally not required for transfers of loan participations, cash settlement can occur promptly after trade date. Loan market participants are working to expand and formalize the availability of participations as an additional mechanism for bank loan funds to enhance liquidity needs in times of heightened redemptions.

In addition, the Proposal does not account for enhancements to liquidity risk management that open-end bank loan funds have implemented since adoption of the liquidity rule in 2016, and unjustifiably dismisses the role that lines of credit serve in addressing fund liquidity risk. Our open-end bank loan funds have on occasion used lines of credit to bridge any gaps between loan settlement times and fund liquidity needs, and have found them to be well-suited for this purpose.[4] The Proposal similarly fails to account for the role that cash management and portfolio construction can play in ensuring that open-end bank loan funds are able to meet redemptions on a daily basis. Taken together, open-end bank loan funds have in place today a robust suite of liquidity risk management tools. The Proposal does not sufficiently recognize the value of these tools or adequately explain why a radical change in the regulation of open-end bank loan funds would benefit investors or capital formation.

The Proposal Does Not Justify the Harm to Investors and Capital Formation

We believe that a change this significant should have an equally significant evidentiary record for support. Instead, the SEC concedes in the Proposal that "bank loan funds were able to meet

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[3] For example, from February 24, 2020 to March 24, 2020, which represents the period during which our bank loan mutual funds experienced the largest volume of redemption requests, one such fund executed 293 trades for a market value of approximately $1 billion with a median settlement time of four business days.

[4] The Proposal also states that borrowing costs "can dilute the value of the fund for remaining investors." Proposal at 77191. The Proposal does not, however, attempt to assess whether this dilution would be meaningful or take account of how funds may manage dilution when determining how to meet redemptions.

redemption requests during March 2020, a period of significant outflows."[5] Open-end bank loan funds similarly weathered the decline in loan markets in late 2018 without any disruption to redemptions, consistent with a two-decade record of meeting redemptions while treating investors fairly. Accordingly, we believe the SEC has not met the burden of proof in proposing such a significant change to open-end funds, and we strongly oppose this change.

If the SEC is convinced that it must take some action with respect to open-end bank loan funds, then we would propose that it explore a less disruptive approach than simply eliminating this category of funds. As an alternative, we support amending the liquidity rule to require open-end bank loan funds to maintain an HLIM of 10%. A 10% HLIM for open-end bank loan funds would exceed the amount needed to meet redemptions even in stressed conditions and should, therefore, satisfy any concern the SEC has regarding the ability of these funds to meet redemptions.

We strongly urge the SEC to consider the concerns that we and other commenters have expressed, and we respectfully request that the SEC not move forward with this unwarranted change to the liquidity rule.

b. Imposition of Uniform Definition of "Significantly Changing the Market Value of an Investment"

The Proposal would introduce a new definition of "significantly changing the market value of an investment," also referred to as the value impact standard, with the result that open-end funds would lose much of their current ability to apply informed judgment in estimating the market impact of trades. The new definition would provide that a sale of fund investments would significantly change the market value of an investment if: (1) for shares listed on a US national securities exchange or foreign exchange, the sale or disposition would represent more than 20% of the average daily trading volume of those shares, as measured over the preceding 20 business days; or (2) for any other investment, the fund would reasonably expect any sale or disposition to result in a decrease in sale price of more than 1%.

MSIM disagrees with the proposed standard and respectfully submits that any rigid standard would do more harm than good. If the SEC adopts a new definition of "significantly changing the market value of an investment," we believe changes from the Proposal are necessary.

The 20% Volume Test for Exchange-Listed Shares

With respect to the test for exchange-listed shares, although volume can serve as a proxy for liquidity in some markets, the new definition would result in significant underestimation of the true liquidity of investments in many markets. Liquidity exists where there are willing buyers to purchase investments from willing sellers. Volume exists when there are both sellers and buyers in the market at the same time. In other words, these are related, but not identical concepts. For some markets, particularly certain emerging and other foreign markets, volumes may be low because, on any given day, few sellers are interested in parting with their investments. There are, however, frequently buyers at the ready when selling interest increases. As a result, in these markets, there is latent liquidity that the volume of shares traded fails to capture.

[5] Proposal at 77191.

Although the SEC observes that some open-end funds currently use volume tests similar to the Proposal as a measure for liquidity, and this may very well be appropriate for some funds, the Proposal would turn a sometimes-useful proxy into a one-size-fits-all requirement. The result would be a rule that, for some funds, could systematically understate liquidity and, similar to other aspects of the Proposal, would reduce returns to shareholders and investor choice. Accordingly, MSIM strongly opposes adoption of this change to the liquidity rule.

MSIM also objects to counting foreign holidays as zero volume days, which would simply amount to a liquidity penalty for non-US investments that could adversely affect funds and their shareholders. Counting foreign holiday market closures as zero volume days is at odds with the purpose of the 20 business day look-back period. The purpose of such a look-back period would be to use the previous period to inform a fund's understanding of the current day's liquidity. However, the occurrence of a foreign holiday in the previous 20 business days is not indicative of trading volume on days when the foreign market is open for trading. Additionally, an open-end fund holding non-US investments has a range of tools available to appropriately manage liquidity for the fund as a whole when foreign holidays affect trading in relevant investments. These include holding investments in other asset classes or markets to maintain adequate overall liquidity and engaging in off-exchange and derivatives-based trades, among others. Accordingly, it is unnecessary to artificially adjust the volume measure downward to ensure that open-end funds holding non-US investments have adequate liquidity.

The 1% Value Impact Test for Other Investments

With respect to the value impact test for investments that are not exchange-listed, MSIM believes the proposed measure is unrealistic and would result in cliff effects in stressed market conditions. The Proposal does not explain how the SEC arrived at this particular measure, other than to note that the measure is "used in several commonly employed liquidity models."[6] Even so, when turned into a mandatory, uniform regulatory requirement, a 1% decrease in sales price is not a realistic or accurate measure for purposes of determining liquidity and creates a variety of problems as discussed below.

First, the trading data that would be necessary to implement the proposed measure is not easily available. Moreover, the Proposal's requirement to make determinations based on this data on a daily basis would be particularly challenging because there is little additional data available on any given day that could inform assessments of price changes over such short periods.

Second, even in normal conditions, certain fixed income markets may see price changes as a result of purchases or sales in amounts approaching the Proposal's prescribed measure, where the price changes reflect price discovery, rather than illiquidity. In other words, even under normal conditions, the bid-ask spreads in some markets may be as wide as the proposed value impact standard. For example, at one point in 2022, almost 14% of the constituents of the JPMorgan Emerging Market Bond Index had a bid-ask spread that would have caused the constituents to fail the proposed 1% value impact test, and the Index ended that year with over 8% of its constituents in that position. Spreads of this size do not mean the market for the investment lacks liquidity, but rather that trading costs for the investment are higher. Accordingly, the 1% assumption would regularly result in investments being assigned to lower liquidity classifications than is appropriate.

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[6] Proposal at text accompanying note 451.

Third, before adopting any uniform measure of value impact for instruments that are not exchange-listed, the SEC should carefully consider the potential for cliff effects in stressed markets. Under these conditions, bid-ask spreads may widen significantly to reflect the increased uncertainty in valuation and heightened risk for market makers. Any uniform measure, and particularly a measure set at an unrealistically low level, could force many open-end funds to reclassify the liquidity of investments across their portfolios simultaneously. In some conditions, this could result, for example, in a significant portion of the high-yield debt market becoming classified as illiquid despite continued liquidity in that market that would otherwise result in a different classification. Under these conditions, many open-end funds may, in turn, stop acting as buyers precisely when the market is in need of buyers, not because the funds do not see opportunities in the market but because the amended rule would put open-end funds on the sidelines, to their detriment. Worse yet, the Proposal may result in pressure on open-end funds to sell reclassified investments at exactly the wrong time. Through this mechanism, we believe the Proposal may actually exacerbate reductions in market liquidity during stressed conditions rather than improve the resiliency of open-end funds and the markets as a whole.

Fourth, the Proposal mandates a fixed, uniform measure of value impact with little evidence that alternatives were considered. For example, the Proposal fails to consider whether a *relative*, rather than an *absolute*, test would more accurately measure liquidity. In this regard, the Proposal does not explore whether a value impact standard that is a multiple of the cost to trade the constituents of a liquidity benchmark or other reference portfolio would gauge the actual liquidity of an open-end fund's portfolio more appropriately than a fixed percentage. Such an approach, which would be analogous to the approach the SEC took in Rule 18f-4, could allow for the value impact standard to adjust for conditions in which spreads are widening across markets.

Accordingly, we disagree with the proposal to adopt a uniform quantitative value impact standard for investments that are not exchange-listed.

If the SEC adopts a fixed, uniform measure of market impact for investments that are not exchange-listed in spite of these significant concerns, we believe it should not be less than 5%. Although any fixed measure would risk harmful unintended consequences, a measure at this level would at least reduce this harm relative to the proposed 1% standard.

c. Replacement of Reasonably Anticipated Trade Size with Stressed Trade Size

In classifying an investment under the liquidity rule, the Proposal would require an open-end fund to "measure the number of days in which the investment is reasonably expected to be convertible to US dollars without significantly changing the market value of the investment, while assuming the sale of 10% of the fund's net assets by reducing each investment by 10%."[7] This requirement to assume a sale of 10% of each investment would replace the current requirement to consider a reasonably anticipated trade size (or "RATS") of a position.

MSIM strongly opposes this proposed change. The Proposal explains that this change is meant to address variability in the RATS that open-end funds use and the potential that open-end funds use small trade sizes for this purpose. The Proposal states that the 10% figure is based on an analysis of weekly flows showing that "outflows of 6.6% occurred 1% of the time in a pooled

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7 Proposal at text accompanying note 80.

sample across weeks and funds."[8] The Proposal explains that this analysis serves as a "useful approximation of the level of outflows funds may experience in future stressed conditions" and then, without any meaningful rationale, increases the outflow figure from the SEC's analysis by approximately half to arrive at 10%.[9]

In attempting to justify this change, the SEC does not offer evidence that the current approach of permitting funds to exercise informed judgment in establishing RATS has been ineffective. In addition, although the Proposal acknowledges that open-end funds currently consider a variety of factors in establishing RATS, such as flow history and trends and shareholder makeup and concentration, the Proposal does not explain why a single, uniform calculation methodology that ignores variations among these factors across funds would balance the costs and benefits of the proposed approach. The proposed 10% assumption would force many open-end funds to hold far more liquid portfolios and, in particular, portfolios that are more liquid than necessary to provide appropriate liquidity even in the historic stress scenarios that the Proposal identifies. By requiring funds to hold liquidity reserves greater than are necessary, the Proposal is likely to reduce open-end fund returns, potentially imposing significant costs on funds and their shareholders.

Accordingly, we believe the SEC should not adopt a change that prevents open-end funds from exercising judgment in establishing their trade size assumptions. Instead, we believe the SEC should preserve the ability of open-end funds to apply informed judgment to take into account important liquidity factors that may vary by fund, including the nature and concentration of fund shareholders.

If the SEC moves forward with a uniform trade size assumption in spite of the serious concerns of commenters, we believe the SEC should at a minimum use a data-driven approach that balances the costs to shareholders of funds maintaining excessive liquidity, rather than arbitrarily picking a round figure that significantly exceeds the stressed flows demonstrated in the SEC's own analysis. In this case, an assumption of 3%, rather than the proposed 10%, would be far less disruptive and much more consistent with the SEC's own data, representing roughly twice the first-percentile daily flow figure of 1.6% shown in Table 3 of the Proposal.[10]

d. Illiquid Investment Classification and Calculation

Under the Proposal, an open-end fund would be required to count toward the 15% illiquid investment limit the value of margin or collateral posted in connection with derivatives classified as illiquid that the fund would receive if it exited the transaction. Currently, non-illiquid investments posted as margin or collateral in connection with illiquid derivatives are not counted towards the 15% illiquid investment limit. The Proposal explains that, "a fund would not be required to specifically identify particular assets that it posted as margin or collateral to cover specific derivatives transactions" but rather "a fund would calculate the value of its assets posted as margin or collateral in connection with illiquid derivatives transactions and treat that value of assets as illiquid."[11]

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8 Proposal at text accompanying note 82.

9 Proposal at text accompanying note 83.

10 Proposal at 77245.

11 Proposal at 77199.

MSIM opposes this proposed change. The Proposal would require an open-end fund to make a number of stylized assumptions regarding the value of assets posted as margin or collateral because initial margin and collateral are commonly not posted on investments on a one-to-one basis. Moreover, the Proposal does not offer evidence that the benefits of the proposed change would be material. Based on current usage by open-end funds of derivatives and the related margin or collateral posted, we believe the net result of the proposed amendment would be only minor changes in a fund's liquidity classifications. Accordingly, this proposed amendment would involve costly system builds with significant complexity to achieve minimal changes in classification based on assumptions that are unlikely to reflect actual impacts on liquidity.

The Proposal would also newly classify as illiquid any "investments whose fair value is measured using an unobservable input that is significant to the overall measurement." However, the Proposal does little to justify this change and concedes that, "observability is a valuation concept and may not always correspond to liquidity."[12] The rough approximation that the Proposal posits does not merit displacing the informed judgment of personnel responsible for liquidity risk management with an arbitrary, hard-and-fast rule tied to observability, and the SEC should not adopt this change.

e. Classification of Liquidity by Asset Class

Currently, open-end funds are generally permitted to classify investments according to asset class groups for purposes of determining the appropriate liquidity bucket. The Proposal would eliminate liquidity bucket classifications based on asset class groups in favor of classifying each investment individually. The Proposal explains that, "there may be weaknesses in asset class level classifications" and "[t]he burden to determine individual investment classifications may have decreased since the adoption of the rule" based on familiarity, automated processes and use of vendors.[13] The Proposal also explains that the SEC "understand[s] that asset class level classifications are not widely used by many funds."[14]

We disagree with any change that would prohibit open-end funds from incorporating asset class information or making assumptions, where appropriate, at an asset class level where funds view that approach to be the most salient information for assessing the liquidity of an investment. In fixed income markets, most CUSIPs do not trade on most days. As a result, for many investments, the most useful information for assessing the liquidity of that investment is often trading information for other, similar investments, not trading information specific to that investment (which may not exist or may be too stale to be currently meaningful). We believe this aspect of the Proposal could result in funds not using sources of information that their advisers or liquidity risk management program administrators believe to be valuable to accurately determine liquidity classifications. Moreover, for certain investments, there is no practical alternative to utilizing asset class information, and the proposal to require daily classification would exacerbate the challenges in obtaining investment-specific information for this purpose. Accordingly, the SEC should not adopt this proposed change.

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12 Proposal at 77192.

13 Proposal at text following note 92.

14 Proposal at 77189.

f. Daily Classification of Liquidity

The Proposal would require open-end funds to classify the liquidity of their holdings daily. The current rule requires full classification no less frequently than monthly but also requires that "a fund monitor and take timely actions related to the liquidity of its investments, including changes to its liquidity profile."[15] The Proposal observes that, "[r]equiring daily classification, while involving costs, may ultimately lead to a more efficient classification process for funds than monitoring trading conditions to determine if and when intra-month classifications are required."[16]

Although the Proposal correctly observes that open-end funds have existing intra-month monitoring obligations, it does not follow that daily classification would either prove efficient or result in greater accuracy of classification. This change is most relevant with respect to investments for which classification is most likely to change in response to stressed market conditions. However, even in rapidly changing conditions, many of the analytical inputs are not likely to change daily. As a result, the Proposal would involve costly system builds but in many cases would not improve accuracy because running the analysis more frequently would not cause the resolution of the inputs to increase. In other words, this change would represent significant cost and little benefit. Accordingly, we do not support this proposed change to the liquidity rule.

g. Day Count Convention

Under the Proposal, an open-end fund would be required to count the day on which a liquidity classification is being conducted when bucketing investments for liquidity classification purposes. For example, a fund classifying an investment on a Monday would be permitted to treat the investment as "highly liquid" (meaning that the fund reasonably expects the investment to be convertible into cash in three business days or less without significantly changing the market value of the investment) only if the fund reasonably expects that the investment could be sold and settled in US dollars by the Wednesday that immediately follows (*i.e.*, the third business day *in a sequence starting on Monday,* rather than on the third business day *after Monday*). The Proposal states that the change is needed because, "inconsistency may lead certain funds to overestimate their liquidity classifications, and reduce their ability to meet redemptions."[17]

Absent this guidance, the natural reading of the liquidity rule would be to count days starting from a Monday (for instance) with day 1 as Tuesday, day 2 as Wednesday and day 3 as Thursday. This follows the normal convention for measuring the passage of time and how counting works in standard arithmetic (*i.e.*, 0 + 3 = 3, not 2).

The counting convention included in the Proposal would have the curious effect of making the proposed seven calendar day settlement period for defining illiquid investments a day shorter than the seven-day period provided in Section 22(e) of the Investment Company Act – an odd result when the time period for the liquidity rule was clearly chosen to coincide with the statutory period. By choosing a day-count standard that is inconsistent with the normal counting convention, this element of the Proposal in effect simply amounts to a shortening of the allowable settlement

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[15] Proposal at text following note 124.

[16] Proposal at 77194.

[17] Proposal at 77192-77193.

periods for liquidity bucketing purposes. As with the other proposed changes to the liquidity rule, the effect of this is to shift more investments into lower liquidity buckets.

MSIM believes that, in counting days for purposes of classifying investments under the liquidity rule, the SEC should specify that funds count *from* (rather than *including*) the date of classification. By requiring funds to count days using the method included in the Proposal, the proposed rule would further harm fund shareholders by exacerbating the requirement for funds to maintain unnecessarily restrictive liquidity positions. Accordingly, we oppose this change to the liquidity rule.

h. Mandate for Highly Liquid Investment Minimum

The Proposal would require all open-end funds (except in-kind exchange-traded funds ("ETFs")) to determine and maintain an HLIM, and each open-end fund's HLIM would need to be at least 10% of fund net assets.

As a general matter, MSIM opposes this proposed change, except in the limited circumstances we discuss above with respect to open-end bank loan funds. The SEC does not provide a meaningful rationale for applying a 10% HLIM to all open-end funds (except in-kind ETFs) other than claiming that it would help open-end funds prepare for "heightened levels of redemptions in stressed conditions."[18] The Proposal points to March 2020 and states that the majority of open-end funds with HLIMs set their HLIMs at under 10% in that month, but the Proposal does not establish that this was inappropriate or that 10% is anything other than an arbitrarily higher number. Indeed, the Proposal does not provide or cite any evidence that an HLIM of 10% would generate benefits to shareholders that would outweigh the impact on open-end funds of losing discretion over the amount of their highly liquid investments. MSIM believes the SEC has not identified sufficient offsetting benefits from this change or adequately addressed the risk of reduced returns to shareholder as a result. Accordingly, we believe the SEC should not adopt this change.

III. Mandatory Swing Pricing and Hard Close

Under the Proposal, each mutual fund (other than a money market fund) would need to adjust its NAV by a "swing factor" if, on a given day, (1) the fund has net cash redemptions; or (2) the fund has net cash purchases exceeding its "inflow swing threshold," which would equal 2% of fund net assets or such lower threshold as the fund's swing pricing administrator determines. In applying swing pricing, each fund's swing pricing administrator would need to determine the fund's daily net cash redemptions or net cash purchases of shares based on "reasonable, high confidence estimates of investor flows." All mutual funds subject to swing pricing would be required to establish and implement board-approved swing pricing policies and procedures and to have a board-designated swing pricing administrator.

The Proposal would also mandate a "hard close" for mutual funds (other than money market funds). Specifically, a purchase or redemption order would be eligible for a given day's price (as adjusted by the applicable swing factor) only if the mutual fund, its transfer agent or the National Securities Clearing Corporation ("NSCC") receives an "eligible order" before the fund's NAV pricing time (generally, 4 pm ET). Orders received by an intermediary but not transmitted to, and

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[18] Proposal at 77195.

received by, the fund, transfer agent or NSCC by the fund's NAV pricing time would receive the next day's price (as adjusted by the applicable swing factor).

Under the Proposal, eligible orders would be defined to include directions to purchase or redeem either (1) a specific number of fund shares or (2) an indeterminate number of shares of a specific value. Eligible orders would also include orders to exchange a specific number of shares held of one fund to purchase an equal value of shares of another fund. Other transactions, such as executing an investor's request to rebalance fund holdings to a target asset allocation or model portfolio, would generally not qualify as eligible orders. As described in the Proposal, "[t]he proposed rule would not permit these orders to receive same-day pricing if they are submitted after the pricing time, and therefore may require the intermediary to achieve the desired rebalancing through a series of orders over more than one day or to rebalance using prices from the prior day. In addition, the proposed hard close might affect current order processing for funds of funds."[19]

MSIM strongly opposes the SEC's proposals for mandatory swing pricing and a hard close. The SEC's reinvention of mutual fund pricing would come at a cost that far exceeds any benefits to mutual fund shareholders that could result. For example, as we explain further below, the Proposal would create an uneven playing field and unfairly disadvantage mutual fund investors, many of whom are retail investors and retirement plan participants, by forcing them to bear an additional day or more of unwanted investment exposure when they redeem their mutual fund shares and to forego an additional day or more of desired investment exposure when they purchase mutual fund shares. These same investors are also likely to share in years of expenses for the systems upgrades that would be needed solely to implement the Proposal.

The introduction of mandatory swing pricing would also result in unnecessary and unwarranted transfers of wealth from investors who transact in a fund's shares in the prevailing daily flow direction to those who transact in the opposite direction on the same day, in effect substituting one potential source of shareholder dilution for another. Because the Proposal would require a mutual fund to use the swung price as the fund's NAV, the amounts paid by transacting fund shareholders who transact in a fund's shares in the prevailing daily flow direction would not be visible to them, creating hidden fees and blunting any deterrence effect that swing pricing may have had on destabilizing investor behaviors.

Accordingly, MSIM strongly opposes the SEC's proposals for mandatory swing pricing and a hard close.

a. A Hard Close Requirement Would Harm Fund Investors

The SEC's proposed hard close at a fund's pricing time would operate to the detriment of mutual fund investors, including many retail investors and retirement plan participants. As the Proposal acknowledges, the effect of the hard close would be to force many intermediaries to establish earlier internal cut-off times in order to provide time to process and submit orders ahead of 4 pm ET. The Proposal does little to assess the consequences of this change, stating without support that, "[b]ecause technology has advanced . . . we generally do not believe, however, that

[19] Proposal at 77213.

intermediaries would need to establish cut-off times significantly earlier than the pricing time set by the fund."[20]

We disagree with this assessment and believe that the proposed hard close would significantly limit the access of a large percentage of mutual fund shareholders, including many retail investors and retirement plan participants, to same-day pricing. This would greatly disadvantage these investors relative to those who invest in other types of investment vehicles or directly in underlying investments that provide access to trading with same-day pricing. Fund investors losing access to same-day pricing would be subject to one or more days of unwanted market risk whenever they redeem shares and one or more days of foregone market exposure whenever they buy shares, exposing them to significant uncertainty and potential investment losses. In effect, the Proposal would create an unequal playing field for investors, allowing some investors to receive same-day pricing and forcing others to bear one or more days of delayed execution, with differences in treatment prevalent even among investors in the same fund. This disparate treatment is fundamentally at odds with the SEC's investor protection mandate and the policy objectives of the Investment Company Act.

By no longer permitting many mutual fund shareholders, including retail investors and retirement plan participants, to rebalance their holdings across multiple funds in transactions executed on the same day, the hard close requirement and limit on eligible orders would also take away a key benefit of investing in mutual funds that makes them attractive for use in retirement accounts and asset allocation programs.

A hard close requirement would also disadvantage mutual funds as a structure compared to other investment vehicles, and we believe it would result in a shift of assets away from mutual funds toward those other vehicles or separately managed accounts. Although each of those alternatives has important benefits and uses, investors should be permitted to choose the vehicle that best suits their needs, rather than facing a weighted choice that imposes heavier, unjustified regulatory burdens on just one type of investment vehicle.

b. A Hard Close Requirement Would Reduce Fund Resiliency

One of the Proposal's principal objectives is to strengthen the resiliency of open-end funds during periods of market stress by reducing incentives for fund shareholders to redeem. We believe a hard close requirement will have the opposite effect. Fund shareholders subject to an early cut-off time will have added incentive to redeem when prices are dropping and fears of further declines are rampant. Today, all mutual fund shareholders can assess market conditions right up until the market close before deciding whether to exit or maintain their share positions on days of significant market stress. With a mandatory hard close in place, shareholders subject to an early cut-off must take action earlier in the day to avoid being locked into their fund positions for another day (plus a weekend, if on Friday). In the face of this added uncertainty, we believe it is likely that a larger percentage of fund investors would choose to redeem during periods of market stress than is currently the case. That is exactly what happened after the SEC introduced fees and gates for prime money market funds. Well-intentioned regulatory changes have sometimes led to unintended consequences, which we believe would happen here again if mutual funds are required to adopt a hard close.

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[20] Proposal at 77212.

c. Alternatives to the Pricing Time Hard Close

The Proposal outlines several alternatives to mandating a hard close at a mutual fund's pricing time. These include: (1) permitting mutual funds to rely on indicative flows, which would require that intermediaries calculate an estimate for what they anticipate the given flows for a particular day to be either before the fund's daily pricing time or a set time thereafter (*e.g.*, by 4:30 pm ET or 5 pm ET); (2) permitting mutual funds to rely on estimated flows, where funds would generate models that incorporate the information that they have already received by a pre-established time as well as historical order flow information; and (3) imposing a hard close but allowing intermediaries to submit orders until a later cut-off time (*e.g.*, until 6 pm ET or 7 pm ET).

While these alternatives may, to the extent they would reduce or eliminate the requirement for intermediaries to impose early cut-offs on fund orders to receive same-day pricing, potentially be less disruptive to some fund investors than the proposed hard close, the SEC should carefully study the feasibility and impact of these alternatives before imposing such significant changes on the US fund ecosystem. The costs of putting in place any of these alternatives would likely be considerable. For example, developing systems to meet the requirement that a fund's swing pricing adjustments are based on "reasonable, high confidence estimates of investor flows" would involve significant effort, expense and coordination across fund sponsors and intermediaries. Any requirement the SEC may consider imposing on funds and intermediaries to calculate and disseminate indicative or estimated daily flows should be developed through a deliberative process in coordination with industry participants, and should be adopted only if the resulting benefits to funds and their shareholders are found to exceed the associated costs.

d. Mandatory Swing Pricing Would Mislead and Harm Investors, Impose Significant Costs and Fail to Achieve the Intended Benefits

The Proposal to require mutual funds to implement swing pricing, together with the required hard close and limit on eligible orders, would be extremely disruptive to funds, intermediaries and retirement plans and would inflict significant harm on fund investors.[21] Beyond the implementation challenges, swing pricing has fundamental flaws as a mechanism for addressing potential shareholder dilution.

Swing Pricing Overcharges Shareholders Contributing to Fund Liquidity Costs to Provide a Benefit to Shareholders Transacting in the Opposite Direction on the Same Day

The primary purpose of swing pricing as described by the SEC is to offset the potential dilution of fund (and long-term shareholder) returns that could arise from providing liquidity to transacting fund shareholders. In attempting to address this perceived inequity, swing pricing creates a new inequity by overcharging transacting fund shareholders contributing to fund liquidity costs to provide a benefit (in the form of a more favorable transaction price) to shareholders transacting in the opposite direction on the same day. In our view, the remedy for addressing one potential source of shareholder dilution should not be to create another source of shareholder dilution.

In swing pricing, the same transaction price applies to both purchases and redemptions of shares on a given day. As a result, a portion of the charges imposed on transacting shareholders

[21] Although such funds were excluded from the Proposal, the SEC also recently proposed to require swing pricing for money market funds. We continue to have significant concerns regarding that proposal as well. *See* MSIM MMF Proposal Comment Letter.

contributing to fund liquidity costs is diverted to benefit shareholders transacting in the opposite direction on the same day, rather than benefitting the fund. In order for a fund to recoup its estimated potential flow-related liquidity costs on any day using swing pricing, the charges imposed on transacting shareholders contributing to fund liquidity costs must be grossed up to compensate for the benefits provided to shareholders transacting in the opposite direction.

The closer the balance between a fund's daily cash inflows and cash outflows, the higher the percentage of swing pricing benefits that accrue to shareholders who transact against the prevailing daily flow direction and the lower the percentage of such benefits that the fund captures. We call this "benefits leakage."

To estimate the amount of benefits leakage that would accompany adoption of swing pricing, we evaluated the daily net flows of 193 Eaton Vance, Morgan Stanley and Calvert mutual funds over a multi-year evaluation period.[22] For the 467,511 aggregate daily fund flow observations included in the study, the median ratio of the lesser of a fund's daily cash inflows and cash outflows to the greater of the fund's daily cash inflows and cash outflows (we call this the fund's "flow min-max ratio") was 32.5%. If swing pricing were applied each day, the median rate of benefits leakage from funds to shareholders transacting against the prevailing daily flow direction would be the same 32.5%. At this benefits leakage rate, in order to fully recoup a fund's potential flow-related trading costs, the charges imposed on transacting shareholders contributing to fund liquidity costs would need to be grossed up from the estimated amount of liquidity costs incurred by the fund by 48.1% (= (1 / (1 – benefits leakage rate)) - 1).

The attached Exhibit (beginning on page A-1) provides a simplified hypothetical example illustrating how benefits leakage would work under swing pricing as proposed. (The dollar amounts in the Exhibit were chosen solely for illustrative purposes and are not intended to be representative of any particular fund.) The swing pricing example in the Exhibit illustrates how swing pricing would transfer to shareholders transacting in the prevailing direction fund liquidity costs that continuing fund shareholders would otherwise bear in connection with shareholder transactions. But swing pricing also dilutes the interests of transacting shareholders contributing to fund liquidity costs by overcharging them to provide an accretion benefit to shareholders transacting in the opposite direction on the same day. As shown in the Exhibit, *at a typical mutual fund flow min-max ratio of 1-to-3, only about 50% of the reduction in potential shareholder dilution from using swing pricing would actually be realized, with the balance merely shifted among different shareholder groups*. As we will discuss further below, no similar transfer of wealth from shareholders transacting in the prevailing direction to shareholders transacting in the opposite direction occurs with daily variable liquidity fees.

Swing Pricing Subjects Transacting Shareholders to Undisclosed Fees

The Proposal's requirement for funds to treat as NAV the swung price at which a fund's share transactions take place would embed a hidden transaction fee in fund NAVs, which shareholders would bear whenever they transact in the same direction as the fund's prevailing net cash flows on days when the fund's applicable swing threshold is exceeded. While the Proposal would

[22] The study included all Eaton Vance, Morgan Stanley and Calvert mutual funds with net assets of more than $50 million on a given day during the measurement period, which was January 1, 2007 to December 31, 2022 for the 100 Eaton Vance funds, January 1, 2010 to December 31, 2022 for the 55 Morgan Stanley funds and December 20, 2016 to December 31, 2022 for the 38 Calvert funds included in the study. Additional information about the study is available upon request.

require funds to report on Form N-PORT each month the number of times the fund applied a swing factor during the month and the amount of each swing factor applied, the reported information would be lagged and not easily accessible to the average investor. Avoiding hidden transaction fees would be virtually impossible for most shareholders. Because the term "NAV" would be used to describe a fund's transaction price, many investors would assume, quite logically, that all share transactions take place at the fund's actual, unadjusted NAV and that no fund transaction fees apply. In other words, the SEC would here endorse through policy a practice that is misleading to investors in a way that the SEC would ordinarily condemn. Moreover, as with any hidden fee, swing pricing creates an incentive for funds to charge more, and it would reward those funds that apply swing pricing most aggressively by increasing fund investment returns. We view this lack of transparency, and the resulting incentive for funds to overcharge, as a significant departure from basic principles of investor protection.

Swing Pricing Will Cause Investor Confusion Concerning Measures of Fund Performance Based on Swung NAVs and Valuations of Shareholder Positions Based on Swung NAVs

Implementation of swing pricing would require funds to adjust their NAVs by the swing factor in effect whenever the applicable swing factor is exceeded. Transactions to buy and redeem shares would take place at the swung price, which funds would, for purposes of transactions in fund shares, report as "NAV." In contrast, funds would be required to calculate total return within the financial highlights and performance information sections of Form N-1A based on GAAP (unswung) NAV. As a result, any source that measures fund performance based on the transactional (swung) NAVs, would present investors with distorted calculations of performance whenever a fund's swing threshold is exceeded at either the beginning or the end of the period over which performance is being measured. The calculation of fund performance based on swung NAVs would be particularly skewed when a fund's price is swung in one direction (up or down) at the beginning of the measurement period and in the opposite direction (down or up) at the end of the period. Moreover, with swing pricing in effect, the value of fund investors' holdings of shares based on swung NAVs could be overstated or understated whenever a fund's swing factor is exceeded, with potential implications for fund investors' compliance with asset-based regulatory limits, investment policy restrictions and/or loan collateral coverage requirements that apply to them. In addition, whenever an investor makes a personal gift or charitable donation of fund shares on a day when the fund's swing threshold is exceeded, the valuation to be used would be subject to uncertainty, and possible challenge by tax authorities.

The result of funds having both swung NAVs and GAAP (unswung) NAVs, and measures of performance based on each, would be significant investor confusion. Investors may not appreciate the distortions in fund performance based on swung NAVs that swing pricing introduces, may not know where to locate or be able to obtain performance information and valuations based on GAAP (unswung) NAV for a given period or a particular day, and may not have clear guidance on which performance measure or valuation to use for any given purpose.

Swing Pricing's Lack of Transparency Blunts Any Deterrence Effect on Destabilizing Investor Behaviors

The Proposal suggests that the favorable effects of swing pricing would include to deter fund shareholder redemptions motivated by perceived first-mover advantages. As explained in the proposing release to the 2016 Swing Pricing Rule, "if remaining shareholders understood that

redeeming shareholders would bear the estimated costs of their redemption activity, it would reduce their incentive to redeem quickly because there would be less risk that they would bear the costs of other shareholders' redemption activity."[23]

We question whether swing pricing as proposed to be implemented would contribute in any meaningful way to attaining this goal. If the fees paid by investors to access fund liquidity are not apparent because they are embedded in the transactional NAV, we find it hard to believe such fees will meaningfully influence investor behavior. Investors are quite unlikely to be deterred by fees they do not know they are paying.

Swing Pricing Does Not Function Effectively for In-Kind Share Transactions

Different from cash transactions in a fund's shares, in-kind purchases and redemptions do not provide an offset against the fund's countervailing cash flows on the same day or normally cause the fund to incur portfolio trading costs. Recognizing this, the Proposal would require funds to exclude in-kind purchases and redemptions from their determination of whether the applicable swing threshold has been exceeded on a particular day. This makes sense.

Yet, under the Proposal, purchases and redemptions of mutual fund shares on an in-kind basis would be required to be met at the same transaction price as cash transactions. Depending on the circumstances, this will cause either the transacting in-kind shareholder or the fund itself (and continuing shareholders) to incur dilution whenever an in-kind share transaction takes place on a day swing pricing is in effect.

A fund's shareholders transacting on an in-kind basis would incur dilution when they transact in kind *in the same direction* as the fund's prevailing flow direction on a day that swing pricing is in effect (as a consequence of buying shares at a premium or redeeming shares at a discount to actual NAV). Conversely, a fund (and continuing shareholders) would incur dilution when shareholders transact on an in-kind basis *in the opposite direction* as the fund's prevailing flow direction on a day that swing pricing is in effect (as a consequence of issuing shares at a discount or redeeming shares at a premium to actual NAV).

While in-kind share transactions are not common among broadly held mutual funds, several funds we sponsor regularly meet a substantial percentage of their redemptions on an in-kind basis. Rather than capturing the benefits of using in-kind share transactions to reduce potential shareholder dilution, swing pricing negates these benefits and imposes unwarranted dilution on transacting in-kind shareholders or the fund itself.

Swing Pricing Will Cause Funds to Incur Dilution (or Sometimes Accretion) in Connection with Reinvested Distributions

The Proposal's method of implementing swing pricing seemingly requires mutual funds to effect the reinvestment of fund dividends and capital gain distributions at the same price as cash purchases and redemptions of shares on the same day. Whenever a fund's swing threshold is exceeded on the reinvestment date, the reinvestment of fund distributions would take place at the swung NAV. When a fund's NAV has been swung lower, the reinvestment of fund distributions

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[23] Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release, Investment Company Act Release No. 31835 (Sept. 22, 2015) at 62329.

would be dilutive to fund returns (as a consequence of issuing shares at a discount to actual NAV); when a fund's NAV has been swung higher, the reinvestment of fund distributions would be dilutive to reinvesting shareholders (as a consequence of buying shares at a premium to actual NAV). Given the Proposal's requirement for funds to apply swing pricing at a zero threshold on net cash outflow days versus a swing threshold of up to 2% on net cash inflow days, we expect most funds to swing their NAVs lower more often than they swing them higher. As a result, we expect the requirement for funds to reinvest distributions at swung prices to be, on balance, net dilutive to fund returns.

e. The Proposal for Mandatory Swing Pricing Is Also Flawed in Its Details

For the reasons described above, we believe that swing pricing is fundamentally flawed and we respectfully request that the SEC not require mutual funds to adopt swing pricing. Moreover, we believe that many of the policy choices embedded in the Proposal are also problematic, some of which we highlight below.

The Proposed Market Impact Threshold is Arbitrary

In determining the applicable swing factor, the Proposal would require funds to include consideration of the market impact of the assumed portfolio transactions whenever a fund's net cash outflows exceed 1% of net assets and whenever net cash inflows exceed 2% of net assets. In our view, the proposed market impact thresholds are completely arbitrary and bear no relation to underlying reality. Across all markets and over all types of market conditions, the market impact of a fund executing a securities transaction varies in large part based on the *absolute size* of the transaction, and not at all based on the *percentage of the fund's net assets* that the transaction represents. The percentage of net assets at which market impact costs are material for a $50 billon mutual fund is very different from the percentage of net assets at which market impact costs are material for a $50 million mutual fund.

Swing Pricing Administrators Would Not Have Sufficient Flexibility to Determine Swing Factors and Swing Thresholds in the Best Interest of Funds

The Proposal is also flawed in its prescriptive method of implementing its swing pricing regime. The Proposal would give swing pricing administrators limited discretion to establish swing pricing policies that are in the best interests of a particular fund in light of the fund's size and its investment holdings and shareholder characteristics. It would mandate key parameters for swing pricing implementation, including that: (1) a fund must establish a swing threshold of zero for net cash outflows and may not establish a swing threshold greater than 2% for net cash inflows; (2) a fund's swing factor must include consideration of market impact at a threshold no higher than 1% for net cash outflows and no higher than 2% for net cash inflows; and (3) the swing factor must be calculated based on selling or purchasing a vertical slice of the fund's portfolio. By severely restricting the ability of swing pricing administrators to exercise appropriate discretion in the manner that they determine to best suit a particular fund, the Proposal risks causing a fund to apply swing pricing too widely or too narrowly or to apply swing factors that are too high or too low. We believe the SEC has not shown evidence that severely restricting the discretion of swing pricing administrators to establish fund-specific parameters is necessary, appropriate or in the public interest.

The SEC Should Take a More Reasonable Approach to the Standard for Estimates

The Proposal would require a fund's swing pricing administrator to use reasonable, high confidence estimates when making determinations of whether and in which direction to swing the fund's NAV, and to make good-faith estimates when determining the swing factor to apply. Mutual funds in the US have not implemented swing pricing in part because of the need for reliance on a significant amount of estimated data. While the proposed hard close requirement would, in theory, reduce the need for estimation with respect to flows, it would come at a steep price and not fully eliminate the need for estimation of flows. Moreover, the proposed hard close does nothing to eliminate the need to rely on estimates for other significant aspects of the required determinations.

In recognition of the necessity of relying on estimates to implement swing pricing, the SEC should provide a safe harbor protecting mutual funds, their boards, investment advisers and other service providers, from liability in connection with reasonable reliance on good-faith estimates in determining a fund's swing factors and swing thresholds in effect.

f. Alternatives to Swing Pricing

As possible alternatives to swing pricing, the Proposal describes several other measures to address potential shareholder dilution that the SEC could require funds to adopt. Among the available choices, we believe that one alternative, daily variable liquidity fees, has the potential to address the fundamental flaws of swing pricing. We believe this alternative merits further study, but that adopting a mandatory mechanism to address potential shareholder dilution would be premature. For example, the Proposal fails to identify the systems requirements and structural features, which we discuss below, that would be necessary for daily variable liquidity fees to realize the benefits that the Proposal aims to achieve.

Accordingly, the next steps in exploring daily variable liquidity fees as an alternative to swing pricing must include: (1) significant coordination and advance planning among the SEC, mutual fund sponsors and intermediaries to ensure that liquidity fees imposed on transacting shareholders would be priced accurately and that implementation could be achieved in a cost-effective manner; and (2) conditioning any requirement for funds to adopt liquidity fees on a determination that the benefits to a fund's shareholders would measurably justify the costs involved. We are prepared to assist the SEC in further study of this alternative and, as a first step in that dialogue, have identified below certain features of daily variable liquidity fees that we believe would be essential to include.

The process culminating in the Proposal notably lacked the kind of advance coordination that we are proposing here, and the Proposal itself provided a comment period that was clearly insufficient to achieve real engagement. The consequences for mutual fund shareholders of any missteps here will be highly significant, requiring the SEC to act deliberately, prioritizing the best outcomes for investors over haste. In this regard, it is essential that the SEC engage extensively with affected parties before adopting any change of this scale and significance.

If the SEC seeks to pursue requiring mutual funds to adopt daily variable liquidity fees, in our judgment it would be essential to include (and further develop) several features that we believe would be necessary to make them fair, efficient and effective:

- A liquidity fee should be applied on a given day only for cash purchases or cash redemptions of a fund's shares in the direction of the fund's prevailing net cash flows on that day. Cash purchases and redemptions against the prevailing daily net flow direction, as well as in-kind transactions and reinvested fund distributions, should be transacted at NAV (without a liquidity fee applying).

- A liquidity fee should be paired with a market-based feedback mechanism that provides fund managers and fund boards with guidance on whether a fund's liquidity fee rate has been set too high or too low and protects transacting shareholders from having to pay overly aggressive fees.

    - We have developed a blueprint for one possible type of market-based feedback mechanism to serve this purpose, and we would welcome the opportunity to engage with the SEC and its staff to discuss the potential approach and possible alternatives. As an example, in our proposed potential method for determining liquidity fees appropriate to apply to a fund's transacting shareholders, a fund would, using a daily market-based process, apply fund liquidity fees to incentivize liquidity providers to buy or redeem fund shares on a short-settlement basis to provide countervailing fund cash flows timed to coincide with cash flows from the fund's regular-settlement shareholder transactions effective on the prior business day. Whenever shares are issued or redeemed through this process at a purchase discount or redemption premium less than the daily maximum allowable discount or premium (determined based on the fund's preliminary liquidity fee rate for the prior business day), the fund's liquidity fee rate for the prior business day would automatically adjust lower. In effect, the cost savings to the fund from issuing shares at a smaller discount or redeeming shares at a smaller premium than reflected in the fund's preliminary liquidity fee rate would pass through to transacting shareholders. This process would provide daily feedback on whether a fund's preliminary liquidity fee rate has been set too high or too low, and would automatically reduce the liquidity fee rate when set too high. To avoid delays in processing regular-settlement share transactions, the daily market-based process of determining the terms and amounts of a fund's countervailing short-settlement share transactions would generally be expected to take place during the evening hours of the business day before such transactions are effective.

    - Because the systems and communication protocols to support this market-based feedback mechanism are expected largely to function apart from the existing mutual fund share processing ecosystem, the incremental effort and expense to build and maintain these systems and protocols may be relatively modest.

- Disclosure about liquidity fees should be designed to avoid discouraging their use or disadvantaging funds that use them.

Applying daily variable liquidity fees in this manner would resolve many of the deficiencies of swing pricing identified above, including: (1) the overcharging of transacting shareholders contributing to fund liquidity costs to provide a benefit to shareholders transacting in the opposite

direction on the same day, creating a new source of shareholder dilution; (2) the non-transparency that exposes transacting shareholders to hidden fees, distorts measures of fund performance and the value of fund positions based on swung NAVs, and mitigates any deterrence effect on destabilizing investor behaviors; and (3) the inappropriate treatment of in-kind shareholder transactions and reinvested fund distributions.

The attached Exhibit provides a simplified hypothetical illustration comparing application of daily variable liquidity fees to swing pricing as proposed by the SEC on a day when a fund experiences cash outflows and partly offsetting cash inflows. As shown, provided that the fund's liquidity fees are appropriately sized, applying daily variable liquidity fees would fully offset liquidity costs, whereas swing pricing merely shifts the incidence of potential dilution among different shareholder groups.

As noted, a critical feature of daily variable liquidity fees is that they include measures to protect shareholders against funds applying fees that are too high or too low in relation to the associated fund liquidity costs. If a fund's liquidity fee rate (or swing factor) is set too high in relation to the amount of fund liquidity costs, transacting shareholders contributing to fund liquidity costs incur dilution from the resulting overcharging. With swing pricing, the amount of cost they incur is further grossed up to provide accretion benefits (in the form of a more favorable transaction price) to shareholders transacting against the prevailing flow direction on that day. If a fund's liquidity fee rate (or swing factor) is set too low, the fund (and continuing shareholders) would not realize the SEC's objective to protect continuing shareholders against potential flow-related dilution.

In the Proposal, the SEC has expressed concerns that fund sponsors have financial incentives to aggressively apply measures to address potential shareholder dilution because of the favorable impact on fund performance.[24] Given these incentives, we believe a well-designed liquidity fee program should include greater protections against overcharging than merely disclosing the fee rate in effect on a given day, particularly when the disclosure is on a lagged basis.

If the SEC determines to pursue a mandatory mechanism for mutual funds to address potential shareholder dilution, we believe daily variable liquidity fees with features like those described above would be significantly fairer, more effective and more efficient than swing pricing or any of the other alternatives described in the Proposal.

As discussed above, we believe any consideration by the SEC of requiring mutual funds to adopt daily variable liquidity fees, rather than swing pricing, should be pursued only through a deliberative process in close coordination with fund sponsors and intermediaries, and should be implemented only if the benefits to funds and fund shareholders are determined to exceed the associated costs.

g. Withdrawal of Guidance and No-Action Letters

In the proposing release, the SEC states that the SEC staff would review letters and SEC staff statements that would be inconsistent with any final rule amendments. MSIM believes that the

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[24] The Proposal states that "[w]e understand that in calculating the swing factor, fund managers may have incentives to over-estimate costs in order to improve fund performance. However, doing so would be misleading. To help address this risk, under the proposal funds would be required to report their swing factor adjustments publicly on Form N-PORT. We believe this public transparency should reduce a fund's incentive to over-estimate costs." Proposal at 77205-77206.

SEC staff should retain the existing Frequently Asked Questions ("FAQs") to the extent they would not be directly superseded by a final rule.[25] These include FAQs on sub-advised funds, ETFs, pooled investment vehicles and related reporting requirements, as well as any FAQs that would be affected by proposed amendments that the SEC does not adopt.

We also believe the SEC staff should not withdraw the no-action letter issued to ReFlow Fund LLC ("ReFlow Letter").[26] The ReFlow Letter continues to be valuable and is not inconsistent with the Proposal. Accordingly, if the SEC adopts amendments to Rule 22c-1, we respectfully urge the SEC staff to either not withdraw the ReFlow Letter or to carefully consider whether at least portions of the ReFlow letter could be left in place.

IV. Reporting Changes

Together with the proposed liquidity rule amendments, swing pricing mandate and required hard close, the SEC is proposing changes to Form N-PORT and Form N-CEN.

a. Changes to Timing and Content of Form N-PORT

Under the Proposal, funds would be required to file reports on Form N-PORT within 30 days of each month-end, with public availability of most reported data 60 days after each month-end. This would replace the current requirement to file reports for each month of a fiscal quarter 60 days after the end of that fiscal quarter, with only the report for the third month of every quarter made public. The Proposal would also require funds to provide a complete portfolio holdings report on Part F of Form N-PORT as of ten month-ends per year rather than only as of the end of the first and third quarters.

We believe that these components of the Proposal should be eliminated. The more frequent public disclosures would, for some funds, be contrary to existing portfolio holdings disclosure policies adopted in the fund's best interest. For example, a fund and its manager may conclude that it would be beneficial for the fund to disclose publicly its holdings only quarterly (rather than monthly) to protect against other market participants re-engineering the fund's investment strategy, which could negatively impact the fund and its shareholders by facilitating trading in advance of the fund.

In addition, the expansion of the Part F filing requirement from twice a year to ten times a year imposes additional costs on funds for little or no apparent benefit.

Accordingly, we believe the SEC should not adopt either the proposed change in filing cadence and timing or the proposed expansion of Part F filings. If the SEC adopts the proposed changes in filing cadence and timing in spite of these concerns, then funds should be given at least 45 days after each month-end to file Form N-PORT to allow funds sufficient time to adequately prepare and review the information required.

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[25] SEC Staff, Investment Company Liquidity Risk Management Programs Frequently Asked Questions (Apr. 10, 2019), available at https://www.sec.gov/investment/investment-company-liquidity-risk-management-programs-faq.

[26] ReFlow Fund LLC, SEC Staff No-Action Letter (pub. avail. July 15, 2002).

b. Public Liquidity Bucket Reporting

The Proposal would require open-end funds to report on Form N-PORT the aggregate percentage of fund assets falling into each of the three remaining liquidity buckets (highly liquid, moderately liquid or illiquid). This information would become public.

MSIM strongly opposes this proposed change to require the public reporting of open-end funds' aggregate liquidity classifications. MSIM is concerned that this information would prove misleading to shareholders, particularly retail investors. For example, two funds with identically managed portfolios could have different liquidity classifications based on differences in data or assumptions or for other appropriate reasons. Because the average investor is not likely to be familiar with the methodologies used for classifying investments by liquidity, he or she is likely to assume that these differences necessarily reflect differences in liquidity risk. Additionally, as discussed above, the Proposal introduces several technical and complex elements into the liquidity classification process that would add further margin for differences in liquidity classification outcomes between similarly managed funds. This public disclosure would be, at best, unhelpful and, more likely, misleading, and it would add nothing to public understanding of fund liquidity that is not apparent from the liquidity requirements imposed on all open-end funds. Accordingly, the SEC should not adopt this reporting requirement.

V. Transition Periods

The Proposal would allow a 12-month transition period after the effective date of the amendments for the liquidity rule-related changes and amendments to Forms N-PORT and N-CEN, other than the swing pricing-related disclosure on Form N-PORT. The Proposal would allow a 24-month transition period after the effective date of the amendments for mutual funds to comply with the hard close requirement, mandatory swing pricing and related amendments to Forms N-PORT and N-1A.

These transition periods are, even taken on their own, completely unrealistic. For the reasons discussed above, the extensive work that would be required to reprogram systems, coordinate with other market participants and, in essence, rebuild the entire architecture of the mutual fund order management and pricing ecosystem, would take much longer than proposed. However, these compliance dates must be considered in the context of the many other recently finalized and proposed rules from the SEC that would affect funds and advisers. Many of these are likely to have compliance periods that run concurrently, straining every resource on which such transitions depend. Accordingly, we believe that an implementation period of even three years after the effective date would be insufficient to implement the proposed changes without material harm to funds and shareholders.

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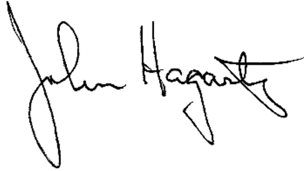
MSIM greatly appreciates your consideration of our comments on these important issues facing funds and their investors. We would welcome the opportunity to provide any additional information that the SEC might find useful. Please do not hesitate to contact the undersigned with any questions.

Respectfully submitted,



John Hagarty

Chief Operating Officer
Morgan Stanley Investment Management Inc.

cc: The Honorable Gary Gensler
The Honorable Hester M. Peirce
The Honorable Caroline A. Crenshaw
The Honorable Mark T. Uyeda
The Honorable Jaime Lizárraga
William A. Birdthistle, Director, Division of Investment Management

EXHIBIT

Example Showing Hypothetical Impact of Swing Pricing and Variable Liquidity Fees

Fund experiences shareholder cash outflows partly offset by cash inflows.

Assume that:

1. The Fund has net assets of $15,000 and 100 outstanding shares. Shareholder A owns 3 shares, shareholder B owns 0 shares and shareholders C through J collectively own 97 shares.

2. Shareholder A redeems 3 shares for cash and shareholder B purchases 1 share for cash effective on the same day.

3. Fund liquidity costs allocated to continuing shareholders equal 1% of daily net cash outflows.

4. Fund liquidity costs are accrued and reflected in NAV as incurred.

5. When applying swing pricing, the Fund uses a zero swing threshold and a swing factor sufficient to fully offset fund liquidity costs allocated to continuing shareholders (= 1.01%).

6. When applying variable liquidity fees, the Fund uses a zero liquidity fee threshold and applies a liquidity fee rate sufficient to fully offset fund liquidity costs allocated to continuing shareholders (= 0.67%).

   - Unlike with swing pricing, neither the fund's swung NAV per share nor the transaction price of shareholders transacting against the prevailing flow direction is adjusted from true NAV per share.

   - The amount paid by transacting shareholders contributing to fund liquidity costs is less than when swing pricing is in effect because no accretion benefit is provided to shareholders transacting against the prevailing flow direction.

Swing Pricing in Effect

Share Transactions

Shareholder	Shares Transacted	Transaction Price per Share	Total Transaction Value	Liquidity Cost Borne per Share Held	Total Liquidity Cost Borne
A	-3	$148.45	-$445.36	$0.03	$0.09
B	1	148.45	148.45	-	-
C thru J	0	-	-	0.03	3.00
Total	-2	$148.45	-$296.91	$0.03	$3.09

Post-Transaction Share Positions

Shareholder	Shares Held	True NAV per Share	True Total NAV	Reported NAV per Share	Reported Total NAV
A	0	-	-	-	-
B	1	$150.00	$150.00	$148.45	$148.45
C thru J	97	150.00	14,550.00	148.45	14,400.00
Total	98	$150.00	$14,700.00	$148.45	$14,548.45

Accretion/Dilution Analysis

Shareholder	Fund Liquidity Cost	Impact of Swing Pricing	Net Potential Accretion/ Dilution	
A	$3.00	-$4.55	-$1.55	<---
B	0.00	1.55	1.55	<---
C thru J	-3.00	3.00	0.00	
Total	$0.00	$0.00	$0.00	

The $3.00 of costs that continuing shareholders C through J potentially incur to provide liquidity to shareholder A is fully offset by the $3.00 benefit to continuing shareholders from shareholder A redeeming shares at a discount to true NAV. In addition to the $3.00 paid by redeeming shareholder A to reimburse continuing shareholders, shareholder A pays another $1.55 to provide a purchase price discount to shareholder B. With swing pricing, transacting shareholders contributing to fund liquidity costs experience net dilution to provide an accretion benefit to shareholders transacting against the prevailing flow direction on the same day

Variable Liquidity Fees in Effect

Share Transactions					
Share-holder	Shares Transacted	Transaction Price per Share	Total Transaction Value	Liquidity Cost Borne per Share Held	Total Liquidity Cost Borne
A	-3	$148.97	-$446.91	$0.03	$0.09
B	1	150.00	150.00	-	-
C thru J	0	-	-	0.03	3.00
Total	-2	$148.45	-$296.91	$0.03	$3.09

Post-Transaction Share Positions					
Share-holder	Shares Held	True NAV per Share	True Total NAV	Reported NAV per Share	Reported Total NAV
A	0	-	-	-	-
B	1	$150.00	$150.00	$150.00	$150.00
C thru J	97	150.00	14,550.00	150.00	14,550.00
Total	98	$150.00	$14,700.00	$150.00	$14,700.00

Accretion/Dilution Analysis			
Share-holder	Fund Liquidity Cost	Impact of Liquidity Fees	Net Potential Accretion/ Dilution
A	$3.00	-$3.00	$0.00
B	0.00	0.00	0.00
C thru J	-3.00	3.00	0.00
Total	$0.00	$0.00	$0.00

The $3.00 of costs that continuing shareholders C through J potentially incur to provide liquidity to shareholder A is fully offset by the $3.00 benefit to continuing shareholders from shareholder A redeeming shares at a discount to true NAV. Because no purchase discount is provided to shareholder B, the amount paid by redeeming shareholder A is limited to the reimbursement provided to continuing shareholders. Unlike with full swing pricing, transacting shareholders contributing to fund liquidity costs do not incur net dilution to provide an accretion benefit to shareholders transacting against the prevailing flow direction on the same day.