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February 14, 2023

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

Re: Comments Concerning the Proposed Amendments to Open-End Liquidity Risk Management Programs and Implementation of Swing Pricing and a Hard Close

File No. S7-26-22

Dear Ms. Countryman:

I am writing on behalf of Massachusetts Financial Services Company ("**MFS**" or "**We**") in response to the invitation by the U.S. Securities and Exchange Commission (the "**Commission**") to provide comments on the Commission's recently proposed amendments to the mutual fund liquidity risk management framework and proposal to mandate the adoption of swing pricing and a hard close by funds.[1,2]

We appreciate the opportunity to provide our thoughts on the Proposal and we support the Commission's initiative to revisit fund regulation and reassess fund practices in light of market events, such as the market volatility experienced during the Covid-19 pandemic. We believe that applying lessons learned from such periods helps to ensure the continued resiliency of the fund industry and reinforces the protections afforded to the millions of U.S. households that rely on funds to achieve their financial goals, including saving for retirement, education, and other major life events.[3] MFS has extensive experience managing funds dating back to 1924 and the creation of the country's first open-end mutual fund, Massachusetts Investors Trust. Since this time MFS has been a leading innovator in the fund industry and currently serves as the investment adviser to

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[1] *Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting*, Investment Company Act Rel. No. 34746, 87 FR 77172 (December 16, 2022), available at https://www.govinfo.gov/content/pkg/FR-2022-12-16/pdf/2022-24376.pdf (the "**Proposal**").

[2] Throughout this letter, the term "**fund**" means open-end mutual fund registered under the Investment Company Act of 1940, as amended (the "**40 Act**").

[3] *See generally* 2022 Investment Company Fact Book, available at https://www.icifactbook.org (the "**ICI Fact Book**").

over 120 funds (the "**MFS Funds**") representing approximately $317 billion in assets under management[4] with over fourteen million shareholders. Based on our experience managing the MFS Funds and given the important role that funds serve for U.S. households, we believe the Commission should only move forward with rulemaking on the scale of the Proposal after thorough analysis of the resulting impacts by all stakeholders, including shareholders, funds, and regulators. As such, we encourage the Commission to consider the targeted comments and proposed alternatives articulated in this letter.

I. Executive Summary

The following summarizes our comments on the proposed changes included in the Proposal:

Proposed Liquidity Risk Management Amendments

- The Commission should replace the proposed uniform 10% stress trade size with an assumed trade size that establishes a lower uniform "floor" while preserving a fund's discretion to set a higher assumed trade size based on the specific attributes of a fund.

- The Commission should replace the proposed static market value assessment for instruments other than listed equities with a dynamic assessment that adjusts with prevailing market conditions.

Proposed Swing Pricing and Hard Close Mandates

- The Commission should reissue the swing pricing and hard close portion of the Proposal as a "concept release" and engage in a more robust industry dialogue before moving forward with any rulemaking in this area.

- If the Commission proceeds with mandating the implementation of swing pricing, it should not require the inclusion of market impact costs in the calculation of a fund's swing factor.

- The Commission should consider further the impact of requiring a hard close on fund of funds structures, 529 plans, and variable investment trusts prior to proceeding with any rulemaking in this area.

[4] As of December 31, 2022 and including only open-end mutual funds and variable investment trusts.

II. Proposed Liquidity Risk Management Amendments

In the Proposal, the Commission proposes a number of changes to the existing fund liquidity risk management program requirements under Rule 22e-4 of the 40 Act, based on the concern that some funds may be overestimating the liquidity of their portfolio and, as such, may be less prepared for future liquidity crises.[5] While these issues warrant further consideration by the Commission, we are concerned that the volume of simultaneous changes proposed by the Commission may in aggregate unduly impact the management of funds that have no historic issues with portfolio liquidity. As such, we encourage the Commission to consider the comments articulated in the comment letters submitted on the subject by the Investment Company Institute ("**ICI**") and the Securities Industry and Financial Markets Association – Asset Management Group ("**SIFMA-AMG**"). We believe that both the ICI and SIFMA-AMG letters raise important considerations relating to several of the components of the liquidity risk management portion of the Proposal that are not addressed in this letter.

II.A. *The Commission should replace the proposed uniform 10% stress trade size with an assumed trade size that establishes a lower uniform "floor" while preserving a fund's discretion to set a higher assumed trade size based on the specific attributes of a fund.*

In the Proposal, the Commission proposes to replace the current liquidity bucketing framework, which requires a fund to classify its holdings into four liquidity buckets based on the number of days needed to convert each holding into cash using a fund's "reasonably anticipated trade size" ("**RATS**") without significant impact to an instrument's market value, with a framework that requires this bucketing analysis to be performed using a uniform "stressed trade size" of 10% of each holding and applying prescriptive definitions of market value for listed and unlisted instruments.[6] The Commission indicates this shift away from the current RATS framework is necessary due to the "variability in funds' reasonably anticipated trade sizes and the potential ineffectiveness of small trade sizes in helping a fund prepare for stress."[7] Additionally, the Commission notes that a fund may lack the ability to adjust its RATS in a timely manner in response to market stress.[8] The Commission further argues that a lack of uniform standards overall reduces comparability of the liquidity profiles of similarly situated funds.[9] While we do not disagree with the Commission's concerns relating to the current RATS framework and recognize

[5] *See* Proposal at 77185.

[6] *See id.* at 77185.

[7] *Id.* at 77187.

[8] *See id.* at 77187, stating "[e]ven if a fund increased its reasonably anticipated trade size during periods of stress, the resulting adjustments in the fund's liquidity risk management may be too late to help the fund prepare for the stressed environment and, thus, may have limited utility."

[9] *See id.* at 77187.

the benefits associated with setting uniform standards, we recommend that the Commission reconsider the proposed 10% stressed trade size and we encourage the Commission to consider the alternative approach we set forth below to address its concerns.

We believe that based on the Commission's analysis set out in the Proposal and our experience managing the MFS Funds, that a uniform stressed trade size of 10% is too high and will unnecessarily restrict the portfolio management of many funds. The Commission's analysis in the Proposal found that weekly fund redemptions, over a period from 2009 to 2021, exceeded 6.6% of a fund's assets in approximately 1% of weeks during the review period, and that a fund had an approximate 0.5% chance of experiencing weekly redemptions exceeding 10% of its assets. We performed a similar analysis for the MFS Funds over the past 10 years and found that only 3 out of the 124 MFS Funds reviewed, or approximately 2.5%, experienced more than one week of redemptions exceeding 10% of assets during this period.[10] Based on this data, we believe that it is clear that the proposed stress trade size of 10% reflects redemption activity from only the most extreme market conditions and would amount to funds assessing their daily liquidity based on outlier stress events.[11] The consequence of using such restrictive parameters will be that funds displaying no daily liquidity concerns or historic liquidity issues will appear significantly less liquid and may, in certain cases, struggle to comply with the 15% illiquid investment limit and the proposed 10% highly liquid investment minimum. As the Commission acknowledges, this framework will result in portfolio adjustments in favor of more liquid instruments and increased holdings of cash and cash equivalents.[12] Both of these outcomes will harm investors by reducing portfolio returns, which the Commission indicates is a worthwhile trade-off to ensure that funds are prepared for future periods of stress.[13] In our opinion, such decisions should be left to the discretion of a fund's investment team, board, and liquidity administrator, who are best

[10] This data reflects daily redemption data collected from 2012 through 2022.

[11] We understand the Commission's logic in assessing redemptions using weekly data, as opposed to daily redemption data, but we note that the Commission is proposing to require funds to assess liquidity on a daily basis (and not a weekly basis), based on a hypothetical daily redemption size of 10%. At minimum, we think the Commission should align the time period of its analysis with the proposed requirements to ensure such requirements are supported by data. Alternatively, if the Commission believes that weekly redemptions are the best benchmark for a fund's liquidity, it should update the Proposal to require funds to perform bucketing analysis and market impact assessments based on hypothetical weekly redemptions.

[12] *See* Proposal at 77187, stating the proposed stressed trade size "may result in funds classifying fewer investments as highly liquid, and may increase the number of investments that are subject to the 15% limit on illiquid investments. These changes, in turn, may lead some funds to rebalance their portfolio holdings to comply with the proposed changes, which could negatively affect the performance of these funds."

[13] *Id.* at 77187.

positioned to analyze the actual liquidity needs of a fund and calibrate a fund's holdings accordingly.

Furthermore, we believe that a proposed uniform stressed trade size of 10% should be revisited for the following reasons:

- **Asset managers should seek to manage risk, not eliminate it.** – While we appreciate the Commission's concern that some funds may be overestimating the liquidity of their portfolio, we believe the Commission, through implementing such a high stressed trade size, is effectively seeking to eliminate liquidity risk from funds. We do not think that replacing a framework where some funds may overestimate their liquidity with one that systematically underestimates liquidity for all funds is a workable alternative. As an active manager, we believe that one of our primary jobs is to seek to achieve excess returns for our investors at an appropriate level of risk. The risks associated with each investment opportunity, including liquidity risk, are among the primary drivers of investment return, and therefore the Commission should seek to implement a framework that ensures proper risk management and not risk elimination.
- **We are in favor of a tailored approach to liquidity risk management, not a one-size fits all approach**. – A fund's liquidity is determined by a number of factors, including, but not limited to, the instrument types and asset classes held by the fund, its investment strategy, geographic concentration, and the profile and concentration of its shareholders. We believe that a one-size fits all approach is inherently flawed as it does not account for the nuances that exist across different funds. Additionally, such an approach removes discretion from a fund's board and liquidity administrator, who are best positioned to assess the appropriate liquidity thresholds based on the specific attributes of a fund.
- **Larger funds will be disproportionately impacted by a stressed trade size of 10%.** – Under the proposed framework, larger funds may struggle to avoid breaching the 15% illiquid investment limit or maintain a highly liquid investment minimum of 10%, solely due to the proposed requirement to evaluate market impact for a pro-rata slice of a fund's portfolio using a stressed trade size of 10%. This would negatively impact the performance of larger funds by requiring managers to hold larger allocations in cash and other instruments that exhibit higher liquidity but provide a lower potential return. We are not aware of any evidence that larger funds are less liquid relative to smaller funds that pursue a similar investment strategy solely due to their size and, in fact, a larger fund may be better positioned to meet investor redemptions by having access to a larger pool of cash. Additionally, larger funds, solely due to their size, are less likely to have a concentrated shareholder base relative to smaller funds and, therefore, are less likely to experience large single "blocks" of daily redemptions. This conclusion is supported by the redemption activity experienced in the MFS Funds, in which, over a ten year period, 14.6% of MFS' large funds experienced at least one daily redemption exceeding 10% of fund assets, compared to 35.5% of MFS' smaller funds, and 0% of MFS' large funds experienced more than 1 daily redemption exceeding 10% of fund assets, compared to 14.5% of

MFS' smaller funds.[14] As noted above, a fund's liquidity is determined by a compilation of factors, and therefore we encourage the Commission to avoid implementing a framework that elevates one characteristic of a fund, such as its size, above other relevant characteristics when determining a fund's liquidity.

As an alternative to the proposed uniform 10% stress trade size, we encourage the Commission to instead (i) adopt a lower uniform assumed trade size that establishes a "floor" and (ii) provide funds the discretion to adjust the assumed trade size above the floor based on the specific attributes of a fund. In addition, the Commission could mandate a standardized approach for stress testing using a uniform 10% daily redemption size, which could compliment the above proposed framework by providing funds with an early "warning sign" of potential liquidity issues but would not be the basis for determining a fund's compliance with the regulatory liquidity limits. Under the above alternative framework, the Commission would determine an appropriate floor based on historic redemption size across all funds over a long enough period to capture redemption data during all market conditions, including periods of market stress.[15] For example, based on our experience with the MFS Funds, we believe an assumed trade size of 2% would be an appropriate floor[16], however this could be further calibrated based on historic industry-wide redemption data available to the Commission. A fund's liquidity administrator would then review each fund's liquidity profile on a regular basis to determine if a higher assumed trade size is appropriate on a fund-by-fund basis, after considering current market conditions, a fund's redemption history, asset class, and any other relevant factors.[17] We note that MFS currently uses this approach in setting the RATS for the MFS Funds and we have found it to be very effective in appropriately calibrating our liquidity risk management program to ensure each fund maintains sufficient liquidity in all market conditions. Additionally, we have found that the flexibility afforded under this approach helps to ensure any portfolio adjustments are made in a timely manner, as a fund's liquidity administrator can increase the frequency of this analysis in response to periods of market stress. Furthermore, we believe this approach addresses many of the Commission's concerns with the current RATS framework and creates a more workable approach by (i) creating a minimum uniform standard applicable to all funds to mitigate

[14] This data reflects daily redemption data collected from 2012 through 2022, for 124 funds. For purposes of this breakdown, large funds are those with assets under management exceeding $1 billion, which amount to 38% (48/124) of the MFS Funds reviewed.

[15] We recognize that the floor for the assumed trade size would need to be adjusted overtime to ensure it reflects the most current redemption data, which could be done by the Commission at set intervals, such as every five years.

[16] Based on MFS analysis of historic redemptions dating back to 2012, reflecting the redemption activity experienced during the Covid-19 pandemic.

[17] The results of the review, including the factors considered and determinations made for each fund, would be subject to oversight and regular reporting to a fund's board. Additionally, such process would be subject to standard recordkeeping requirement. This would allow the Commission to review the adequacy of a fund's process, as needed.

the risk that funds are overestimating their liquidity, (ii) avoiding an overly prescriptive assumed trade size that unnecessarily hinders a fund's investment team in normal market conditions, (iii) preserving the discretion of the fund's board and liquidity administrator to tailor each fund's assume trade size based on the attributes of a fund; and (iv) implementing a dynamic approach that can be adjusted based on current market conditions.

II.B. *The Commission should replace the proposed static market value assessment for instruments other than listed equities with a dynamic assessment that adjusts with prevailing market conditions.*

In our experience, under the existing liquidity risk management framework, estimating market value impact is a very subjective and difficult undertaking. As such, we support the Commission's initiative to set common standards for determining what constitutes a significant change in market value, as this will provide clarity to funds' liquidity administrators and ensure consistent and comparable practices in an area where the Commission notes there is significant variation. Furthermore, we do not object to the Commission's proposed approach to determining significant change in market value for listed equities comprising of a threshold of 20% of an instrument's average daily trading volume. We do, however, recommend the Commission reconsider the proposed approach to determining significant change in market value for non-listed equities and other instruments (i.e., fixed income instruments). For these instruments, the Commission is proposing that significant change in market value be assessed using a static threshold consisting of a 1% decline in the market value of an instrument.[18] We believe, based on our experience employing a similar approach for the MFS Funds, that using a static market value threshold results in an approach that is too conservative and generates an unnecessary level of "false positives" during times of increased market volatility for instruments that are not experiencing liquidity issues. This is due to increased bid-ask spreads and other transaction costs that are often observed on a market-wide basis during periods of market stress and not isolated to individual instruments. As a result, certain instruments appear less liquid through the lens of a static change in market value, even when such instruments have a readily available trading market and are trading at a value that is normal under the current market conditions. In these instances, investment teams may be required to rebalance a fund's holdings at the least opportune time to avoid breaching the 15% illiquid limit.

To ensure the liquidity assessment for funds is truly reflective of an individual instrument's liquidity, we propose the Commission adopt a dynamic approach for instruments other than listed equities that seeks to control for market-wide volatility. Under such an approach, the threshold for significant change in market value for these instruments would consist of a percentage change (e.g., 1%) relative to a "reference cost" calculated for groups of instruments that have similar characteristics, such as credit quality, sector, and currency. The reference cost serves as a relative benchmark that adjusts with market

[18] *See* footnote 12.

conditions and, therefore, serves as a better indicator of the change in market value attributed to an individual instrument based on the market conditions at that time. The Commission could retain the proposed static threshold of a 1% market value change as a "floor" to address the Commission's concerns that funds may overestimate the liquidity of these instruments. Overall, we believe the above proposed dynamic approach reflects a more precise and workable alternative to assessing the liquidity of instruments in all market environments.

III. Proposed Swing Pricing and Hard Close Mandates

In the Proposal, the Commission proposes to mandate that funds adopt swing pricing and implement a hard close. As discussed further below, we have serious concerns about the Commission proceeding with this initiative given the lack of data and analysis concerning (i) the costs that will be borne by shareholders as a result of this Proposal, (ii) the impact on the attractiveness of funds relative to other pooled investment vehicles, and (iii) the viability of potential alternatives to swing pricing with a hard close. Additionally, we believe that, despite technological advances, this Proposal will upend the current fund distribution model and retirement plan infrastructure, both of which have been developed over decades and continue to successfully provide market access to millions of U.S. households.[19] The comments set forth below address targeted issues and alternatives that we would like to highlight for the Commission, however these do not reflect the entirety of our concerns with this Proposal. As such, in addition to our letter, we encourage the Commission to consider the comments on swing pricing and the hard close articulated in the comment letters submitted by the ICI and SIFMA-AMG.

III.A. *The Commission should reissue the swing pricing and hard close portion of the Proposal as a "concept release" and engage in a more robust industry dialogue before moving forward with any rulemaking in this area.*

In the Proposal, the Commission recognizes the disruption that swing pricing and, in particular, a hard close would cause to the current fund distribution model but determines that such consequences are outweighed by the need to address shareholder dilution and reduce the potential "first mover advantage" in funds.[20] While we support the Commission's initiative to explore ways to enhance the fund industry to better serve shareholders and we recognize that such initiatives may be appropriate in light of technological advances, we do not believe such sweeping changes should occur without the utmost consideration of the entirety of the resulting impacts. Additionally, we do not believe initiatives that have an impact on the scale and cost that will accompany a swing pricing and hard close mandate should be accomplished in the "vacuum" of rulemaking, but rather should be reached only after robust dialogue involving all impacted

[19] *See generally* ICI Fact Book.

[20] *See generally* Proposal at 77211 through 77214.

stakeholders, including shareholders, funds, intermediaries, retirement plans and retirement plan recordkeepers, and regulators. We are not opposed to swing pricing as an anti-dilution mechanism. In fact, we have employed swing pricing for MFS' Luxembourg-domiciled UCITS for a number of years[21] and have found it to be, under the right circumstances, an effective tool to more fairly allocate transaction-related costs to shareholders. We do, however, believe that based on the level of analysis set forth in the Proposal and the significance of the open questions, particularly involving the costs to shareholders and industry participants, that more consideration should be given outside of the rulemaking context to the costs and benefits of swing pricing with a hard close and other potentially viable alternatives.

We encourage the Commission to retract the swing pricing and hard close components of the Proposal, and instead reissue this portion of the Proposal as a "concept release". We believe that a concept release is the preferred approach in this case as it would encourage more fulsome dialogue of the merits of the proposal without the prospect of an "either/or" outcome resulting in a final rule.[22] Additionally, the Commission should coordinate this concept release with other outreach initiatives, such as organizing a swing pricing/hard close advisory committee, similar to the Asset Management Advisory Committee ("**AMAC**")[23], composed of a cross-section of impacted stakeholders to assist in organizing and centralizing recommendations.[24] We believe this approach would help gather the critical missing data around the costs and other impacts of this initiative. For example, the Commission indicates in the Proposal that the costs of a hard close in particular are not quantifiable for several reasons, including due to a lack of: (i) data on the costs and steps in the intermediary order-placement chain and who bears these costs; (ii) "granular" data on the current practices of intermediaries; (iii) information on the systems and practices that would need to change and the costs associated with such changes; and (iv) information on how impacted shareholders would respond to the proposed changes.[25] We believe this data is quantifiable, but only through extensive participation from industry participants and shareholders. We additionally do not think it is prudent to move forward with any rulemaking, and particularly one with such significant

[21] MFS currently sponsors two Luxembourg-domiciled fund families, the MFS Meridian Funds and MFS Investment Funds, that collectively offer 49 sub-funds with aggregate assets under management of approximately $31 billion as of December 31, 2022. MFS has employed swing pricing in these fund families since 2013.

[22] We note that the Commission has used concept releases in recent years to solicit information on complex topics from impacted stakeholders to inform future rulemaking under the 40 Act. *See Use of Derivatives by Investment Companies Under the Investment Company Act of 1940*, Investment Company Act Rel. No. 29776, 76 FR 55237 (September 7, 2011), available at https://www.sec.gov/rules/concept/2011/ic-29776fr.pdf.

[23] Alternatively, such a committee could serve as a sub-committee to the AMAC.

[24] Additionally, the Commission should explore investor education programs, as this Proposal is ripe with complex concepts, such as dilution and swing pricing, that are not intuitive and may be completely unfamiliar to impacted shareholders. As such, we believe investor education will be critical to any path forward.

[25] *See* Proposal at 77261.

consequences, without the insights gleaned from the above critical information. Other topics that warrant analysis prior to any rule proposal in this area and could be addressed in a concept release and considered by an advisory committee include, but are not limited to:

- Any shift in consumer preferences away from funds to other pooled vehicles, and the resulting impact on shareholder suitability and choice;

- Any variation in the scale of shareholder dilution based on fund asset classes, size, or other characteristics;

- Impact to long-term shareholders from not receiving same day pricing, such as the assumption of additional investment risk;

- The implications of replacing a shareholder "first mover advantage" with a "last mover advantage"[26]; and

- The appropriate timetable to implement any changes from a shareholder, intermediary, and fund standpoint.

Additionally, we believe that the approach we recommend above would be helpful to gather practical insight and further assessment of the alternatives to swing pricing with a hard close. In the Proposal, the Commission identifies a number of alternative anti-dilution tools, such as static and dynamic liquidity fees and dual pricing, and additionally discusses potential alternatives to a hard close, such as later order cut-off times and the use of indicative and estimated order flows.[27] We recognize that there is no perfect solution to address dilution in funds and that each alternative has its unique benefits and flaws, but we do not believe the Commission currently has the necessary data and analysis to adequately assess each alternative, as indicated by the volume and breadth of questions the Commission poses for feedback on each alternative. As noted, any rulemaking should not proceed without the benefit of insights gained from access to all relevant information, and we believe a concept release paired with an advisory committee can assist in gathering and interpreting this information. Additionally, we believe proceeding with our recommended approach will result in a better outcome overall, as it will facilitate all stakeholders coalescing around a path forward and help ensure "buy in" from such parties concerning any recommendation.

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[26] "Last mover advantage" results from investors trading directly with a fund having an information advantage by not being subject to any earlier order cut off imposed by an intermediary, and therefore can trade and benefit from information regarding market events until the fund's order cut off.

[27] *See generally* Proposal at 77215 through 77226.

III.B. *If the Commission proceeds with mandating the implementation of swing pricing, it should not require the inclusion of market impact costs in the calculation of a fund's swing factor.*

If the Commission decides to proceed with mandating that funds adopt swing pricing, it should revise the proposed framework for calculating a fund's swing factor by removing the mandate that funds incorporate market impact costs. The Proposal requires market impact costs to be incorporated into a fund's swing factor where daily net subscriptions exceed 2% or daily net redemptions exceed 1% of a fund's net assets.[28] The Proposal further mandates that funds estimate such costs for a pro-rata slice of a fund's portfolio and maintain records evidencing the data used to calculate the market impact costs.[29] While we do not dispute that market impact costs may be, in certain instances, an important component when determining a fund's swing factor, we believe that there are inherent limitations to estimating market impact that should be evaluated on a fund by fund basis. As such, we recommend that the Commission replace this mandate with a more flexible approach that provides fund boards and swing pricing administrators with the discretion to include market impact costs in a fund's swing factor, if they determine that (i) such costs are a material driver of potential dilution based on a fund's specific attributes[30] and (ii) such costs are capable of being accurately measured for the instruments held by the fund.[31]

We believe that determining market impact costs introduces a level of subjectivity that adds a lack of precision to the calculation of the swing factor and, therefore, a fund's net asset value ("**NAV**"). This lack of precision would ultimately undermine one of the most important and core features of a fund, that shareholders have certainty when transacting in a fund that the price paid or received reflects an accurate calculation of the proportionate share of a fund's holdings. It is universally recognized that determining the market impact of a fund's transactions is an "estimate" and will be impacted by factors

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[28] *See id.* at 77206.

[29] *See* proposed Rule 22c-1(b)(2)(iii) and proposed rule 31a-2(a)(2).

[30] Such attributes could include, but not be limited to, the size of the fund, types of instruments held by the fund, the impact of current market conditions on the fund, etc.

[31] As previously indicated in our response to the proposed changes to the liquidity risk management program, we are supportive of the inclusion of market impact in assessing a fund's portfolio liquidity. Despite the inherent flaws of estimating market impact generally, regardless of the methodology employed, we believe that the primary benefit of performing liquidity analysis is to provide a fund's board and investment team with an early "warning sign" of potential liquidity issues within a fund that may warrant further analysis. In our view, reliance on imperfect data, such as an estimate of market impact, in this context is an acceptable risk-based decision, as such data is not, by itself, a determinative factor that further action must be taken. We do not believe the same analysis holds true when using swing pricing to adjust a fund's NAV. Given that components of a fund's swing factor directly impact the price paid or amount received by a shareholder, the decision to include an input based on estimation, such as market impact costs, should only be made after very careful consideration by a fund's board and swing pricing administrator.

that are entirely unrelated to a fund adviser's decision to buy or sell a specific instrument. Most notably, a fund's transactions do not occur in isolation where the movement of an instrument's price can be directly attributed to the fund's activity, but rather driven by a compilation of factors, such as the activity of other market participants, the depth of the market for each instrument, and broad market momentum. In our opinion, at this point, it is virtually impossible to decouple such factors to gain accurate insight into the market impact of a fund's transactions, therefore inclusion of market impact estimation injects significant subjectivity into this analysis. The result of this subjectivity will ultimately be reflected in a fund's NAV, which will knowingly be overestimated or underestimated each trading day that the swing factor is applied. We understand that there may be instances where overriding concerns, such as the dilution of a fund's shareholders, may warrant using estimations in the absence of certainty, but we believe such decisions should be left to the discretion of a fund's board and swing pricing administrator to be carefully weighed based on the specific attributes of a fund.

The Commission previously recognized the issues associated with estimating market impact costs in the adopting release for amendments to Rule 22c-1 under the 40 Act, where the Commission decided to eliminate a mandate to consider market impact costs when determining a fund's swing factor.[32] The Commission again acknowledges this issue in the Proposal, recognizing that it "may continue to be difficult to determine market impact costs with precision, while a fund would be able to determine other relevant factors more precisely."[33] To alleviate this concern, the Commission proposes enhancing recordkeeping requirements to document the process for calculating a fund's swing factor.[34] While we believe these enhancements are an important tool for creating an audit trail, they do not address the issue that market impact costs, even when estimated in good faith, are inherently going to reduce the precision in determining a fund's swing factor.

We additionally are not aware of any other jurisdictions that permit swing pricing and mandate the incorporation of market impact costs. Throughout the Proposal, the Commission relies heavily on the widespread adoption of swing pricing in the European Union ("**EU**") as a model to justify mandating swing pricing for U.S. registered funds. We note, however, that EU regulators provide fund boards and advisers with wide discretion to determine the components of each fund's swing factor, including whether to incorporate

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[32] *See* Investment Company Swing Pricing, Investment Company Act Rel. No. 32316, 81 FR 82084 (Nov. 18, 2016), available at https://www.govinfo.gov/content/pkg/FR-2016-11-18/pdf/2016-25347.pdf, at page 82105, stating "[i]n light of concerns that many funds may not be able to readily estimate market impact costs, as well as concerns that subjective estimates of market impact costs could grant excessive discretion in the determination of a swing factor, we have eliminated the consideration of market impact costs in setting the swing factor under the final rule."

[33] Proposal at 77206.

[34] *See id. at* 77206 and proposed Rule 31a-2(a)(2).

market impact costs.[35] Using this discretion, MFS and our Luxembourg funds' board decided not to incorporate market impact in the determination of the swing factor for MFS' Luxembourg-domiciled funds.[36] This decision is reevaluated on a regular basis after careful consideration of the benefits and risks to existing and transacting shareholders, any added operational complexity, and the availability of suitable solutions from third-party vendors. We believe this approach continues to result in decision making that is appropriately tailored to MFS' Luxembourg funds and is in the best interest of these funds' shareholders.

In the Proposal, the Commission cites a recent industry survey published by the Association of the Luxembourg Fund Industry ("**ALFI**"), indicating that as of July 2022, 35% of the survey respondents indicated that they include market impact costs as a component in the calculation of their swing factor.[37] While ALFI indicates in its survey that inclusion of market impact costs appears to be increasing amongst survey participants[38], we note that 35% still represents a significant minority of the survey participants and, in our opinion, indicates a hesitation by asset managers to endorse the accuracy of market impact costs at this time. We note further that ALFI does not indicate in the survey the percentage of asset managers that incorporate market impact costs, but only incorporate such costs for a subset of their funds.[39] Finally, ALFI points out that market impact costs are typically used by asset managers that have adopted a multi-tiered swing pricing model and have not historically been applied by asset managers using a single swing threshold model, which is what the Commission is seeking to mandate in the Proposal.[40] As such,

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[35] *See CSSF Swing Pricing Mechanism-FAQ*, Version 4-August 2021, www.https://www.cssf.lu/wp-content/uploads/FAQ_Swing_Pricing.pdf. Laying out the governance, control, and oversight framework for Luxembourg-domiciled UCITS that seek to use swing pricing, including but not limited to, the methodology applied for the determination of swing factors and thresholds, but does not prescribe the components of such methodology.

[36] MFS' Luxembourg domiciled fixed income funds do include historic bid/ask spread as a component of the swing factor for these funds. While bid/ask spread captures the overall market environment, it does not provide an accurate assessment of the market impact resulting from a specific transaction.

[37] *See* Proposal at 77206.

[38] *See* ALFI Swing Pricing Survey 2022 (July 2022), available at https://www.alfi.lu/getattachment/8417bf51-4871-41da-a892-f4670ed63265/app_data-import-alfi-alfi-swing-pricing-survey-2022.pdf ("**ALFI Survey**") at 8.

[39] For example, a fund manager may incorporate market impact costs into the calculation of the swing factor for funds that invest in bespoke or thinly traded instruments, where market impact can be determined with more accuracy, but decide not to include impact costs for other funds. We note that under the Proposal's requirements, this type of tailoring would not be permitted.

[40] *See* ALFI Survey at 8. A multi-tiered swing pricing model includes multiple swing thresholds for redemptions and/or subscriptions and applies swing factors that escalate in magnitude as higher swing thresholds are crossed. For example, a 2% net inflow may trigger a 10-basis point swing factor, while a 10% net inflow may trigger a 50-basis point swing factor. While the Commission does not preclude asset managers from adopting a multi-tiered swing pricing model in the Proposal, it is likely that most managers will not adopt such an approach initially due to its increased complexity.

if the Commission determines to move forward with mandating swing pricing, we encourage the Commission to follow the EU model and provide fund boards and swing pricing administrators the discretion to determine whether market impact costs are an appropriate component of a fund's swing factor.

III.C. *The Commission should consider further the impact of requiring a hard close on fund of funds structures, 529 plans, and variable investment trusts prior to proceeding with any rulemaking in this area.*

Prior to proceeding with any rulemaking that mandates that funds implement a hard close, we encourage the Commission to conduct a more thorough assessment of the impact of such a mandate on multi-tiered products. Such products offer investors an efficient way to save for major life events and include funds that are structured to invest their assets in shares of other funds to achieve their investment objectives ("**funds of funds**") and funds that are designed to exclusively serve as investment vehicles for variable annuity and variable life insurance contracts ("**variable investment trusts**"). We believe such an analysis should be included as part of the concept release and would be an appropriate topic for consideration by the advisory committee recommended in Section III.A above.

Funds of funds serve a vital role in helping retail shareholders achieve their financial goals through offering a cost-efficient method of providing diversification and asset allocation.[41] Additionally, so called "target-date funds", which are funds designed to periodically reallocate a fund's investment in various asset classes and strategy types in accordance with a set "glidepath", are typically organized as funds of funds and serve as a very popular option for shareholders saving for retirement, education through 529 plans, and other major life events. Target date funds in particular continue to grow in popularity accounting for approximately $1.8 trillion in assets under management as of the end of 2021, compared to approximately $375 billion invested in such funds as of the end of 2011, and receiving net inflows of $462 billion over this period.[42] Similarly, variable investment trusts serve as "underlying" investment vehicles for various insurance products, such as variable annuities, which have long been popular investment options for investors seeking predictable income streams in retirement. Similar to fund of funds, variable investment trusts account for a very large pool of assets, amounting to approximately $2.1 trillion in assets under management as of the end of 2021.[43]

We are concerned that the implementation of a hard close will make these products more challenging to manage from an operational standpoint and potentially less attractive to shareholders. Specifically, since both the "top-tier" and "underlying" funds in a fund of

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[41] *See* Proposal at 77243, indicating that there are currently 1,650 mutual funds of funds that hold approximately $3.1 trillion in net assets.

[42] *See* ICI Fact Book at 59 and 221.

[43] *See id.* at 223.

funds structure would be required to implement a hard close under the Proposal, a top-tier fund would likely not have sufficient time to net its daily order flow and place corresponding orders in the relevant underlying funds to receive same day pricing. A similar dynamic exists for variable investment trusts, which serve as the underlying fund for various insurance products. Insurance companies offering these products must have sufficient time to collect, process, and place orders in the underlying variable investment trusts, which typically concludes after a variable investment trust's NAV is determined. We believe these issues would require such products to (i) set an earlier order cut off relative to the underlying funds in which it invests to provide sufficient time to determine daily order flow, or (ii) operate using next day pricing. The Commission acknowledges the above issues in the Proposal but is unable to estimate the potential costs or other impacts (e.g., potential divestment by shareholders) largely due to a lack of stakeholder data and feedback.[44]

Additionally, the above issues will impact any fund that invests in other funds as part of its investment strategy, including funds that employ a "central fund" structure.[45] It is very common for funds, not operating as funds of funds, to invest occasionally or systematically in other funds to efficiently gain exposure to a specific asset class or geographic region. We believe however that, unlike funds of funds, managers of these funds will simply opt to avoid the challenges associated with implementing a hard close by no longer investing in other funds and, therefore, forego the cost efficiencies and other benefits gained from these allocations.

As discussed above, given the important role that funds of funds and variable investment trusts serve and the efficiencies achieved by non-funds of funds investing in funds, we believe that any proposal impacting the attractiveness or viability of these structures should only be made after very careful analysis. As such, we believe this concern supports our recommendation that the swing pricing and hard close portion of the Proposal be reissued as a concept release and submitted for consideration by an advisory committee to provide a forum for further discussion and analysis.

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[44] *See* Proposal 77261 stating "…the proposed hard close might affect current order processing for funds of funds. We understand that an upper-tier fund in a fund of funds structure may not submit its purchase or redemption orders for lower-tier funds' shares until after 4 p.m. Under the proposed rule, the upper-tier fund would have to submit purchase or redemption orders for lower-tier funds' shares before the lower-tier funds' designated pricing time in order to receive that day's price for the orders."

[45] Central funds are generally organized as open-end funds that are registered under the 40 Act and serve as an important tool to gain exposure to specific asset classes that may be inefficient or costly to purchase directly, such as high yield fixed income instruments.

We appreciate the opportunity to provide comments on the Proposal. If you have any questions, please contact me at [redacted] or Brad Wilson at [redacted]

Sincerely,

Heidi W. Hardin
Executive Vice President and General Counsel

cc:

The Honorable Gary Gensler
Chairman
U.S. Securities and Exchange Commission

The Honorable Caroline A. Crenshaw
Commissioner
U.S. Securities and Exchange Commission

The Honorable Jaime Lizárraga
Commissioner
U.S. Securities and Exchange Commission

The Honorable Hester M. Peirce
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The Honorable Mark T. Uyeda
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