PIMCO MFS

Via Electronic Submission

December 8, 2023

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

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

Dear Secretary Countryman:

Pacific Investment Management Company LLC ("PIMCO")[1] and MFS Investment Management ("MFS")[2] appreciate the opportunity to supplement our prior comments on the Commission's proposed rule amendments regarding open-end fund liquidity risk management ("Proposal").[3] We respectfully submit this letter as follow up to our prior comments, and to our meeting with certain members of the SEC staff regarding the Proposal on September 19, 2023.

Our Prior Comment Letters discussed our significant concerns with the proposed changes to Rule 22e-4 ("Liquidity Rule") under the Investment Company Act of 1940 ("1940 Act"), including the proposed value impact standard for non-exchange-traded investments, the proposed 10% stressed trade size presumption and the proposed elimination of asset class classifications.[4] We continue to believe that these proposed changes are unnecessary and would adversely impact open-end funds and investors, as well as market liquidity and resiliency more generally. We also

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[1] PIMCO is registered as an investment adviser with the U.S. Securities and Exchange Commission ("SEC" or "Commission") and as a commodity trading advisor and a commodity pool operator with the U.S. Commodity Futures Trading Commission. As of September 30, 2023, PIMCO managed approximately $1.74 trillion in assets on behalf of millions of individuals and thousands of institutions in the United States and globally, including state retirement plans, unions, university endowments, corporate defined contribution and defined benefit plans, and pension plans for teachers, firefighters and other government employees.

[2] MFS traces its history back to 1924 and the creation of the country's first open-end mutual fund, Massachusetts Investors Trust. Today MFS is a global investment manager managing approximately $539 billion in assets as of October 31, 2023, through a variety of collective investment vehicles and separate accounts, including approximately $317 billion managed in registered investment companies for which MFS serves as the primary investment adviser.

[3] *See* Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting, SEC Rel. No. IC-34746, 87 Fed. Reg. 77172 (proposed Nov. 2, 2022); Letter from Emmanuel Roman, Chief Executive Officer, PIMCO, to Vanessa Countryman, Secretary, U.S. Securities and Exchange Commission, Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting, File Number S7-26-22 (Feb. 13, 2023) ("PIMCO Comment Letter"); Letter from Heidi W. Hardin, Executive Vice President and General Counsel, MFS, to Vanessa Countryman, Secretary, U.S. Securities and Exchange Commission, 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 (Feb. 14, 2023) ("MFS Comment Letter" and, together with the PIMCO Comment Letter, the "Prior Comment Letters").

[4] The MFS Comment Letter focuses on issues relating to the proposed 10% stressed trade size and proposed value impact standard for non-exchange-traded instruments.

have particular concerns that various other aspects of the Proposal individually, and in the aggregate as they interact with each other[5], would disproportionately and adversely impact fixed income open-end funds and their investors due to the particular nuances of fixed income markets. For example, the proposed value impact standard would impose a single numerical standard for all non-exchange-traded investments, which would not account for known differences in value impact dynamics across securities as different as U.S. Treasuries and emerging market local bonds. Other proposed provisions like eliminating asset class classification do not take into account the reality that many fixed income securities may not trade daily, but that such securities could be traded if and when desired, and reliable liquidity information for such instruments is available from reviewing similar securities.

Should the SEC determine to proceed with Liquidity Rule changes notwithstanding such concerns, we wish to offer in this supplemental letter certain more narrowly tailored and practical alternatives. We believe that these alternative solutions will have a less adverse impact on market liquidity and resiliency and open-end funds and their investors than the current Proposal, while at the same time addressing the Commission's goal, as described in the Release accompanying the Proposal, of improving the quality of classifications by preventing funds from over-estimating the liquidity of their investments, including in times of stress.

I. Alternatives to the Proposed Value Impact Standard for Non-Exchange-Traded Investments

We believe the proposed fixed, absolute 1% value impact standard[6] for non-exchange-traded investments would result in artificially and misleadingly lower liquidity profiles for fixed income funds generally and particularly in stressed environments. When market events lead to volatility in certain asset classes, a uniform fixed, absolute 1% value impact standard likely would lead to unwarranted downward reclassifications of holdings in those asset classes, resulting in a regulatory liquidity profile that misrepresents a fund's true liquidity profile. This could occur despite the fact that the liquidity of a particular instrument or asset class may not be impacted during periods of market stress (such as due to increased bid-ask spreads and other transaction costs that are observed on a market-wide basis during periods of markets stress and not isolated to individual instruments or asset classes). As a result, certain instruments may appear less liquid under such a value impact standard, even when such instruments have a readily available trading market and are trading at a value that is normal under current market conditions. Unwarranted downward reclassifications of a fund's holdings may also trigger fund sales of such assets into

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[5] *See, e.g.*, PIMCO Comment Letter at n.9 and accompanying text ("In stressed environments when spreads are wider, a relatively greater percentage of fixed income securities may erroneously be considered illiquid under the proposed value impact standard (particularly when coupled with the proposed 10% stressed trade size presumption, the impact of which increases with fund size).").

[6] Under the Liquidity Rule, each liquidity category is defined by reference to a period of time within which a fund reasonably expects to be able to sell or dispose of, or convert to cash (as applicable), an investment without such sale or disposition, or conversion to cash, "significantly changing the market value of the investment." This standard is referred to as the value impact standard. The Liquidity Rule does not currently define the value impact standard, but the Proposal would impose specific definitions for "shares listed on a national securities exchange or a foreign exchange" and for "any other investment" (*i.e.*, non-exchange-traded investments). For non-exchange-traded investments, the Proposal would define "significantly changing the market value of an investment" to mean "any sale or disposition that the fund reasonably expects would result in a decrease in sale price of more than 1%."

already distressed markets. Further, this element of the Proposal, as currently written, would seem to require funds to conduct predictive analytics on future bid-ask spreads, which would introduce new risks and present significant practical difficulties.

If, notwithstanding the concerns expressed above and in our Prior Comment Letters, the SEC is committed to amending the value impact standard for non-exchange-traded investments, we propose an approach that would permit a fund's liquidity risk management program administrator to apply either a relative or an absolute value impact standard with respect to each portfolio investment, in each case also subject to an upper limit. This alternative is structurally similar to the framework the SEC implemented in Rule 18f-4 under the 1940 Act. Rule 18f-4 requires funds to comply with an outer limit on fund leverage risk based on value-at-risk ("VaR") but provides funds transacting in derivatives, other than limited derivatives users, with the option to comply with a relative VaR test or an absolute VaR test.[7] Our proposed approach to the value impact standard would permit funds to determine the value impact standard for a given portfolio investment by reference to the average estimated cost and/or impact of disposing of an instrument of that specific "instrument type," or, instead, utilize a set, absolute value impact standard of 5% subject to findings as further described below.

Under our proposed relative value impact standard, the "instrument type" for a portfolio investment, *i.e.*, the relevant reference instruments for use in determining the investment's value impact standard, could be based on, for example and without limitation, an index or representative sample thereof or other group of securities or instruments. The value impact standard for the portfolio investment in question could then be subject to an upper limit of the lesser of (i) 200% of the average estimated cost or impact for the "instrument type" (*i.e.*, measured on a relative basis) and (ii) 5% (*i.e.*, measured on an absolute basis).

For any non-exchange-traded portfolio investment whose value impact standard is not determined utilizing the relative approach, under our proposal, a fixed, absolute 5% value impact standard would apply. Utilization of the 5% value impact standard, in lieu of the relative approach, could be contingent upon the liquidity risk management program administrator reasonably determining that no group of reference instruments would provide an appropriate basis for determining the portfolio investment's value impact standard. This approach would be analogous to the approach under Rule 18f-4, where a fund must comply with the relative VaR test unless the derivatives risk manager reasonably determines that a designated reference portfolio would not provide an appropriate reference portfolio for purposes of the relative VaR test, taking into account the fund's investments, investment objectives, and strategy. A fund that does not apply the relative VaR test must comply with the absolute VaR test.[8] In evaluating the 5% value impact standard, the liquidity risk program administrator could utilize cost data and other information.

Calculation methodologies for estimating value impact would be reasonably determined by the liquidity risk management program administrator or its delegate. The time period for relevant data in either the relative or absolute approach could be subject to a maximum period of 60 days and minimum period of one day, based on the liquidity risk management program

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[7] *See* Use of Derivatives by Registered Investment Companies and Business Development Companies, SEC Rel. No. IC-34084, 85 Fed. Reg. 83162 (Nov. 2, 2020).

[8] *See* 1940 Act Rule 18f-4(c)(2)(i).

administrator's or delegate's determinations concerning data availability and quality.

Our alternatives to the proposed value impact standard seek to recognize important differences among markets and asset classes and remain consistent with the SEC's position that security-specific analysis is necessary, particularly in light of changing market conditions.[9] Our alternatives provide certain benefits over the proposed value impact standard, including providing principled flexibility to address circumstances where security-specific data is limited for liquid securities and being closer in line with the proposed value impact standard for exchange-traded investments.

II. Alternatives to the Proposed 10% Stressed Trade Size

We oppose a requirement to measure and manage fund liquidity on a daily basis to the extreme stress level represented by the proposed 10% stressed trade size, and instead propose the implementation of a more data-driven approach.[10] We do not believe an approach based solely on applying a uniform percentage sale assumption to all holdings in a fund's portfolio would fairly reflect the realities of fund liquidity management. Among other matters, such an approach fails to appreciate that a fund's liquidity can be impacted by a multitude of factors, including, but not limited to, investment types and asset classes held by a fund, geographic concentration, a fund's size, and shareholder type and concentration. We additionally believe that requiring the assessment of a fund's liquidity using the proposed 10% stressed trade size will result in unintended consequences in the management of many funds, including difficulties managing funds in accordance with their stated investment strategies and requiring certain funds to hold larger concentrations of cash and cash equivalents, thereby reducing potential long-run returns for shareholders.

Under our proposed alternative, funds would be subject to a reasonably anticipated trade size of 2%[11] as a rebuttable presumption, with that trade size potentially changed to a higher or lower level based upon an assessment of factors deemed relevant by the liquidity risk management program administrator, which could include, but not be limited to, fund size, historical flows, investor concentration and/or the degree to which redemptions have been, or could be, satisfied in-kind. Adjustments to the 2% presumption would also be subject to fund board reporting and non-public SEC disclosure through Form N-CEN.

Alternatively, funds could be permitted to establish trade size assumptions utilizing an SEC-outlined methodology. For example, the SEC could require the use of a reasonably anticipated trade size calibrated at a 99% confidence level based on daily net flows over the past

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[9] *See* Proposal at 77189-77190.

[10] *See, e.g.*, PIMCO Comment Letter at 11-12 and MFS Comment Letter at 3-7.

[11] While daily flows above 2% are a rare occurrence, PIMCO believes this trade size assumption represents a more realistic degree of stress, and is better supported by the SEC's data on daily outflows, than the SEC's proposed 10% stressed trade size. *See* Proposal at 77244-77245. According to the SEC's data, daily outflows of 1.6% of net assets or higher happen less than one out of 100 days, and daily inflows of 2% of net assets happen less than one out of 100 days. *Id.* Confusingly, it appears that the SEC utilized weekly redemption data to support its proposed 10% daily stressed trade size. *See id.* at 77187, 77250. Setting aside the question of whether such weekly redemption data truly justifies a 10% daily assumption, daily outflow data would appear to be more relevant to underlying assumptions used in a daily classification exercise.

five years,[12] with appropriate flexibility for funds without five years of operating history to use a reasonable good faith estimation approach based on flows for similar funds or other factors.

We believe that either of the above alternative approaches to the SEC's proposed 10% stressed trade size accomplishes the SEC's goal of establishing more uniformity in the practices of fund managers, while also preserving a liquidity risk management program administrator's discretion to assess the appropriate liquidity threshold based on the specific attributes of a fund.

III. Opposition to the Proposed Elimination of Asset Class Classification and Proposal for Daily Liquidity Classifications

We continue to believe that the proposed requirement to examine each security on a daily basis in isolation for liquidity classification purposes ignores the realities of fixed income markets and how such instruments trade. Because daily trade data will not always be available for a given instrument despite meaningful demand, and thus, liquidity, funds and their vendors must be able to look to similar securities for trade data to inform liquidity classifications.[13] Indeed, it is a feature of fixed income markets that specific securities often do not trade daily but share many key characteristics – including characteristics foundational to assessing liquidity – with other securities for which trade data for a given day is available.[14] An asset class can be a valid proxy or input for fixed income instruments, structured products, new issues and a stop-gap when security-specific data is unavailable.[15]

In addition to acknowledging the practical realities that necessitate asset class classification, we urge the SEC to modify the proposal to provide that any daily classifications need only be reasonable provisional classifications produced in the ordinary course. We believe that the costs of determining each investment's liquidity classification each day with regulatory certainty outweighs the marginal value of such frequent classifications.

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[12] Funds would be permitted to exclude in-kind redemptions from such flow data.

[13] As noted in the PIMCO Comment Letter, the SEC has not proposed to deem as *per se* illiquid securities priced using Level 2 inputs under U.S. GAAP. Such securities are routinely priced using price information from proxy securities.

[14] *See, e.g.*, PIMCO Comment Letter at text accompanying n.16 ("A fundamental characteristic of fixed income markets is that each unique security, of which there are many, may not trade daily and the salient information when anticipating how such instrument will trade is not the historical information about how that instrument has traded but information about how instruments with similar characteristics have traded (*i.e.*, related securities with similar characteristics are often the best proxy for determining how an instrument will trade). . . . [F]ixed income markets . . . are characterized by numerous individual issues that do not regularly trade but for which there is meaningful demand, and thus, liquidity.").

[15] As described in section I above, under our alternative to the proposed value impact standard for non-exchange-traded investments, if it is reasonably determined that no group of reference instruments would provide an appropriate basis for determining a portfolio investment's value impact standard, a 5% value impact standard would apply.

IV. Carveout to the Proposed *Per Se* Illiquid Classification of Investments Fair Valued Using Unobservable Inputs

As discussed in the PIMCO Comment Letter, it is common for certain newly-issued investments to be valued using unobservable inputs for a brief period until the fund's pricing vendor establishes coverage of the instrument. We believe that investments that are expected to be valued within 30 days using observable inputs (*i.e.*, Level 2 inputs under U.S. GAAP) when the pricing vendor establishes coverage should be carved out of the proposed expansion of the Liquidity Rule's illiquid investment category, which would treat as *per se* illiquid any investment whose fair value is measured using an unobservable input that is significant to the overall measurement. Without this carve out, the proposed expansion of the illiquid investment category would impede capital formation, as funds may be unable or reluctant to acquire newly-issued securities that would be treated as *per se* illiquid until the fund's pricing vendor establishes coverage.

Additionally, the proposed carveout should include investments for which there are observable pricing inputs (*i.e.*, where there is a vendor price), but where the fund's board or valuation designee (as applicable) overrides a Level 2 price and instead treats the investment as a Level 3 security. In this situation, the fund's board or valuation designee's belief that a fair value using unobservable inputs is more accurate does not necessarily impact the investment's liquidity. Rather than a *per se* illiquid classification in such case, such an instrument should be subject to normal course review for its liquidity classification.

The recommended carveout would not undermine the Proposal's goal of providing more "consistent guideposts" for liquidity classifications.[16] It would, on the other hand, help to avoid the adverse effects on funds of unnecessarily treating as *per se* illiquid those investments that have observable inputs but that may be valued at a particular point in time based on unobservable inputs.

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We would also like to take this opportunity to reiterate our views and recommendations in our Prior Comment Letters not otherwise discussed above, such as those raised in the PIMCO Comment Letter concerning the method for day counting for liquidity classification purposes and the appropriateness of either "grandfathering" funds materially impacted by the SEC's proposal to remove the "Less Liquid" category under the Liquidity Rule and shift such assets into the "Illiquid" category or offering them exemptive relief from applicable shareholder requirements to convert to monthly or quarterly interval funds subject to Rule 23c-3 (or exemptive relief therefrom to act as monthly interval funds). Further, we continue to believe that the Proposal, in its current form, would be deleterious to open-end funds and their investors and in particular would have a disproportionate adverse impact on fixed income open-end funds and their investors, many of who are retirees and other individuals saving for financial goals. We continue to urge the Commission to explore other alternatives, such as more principles-based changes to the Liquidity Rule rather than the prescriptive changes included in the Proposal.

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[16] Proposal at 77192.

We thank the Commission for allowing us to comment supplementally on the Proposal and appreciate in advance the Commission's diligent consideration of the alternatives provided in this letter. Please feel free to contact us if we can provide any assistance to you in the further evaluation of these critically important issues.

Sincerely,

David Flattum

David Flattum
Managing Director and Global General Counsel, PIMCO

Heidi Hardin

Heidi Hardin
Executive Vice President and General Counsel, MFS

cc: The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
The Honorable Mark T. Uyeda, Commissioner
The Honorable Jaime Lizárraga, Commissioner
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