INVESTMENT COMPANY INSTITUTE ICISouthwest

December 22, 2023

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

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

Dear Ms. Countryman:

The Investment Company Institute and ICI Southwest are writing to express our joint concerns with how the SEC's proposed amendments to the liquidity risk management rule (the "liquidity rule") would affect mutual funds and ETFs ("funds") investing in bank loans.[1] In so doing, we express support for the SEC's customary consideration of comments received after the close of formal comment periods.[2] Given the SEC's volume and pace of rulemaking, it is particularly important for the public to have the ongoing opportunity to comment on proposed rulemakings.[3]

If adopted, the proposed liquidity rule amendments would eliminate funds investing primarily in bank loans ("bank loan funds"), a category that long has been beneficial to retail investors,

---

[1] *Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N–PORT Reporting*, SEC Release No. 33-11130, 87 Fed. Reg. 77172 (Dec. 16, 2022) (the "proposal").

[2] *See* Testimony of Chair Gary Gensler Before the United States House of Representatives Committee on Financial Services, April 18, 2023 ("With the closing of a formal comment period, staff begins its work to account for this important public input but continues to receive additional comments, which the Commission may consider. We greatly benefit from public input and consider adjustments that the staff, and ultimately the Commission, think are appropriate."); Oversight of the Securities and Exchange Commission, Hearing of the House Financial Services Committee (April 18, 2023) ("We also often consider comments well beyond that [formal comment] period of time and continue to receive comments."). *See also* *Market Data Infrastructure*, SEC Release No. 34-90610, 86 Fed. Reg. 18596 at 18601 (Apr. 9, 2021) ("The Commission has considered all comment letters received to date, including comments that were submitted after the comment deadline had passed.").

[3] ICI, along with 24 other trade organizations, previously expressed concerns about "[e]xceedingly short comment periods associated with numerous concurrent potentially interconnected rule proposals that touch on significant changes to the operational and regulatory regime applicable to financial firms." *See* Joint Trade Associations' Letter to SEC Chair Gensler (Apr. 5, 2022).

especially in rising interest rate environments.[4] While the amendments would be fatal to these funds, they also would adversely affect other funds that hold bank loans. In their approximately 25-year history, bank loan funds have operated successfully within the open-end fund regulatory structure, and to date, *no* bank loan fund has suspended redemptions. Bank loan funds also have helped facilitate capital formation.

History, practice, presence of a sound existing regulatory framework, and potential harm to retail investors (including, for current fund investors, transaction and other costs, tax liability, and any losses from forced selling due to redemptions and liquidations of these funds) and other market participants all weigh strongly against adopting the proposed amendments. In addition, we do not believe that the SEC has the authority to impose onerous constraints on portfolio construction that would create a *de facto* prohibition on an existing fund category.

In this letter, we:

- provide data on funds' exposure to and experience with bank loans;
- assess the proposal and explain why it would render continued operation of bank loan funds impossible;
- consider the proposal's underlying statutory authority and economic analysis relating to bank loan funds;
- offer alternative policy recommendations that would further mitigate bank loan funds' liquidity risk while still preserving their core features; and
- set forth the consequences for bank loan funds and others of adopting these amendments.

Section 1: Funds' Exposure to and Experience with Bank Loans

For approximately 25 years, bank loans have been a unique income-based asset class for retail investors, making bank loan funds an important part of retail investors' overall portfolios. This asset type and fund category are particularly useful in a rising interest rate environment. Interest payments on bank loans will periodically reset in accordance with changes in prevailing interest rates. As interest rates increase, the holders of bank loans (e.g., funds) receive more interest income. By contrast, many other debt instruments pay fixed coupons, and as interest rates rise, holders of that existing debt continue to receive a fixed amount of income that is lower (and comparatively less attractive) than newer debt paying the higher prevailing rates.

Take, for example, the experience of the past two years. Total returns on the S&P US Aggregate Bond Index were down 12 percent in 2022 followed by a modest recovery of 2.2 percent in 2023

---

[4] *See* ICI Comment Letter (Feb. 14, 2023) ("ICI Letter") at Section 2.7.2. While this letter focuses on the impact of the proposed liquidity amendments on funds investing in bank loans, our focus here in no way diminishes our serious concerns with all major aspects of the proposal—the liquidity amendments, mandatory swing pricing and "hard close" requirements for mutual funds, and the Form N-PORT amendments—on funds generally.

(year-to-date through November 30, 2023). By contrast, returns on bank loans were much better. Total returns on bank loans (as measured by the S&P/LSTA US Leveraged Loan Index) were down less than 1 percent in 2022 and have increased by 11 percent in 2023.

Figure 1
Leveraged Loans Continue to Perform Well Compared with Other Investments
Percent

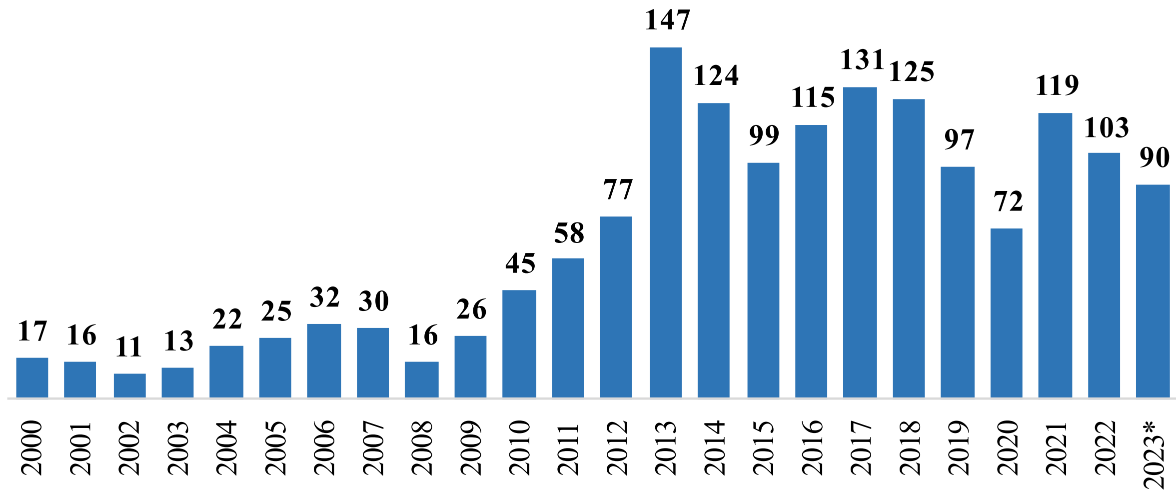
	Annual percent change	
	2022	**2023***
S&P/LSTA US Leveraged Loan Index	-0.6%	11.0%
S&P 500 Index	-18.1%	20.8%
S&P US Aggregate Bond Index	-12.0%	2.2%
FTSE US Broad Investment Grade Bond Index	-13.3%	-2.7%
ICE BofA US High Yield Index	-11.2%	9.4%
S&P Municipal Bond Index	-8.0%	3.6%

*Data are year-to-date through November 30, 2023.
Source: ICI calculations of Refinitiv data

Figure 1 shows that the debt markets are diverse—"fixed income" or "debt" is not a homogenous asset class. Different debt asset categories have different risk-return profiles, each of which may be useful to investors in constructing diversified portfolios and responding to changing market conditions. *If retail investors lose their ability to invest in or gain exposure to bank loans conveniently through mutual funds and ETFs, it will detract from their ability to manage their overall risk and generate income*. The September bi-partisan letter from members of the US House of Representatives—19 Democrats and 19 Republicans collectively requesting that the SEC withdraw the proposal—echoed these sentiments, adding that "[b]y curtailing access to this strategy, the SEC would limit the ability of the more than 100 million Americans invested in mutual funds to customize their investments and retirement savings based on current market conditions."

Partly because of their unique attributes, total net assets of bank loan funds grew substantially after the 2007–2009 financial crisis (Figure 2). Net assets increased markedly from 2008 through 2013, when they reached their peak. Since then, net assets of bank loan funds have fluctuated, which is due in large part to investor demand. Flows to these funds have varied over the past fifteen years (Figure 3). Bank loan funds have successfully accommodated this changing investor demand—including during stressed periods.

Figure 2
Total Net Assets of Bank Loan Funds Have Fluctuated Since Peaking in 2013
Billions of dollars, year-end

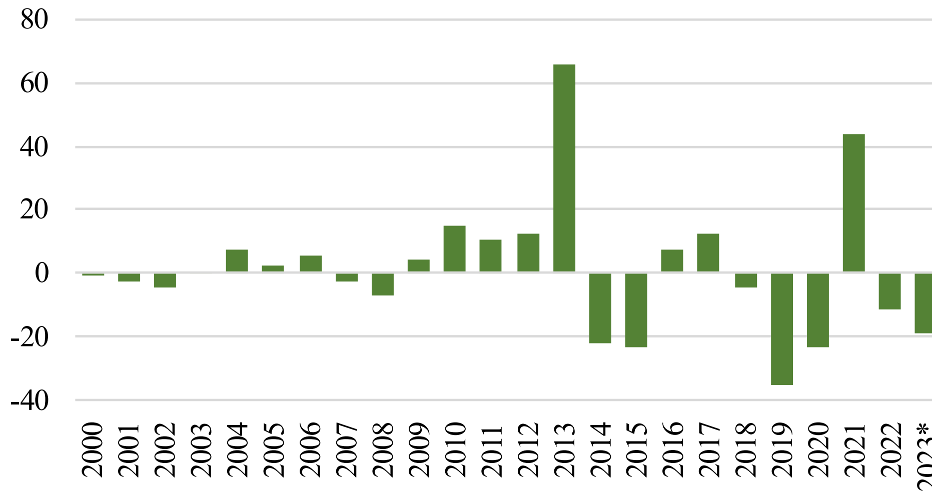


Memo: number of funds

14 21 20 19 22 24 22 27 29 29 31 38 42 54 55 59 62 67 72 73 71 65 70 70

*Data are as of October 2023.
Note: Data include mutual funds and ETFs. Data exclude funds of funds.
Source: Investment Company Institute

Figure 3
Net Flows to Bank Loan Funds Have Varied
Billions of dollars, annual



*Data are as of October 2023.
Note: Data include mutual funds and ETFs. Data exclude funds of funds.
Source: Investment Company Institute

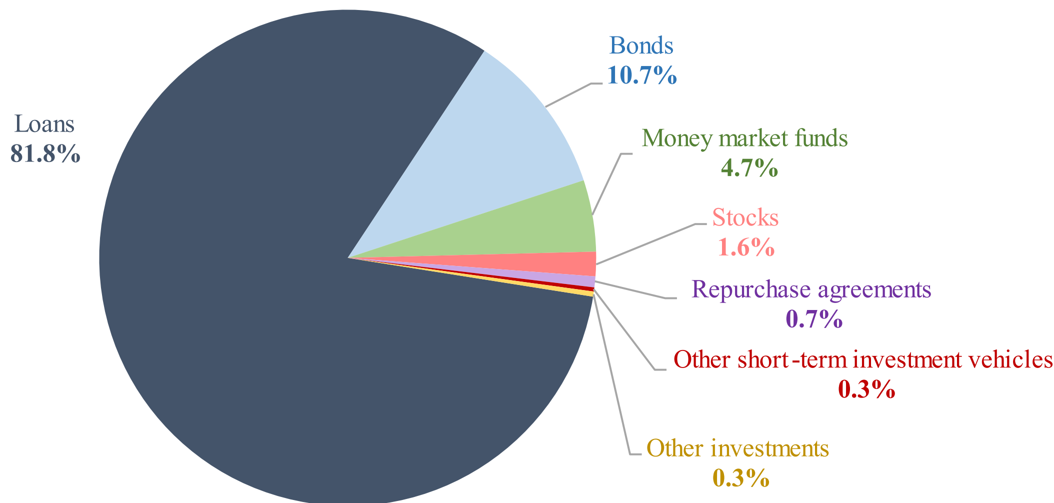
We recognize that this fund category has a different liquidity risk profile because of the settlement conventions of bank loans—they can take somewhat longer to settle in cash after a fund and the counterparty enter a binding trade. Precisely for this reason, these funds use liquidity risk management tools and mitigants, such as: holding highly liquid portfolio investments, in accordance with the liquidity rule's highly liquid investment minimum (HLIM) requirement;[5] lines of credit; expedited settlement arrangements; and interfund lending arrangements.

As Figure 4 shows, bank loan funds held 81.8 percent of their June 2023 assets in loans. Other bank loan fund holdings have more conventional cash settlement features, including 5.4 percent in cash equivalents such as money market funds and repurchase agreements, 10.7 percent in bonds, and 1.6 percent in stocks. In addition, bank loan funds have ongoing sources of liquidity

[5] Rule 22e-4 requires a fund that does not primarily hold assets that are highly liquid investments to determine and maintain a "highly liquid investment minimum," which the rule defines as "the percentage of the fund's net assets that the fund invests in highly liquid investments…" The rule defines a "highly liquid investment" as "any cash held by a fund and any investment that the fund reasonably expects to be convertible into cash in current market conditions in three business days or less without the conversion to cash significantly changing the market value of the investment…"

from bond or loan maturities or prepayments, meaning that liquidity is not generated solely from sales of portfolio investments and fund share purchases.

Figure 4
Bank Loan Funds Have Substantial Highly Liquid Holdings
Percentage of total holdings,[1] data centered around June 30, 2023[2]



Total bank loan fund holdings: $87 billion

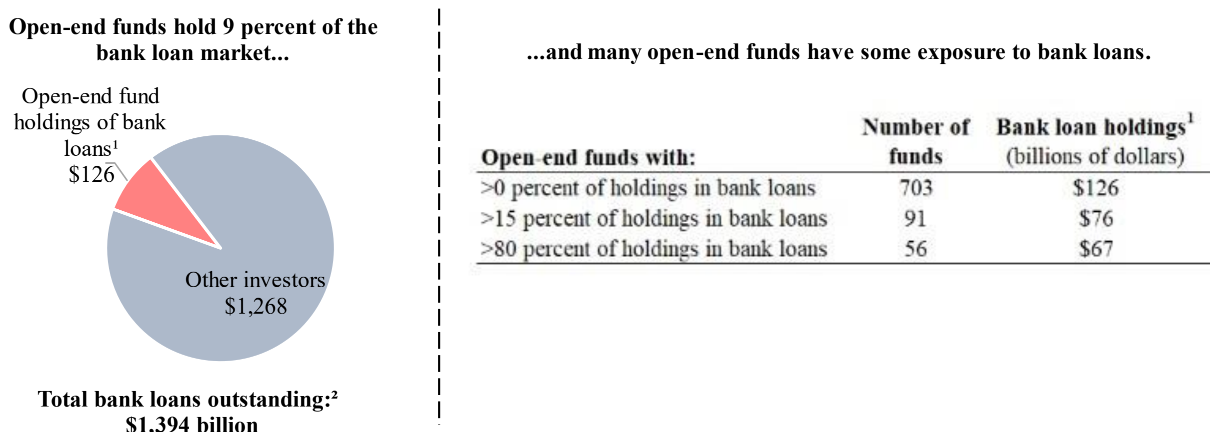
[1] Data are based on Form N-PORT filings centered around June 2023: 37 percent of total holdings for bank loan funds had a filing date of May 31, 2023; 24 percent as of June 30, 2023; and 39 percent as of July 31, 2023.
[2] *Bonds* include debt and asset-backed securities; *stock* includes public and preferred stock; *other investments* includes derivatives and other securities.
Note: Data include mutual funds and ETFs. Data exclude funds of funds.
Source: Investment Company Institute calculations of publicly available SEC Form N-PORT data

Funds successfully have "bridged" lags in settlement times through use of these portfolio construction techniques and liquidity tools. Furthermore, in stressed market conditions (including March 2020), funds have been able to (i) sell bank loans, and (ii) settle those sales more quickly than median loan settlement figures suggest. According to LSTA's data, the median buyside sale settlement time in March 2020 was seven days, shorter than the long-term median buyside sale settlement time of nine days.[6] Market participants understand settlement times may matter more for funds and frequently are able to expedite the process for their benefit.

[6] *See* LSTA February Comment Letter (Feb. 14, 2023) at 6 ("The long-term median buyside settlement time is nine days and it is shorter in times of market stress in light of the inherently higher settlement urgency. For example, in March 2020, the median buyside sale settlement time was seven days.").

Finally, other open-end funds with different and broader investment mandates also invest in bank loans in the ordinary course of operating and/or opportunistically as market conditions warrant. Overall, open-end funds hold 9 percent of the bank loan market (Figure 5). While the majority of bank loans are held by bank loan funds (57 percent), 703 funds have some exposure to bank loans, and 91 funds hold at least 15 percent of their assets in bank loans.

Figure 5
Open-End Funds Are a Source of Financing for the Bank Loan Market
Billions of dollars, June 2023[1, 2]



Open-end funds with:	Number of funds	Bank loan holdings[1] (billions of dollars)
>0 percent of holdings in bank loans	703	$126
>15 percent of holdings in bank loans	91	$76
>80 percent of holdings in bank loans	56	$67

[1] Data for open-end fund holdings of bank loans are centered around June 2023: 19 percent of total holdings for open-end funds had a filing date of May 31, 2023; 55 percent as of June 30, 2023; and 26 percent as of July 31, 2023.
[2] Data for total bank loans outstanding are from LSTA and as of June 30, 2023.
Note: Data include mutual funds and ETFs. Data exclude funds of funds.
Source: Investment Company Institute calculations of SEC Form N-PORT data and LSTA

Thus, any regulatory changes that disfavor funds' investing in bank loans will have real effects on hundreds of funds and their investors, well beyond bank loan funds.

Section 2: Assessing the Proposal's Impact on Funds Holding Bank Loans

2.1 Examining the Current and Proposed Rule Text

Currently, the liquidity rule requires a fund to classify each portfolio investment into one of four liquidity "buckets"—highly liquid, moderately liquid, less liquid, and illiquid—at least monthly.[7] Bank loan funds function effectively within the current liquidity framework because most of the

[7] This bucketing exercise requires a fund to determine how quickly (in days) it can convert to cash (or sell, depending on the bucket) a reasonably anticipated trading size (RATS) of each investment, factoring in the sale's potential impact on the investment's market value ("value impact") and numerous other market, trading, and investment-specific considerations.

loans they hold typically meet the definition of a "less liquid" investment.[8] Consistent with this definition, a fund typically is able to enter a *binding sale* of a bank loan with a counterparty within seven days, but these trades may take somewhat longer to *settle in cash* after execution.[9] Consequently, bank loan funds have complied with the rule's 15% illiquid limit.[10]

The proposal would amend the rule's bucketing requirements in several respects.[11] We—and most other commenters—strongly oppose these changes as they would apply to *all* funds subject to the liquidity rule.[12]

While unjustified and inappropriate for all mutual funds and ETFs, their impact on bank loan funds would be most severe. Crucially, the proposal would eliminate the "less liquid" bucket and significantly expand the "illiquid investment" bucket[13] in a way that would render most bank loans technically "illiquid" under the rule, and therefore make it impossible for bank loan funds to comply with the rule's 15% illiquid limit. Accordingly, assuming settlement conventions remain unchanged, adoption of the SEC's proposed bucketing changes would be fatal to open-end funds (including ETFs) investing primarily in bank loans.[14]

---

[8] Currently, the liquidity rule defines a "less liquid investment" as "any investment that the fund reasonably expects *to be able to sell or dispose of* in current market conditions in seven calendar days or less without the sale or disposition significantly changing the market value of the investment…" (emphasis added) However, while it is common for funds to classify bank loans as "less liquid," in certain circumstances funds classify them as "illiquid." We understand from members that factors that could lead to an "illiquid" classification include changes in relevant trading data or activity (e.g., with respect to bid/ask spreads, trading volumes, or dealer market making), company-specific events, credit status of the loan (e.g., if it is distressed), and the nature of the security interest.

[9] *See supra*, note 6.

[10] Currently, the liquidity rule defines an "illiquid investment" as "any investment that the fund reasonably expects *cannot be sold or disposed of* in current market conditions in seven calendar days or less without the sale or disposition significantly changing the market value of the investment…" (emphasis added)

[11] The proposal would: (i) change the size assumption to 10% for each investment (from a fund-determined RATS); (ii) impose a fixed value impact requirement by defining "significantly changing the market value of an investment" to include precise numerical standards; (iii) eliminate the asset class classification method; (iv) eliminate the "less liquid" bucket, reducing the number of buckets from four to three, and change the definitions for the remaining three buckets to narrow the "highly liquid" bucket and expand the "illiquid" bucket; (v) change the method for counting days in a way that shaves a day off the highly liquid and illiquid buckets; and (vi) require daily bucketing. Collectively and industrywide, these changes would lead to a significant migration of assets from more to less liquid buckets.

[12] *See* ICI Comment Letter at Section 2; *see also* Joint Comment Letter of ICI and ICI Southwest (Nov. 21, 2023) ("Joint ICI/ICI Southwest Letter").

[13] The proposal would redefine "illiquid investment" in relevant part to mean "any investment that the fund reasonably expects not to be *convertible to U.S. dollars* in current market conditions in seven calendar days or less without significantly changing the market value of the investment…" (emphasis added) The revised definition also would require funds to classify as "illiquid" those investments that are classified as "level 3" under the US GAAP fair value hierarchy.

[14] We recognize that the proposal does not treat bank loans as categorically illiquid in the same way that it does level 3 investments. *See supra*, note 13. Still, both the purpose and effect of the proposed bucketing amendments

2.2 Examining the SEC's Rulemaking Authority and Its Case for Policy Change

For the reasons set forth in our prior joint comment letter on the liquidity proposal, we do not believe that the SEC has the statutory authority to impose the proposed liquidity requirements on funds—particularly liquidity requirements that effectively prohibit open-end bank loan funds.[15]

Furthermore, the SEC has not adequately justified its policy reversal with respect to this fund category and asset type, especially considering its obligation to consider whether the action will promote efficiency, competition, and capital formation.[16] The rule adopted in 2016 was deliberately structured to accommodate bank loan funds.[17] The current proposal notes that bank loan funds had outflows of $11.4 billion (13.6%) in March 2020.[18] Yet the SEC concedes that, even upon the occurrence of a global pandemic, "bank loan funds were able to meet redemption requests during March 2020, a period of significant outflows."[19]

In other words, bank loan funds passed their March 2020 stress test. In fact, to date, *no* bank loan fund has ever suspended redemptions. Thus, bank loan funds' success in meeting redemptions calls into question the Commission's justification for adopting amendments that effectively ban bank loan funds by reclassifying bank loans as "illiquid."

Moreover, the Administrative Procedure Act requires that "when an agency changes course, it must take into account … alternatives that are within the ambit of the existing policy."[20] Yet the SEC provides no evidence as to why targeted risk mitigants, such as its proposed minimum 10% HLIM (discussed below), would not themselves fix any lingering concerns about bank loan funds.

Finally, to support its concern that bank loans' settlement times are increasing, the SEC compares apples to oranges and implies the existence of an upward trend in settlement times for funds' sales that is not supported by the cited data. The proposal notes that "[a]round the time that the Commission adopted the liquidity rule, the median settlement time for a loan sale was about 12

(particularly the elimination of the "less liquid" bucket and expansion of the "illiquid" bucket) would be to make operating a bank loan fund impossible under current settlement conventions in this market.

[15] *See* Joint ICI/ICI Southwest Letter at Section 2.

[16] Section 2(c) of the Investment Company Act directs the Commission, when engaging in rulemaking where it is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

[17] *See supra*, notes 8 and 10, for the current definitions of "less liquid" and "illiquid" investments. *See also* *Investment Company Liquidity Risk Management Programs*, SEC Release No. IC–32315, 81 Fed. Reg. 82142 (Nov. 18, 2016) at 82176 (mentioning U.S. bank loan participations as a kind of "less liquid investment" under the new rule).

[18] Proposal at n.49.

[19] *Id*. at 77191.

[20] *R.J. Reynolds Vapor Co. v. FDA*, 65 F.4th 182, 189 (5th Cir. 2023).

days" and "[b]y July 2021, the average time to settle a bank loan par trade in the secondary market increased to a then seven-year high of T+23, and the median was at T+15."[21]

This comparison is deeply flawed because these quoted numbers measure different things. The 12-day figure the SEC cites comes from LSTA's January 2016 comment letter, which LSTA describes as "the median settlement time for *buyside sales*." (emphasis added) The better apples-to-apples comparison would be to data included in the LSTA's February 2023 comment letter, which indicated that the "long-term median buyside settlement time is nine days." By contrast, both the 23- and 15-day figures that the SEC cites in the proposal are settlement times on *all traded loans*, a larger and more general data set that captures the activity of a wider array of market participants, many of which do not have the same settlement urgency as funds. It is therefore inappropriate to compare the (typically shorter) *buyside sale settlement times* that are far more representative of funds' actual experience to settlement times on *all traded loans* and infer an increase in settlement times for funds selling bank loans.

2.3 Assessing the SEC's Economic Analysis of the Proposed Amendments

The SEC's economic analysis does not quantify the proposal's impact on funds holding bank loans, investors generally, the bank loan market generally, or other entities (e.g., corporate borrowers). Rather, the economic analysis is high-level and qualitative in nature. The SEC's quantitative data is generally limited to funds' exposure to bank loans, bank loan funds' flows, bank loans' liquidity classifications, line of credit usage,[22] and data on settlement times from LSTA.

This is far from sufficient, especially given how dramatically the proposal would affect bank loan funds and their investors. The analysis provides no sense of whether the proposed changes on balance would benefit investors and markets or not, much less attempt to estimate magnitudes of impact. In places, the analysis is exceedingly broad and noncommittal in its assessments:

> To the extent that the proposed amendments would lead market participants to standardize and shorten the settlement process for bank loan interests, the prices and spreads for bank loans may become more transparent at a sector level, increasing the efficiency in this market. On the other hand, the proposed liquidity requirements may lead funds to allocate less to these investments. Absent other frictions, the difference in demand for these investments could be made up for by other investors or other the same [sic] investors through other structures (such as more direct investment). However, if this difference in demand is not fully

---

[21] Proposal at 77191.

[22] While the SEC provides data on funds' use of credit lines, this is very different from quantifying any dilutive impact. *See* ICI Letter at Section 2.7.2 for a discussion of why use of credit lines is less dilutive than the SEC appears to believe. We also would note that to the extent that "costs of borrowing have risen" (proposal at 77191), so too have the yields on bank loans, which can offset higher borrowing costs. As discussed above, bank loans tend to perform relatively well in rising interest rate environments. And as for concerns about "credit [becoming] more difficult to obtain over time" (id.), the SEC's data show that funds used credit lines in 2020, a highly stressed period.

> absorbed by other market participants, the efficiency in this market may decrease.[23]

The proposal asks some good questions:

> Would the proposed changes to the liquidity classifications affect investment options available to investors? For example, would bank loan funds only be available in non-open-end investment vehicles? What effect would these proposed changes have on those asset classes that are less available for investment by open-end funds for liquidity reasons, the availability of credit to borrowers, and more generally, on capital formation?[24]

These questions, however, raise only some of the matters requiring deeper evaluation and assessment prior to adopting amendments that would eliminate bank loan funds, adversely impact many other funds investing in them, and harm their investors. In this letter, we provide our views on these fundamental matters; others also have addressed them in their comment letters. But while commenters can provide valuable perspective on these sorts of questions, that alone is neither sufficient nor a substitute for the *Commission* gathering and analyzing relevant information[25] and ensuring that *its* economic analysis, as informed by public comment, supports its chosen policies. Simply asking the questions is inadequate. Here, the proposal's economic analysis does not support the Commission's chosen policies.

2.4 ICI's Policy Recommendations

We strongly oppose the proposed bucketing changes.[26] We offer below other constructive steps the SEC could take to further bolster the liquidity profiles of bank loan funds:[27]

---

[23] Proposal at 77263.

[24] *Id*. at 77194.

[25] *Cf.* *Unsettling End of an Era: Statement on Adoption of Rule Prohibiting Conflicts of Interest in Certain Securitizations*, Commissioner Hester M. Peirce, Nov. 27, 2023 ("Re-proposing this rule [prohibiting conflicts of interest in certain securitizations] would have counteracted a troubling recent pattern from the Commission: release an expansive, unworkable rule proposal that includes myriad questions; watch as concerned commenters expend available resources to mount an all-out attack on the most unrealistic and potentially catastrophic provisions in the proposed rule, leaving them with little to no remaining resources to address questions about other, less immediately alarming, yet also concerning provisions in the proposed rule; trim the rule's unworkable excesses when finalizing the rule after the comment period has closed; and cite to the proposal's myriad questions – both answered and unanswered – to support the contention that the rule is responsive to commenters and a logical outgrowth of the proposal.").

[26] *See supra*, notes 11 and 12 and accompanying text.

[27] ICI and ICI Southwest maintain that the Commission lacks statutory authority to impose the proposed liquidity requirements and provide these recommendations only as alternatives the Commission should consider if it has statutory authority to impose such requirements.

- For funds investing primarily in longer-settling securities (e.g., those that generally would not be settled in cash in 7 calendar days or less, including bank loans), we support a 10% minimum HLIM.[28] Consistent with the proposal, this would be the "floor" for these funds, and these funds still would be required to comprehensively assess their liquidity risk factors and consider whether a higher figure would be appropriate.

- We support amending the rule's liquidity risk factors[29] to expressly address funds' longer-settling investments. The SEC could pair this new language with guidance setting forth its expectations regarding funds' use of liquidity risk mitigants.

We remain committed to working with all relevant parties to improve the bank loan market itself, including reducing current settlement times. As with reductions in settlement times generally, we believe that reduced settlement times for bank loans would benefit funds.

In short, ICI and others[30] have put forth viable recommendations that would further mitigate liquidity risk while preserving the core benefits that these funds and this asset class provide to investors and other market participants.

Section 3: Consequences of Reclassifying Bank Loans as Illiquid

If any final amendments render continuation of open-end bank loan funds impossible, we believe the consequences would be severe. Bank loan funds currently hold approximately $90 billion in net assets, and it is highly unlikely that these assets would easily transition into closed-end funds or liquidated in an orderly and pain-free manner. Instead, fund sponsors and boards would make difficult and costly decisions. Fund boards may consider whether conversion to another fund type (e.g., as a closed-end interval fund) would be in the best interest of investors. Conversions would require shareholder approval,[31] an expensive and time-consuming process for which retail investors ultimately would shoulder the burden.

---

[28] We do not support a mandatory 10% minimum HLIM for all funds subject to the liquidity rule. *See* ICI Letter at Section 2.5.

[29] Rule 22e-4(b)(1)(i) lists factors that a fund must consider (as applicable) in assessing, managing, and periodically reviewing its liquidity risk.

[30] *See, e.g.*, LSTA's October Comment Letter (describing standardized expedited settlement arrangements (ESAs) that have been developed that would permit funds to settle sales of loans within three business days after the trade date where an ESA exists between the fund and the buyer).

[31] Section 13(a) of the Investment Company Act states that no fund shall, unless authorized by the vote of a majority of its outstanding voting securities, change its subclassification as an open-end or closed-end fund. Section 2(a)(42) defines "majority vote" for this purpose as "the vote, at the annual or a special meeting of the security holders of such company duly called, (A) of 67 per centum or more of the voting securities present at such meeting, if the holders of more than 50 per centum of the outstanding voting securities of such company are present or represented

Apart from the challenges and high costs that accompany fund proxy campaigns generally (particularly for items that require a "majority vote" as defined by the Investment Company Act),[32] we believe that convincing fund investors that the closed-end fund structure would be an acceptable substitute would be a hard sell, notwithstanding the considerable benefits of closed-end funds. Current investors in open-end bank loan funds have chosen to invest in them in part because of *their* specific characteristics, including the ability to redeem fully each day. A proxy campaign would therefore be a costly, challenging, and uncertain option for most bank loan funds, and quite possibly futile for many. We believe that registered funds collectively (i.e., open- and closed-end funds) would lose a significant amount of bank loan assets, due to the sharp drop within open-end funds.

The alternative would be for fund sponsors and their boards to liquidate these funds. The transaction and other costs associated with these liquidations caused by the SEC's amendments would be borne by the funds' investors, irrespective of their preferences. Liquidations would subject some fund investors to two types of tax liability: (i) sales of portfolio investments could generate taxable gains, which would be distributed to the fund's investors; and (ii) individual investors could realize taxable gains if their shares have appreciated in value, upon the final liquidation (or upon redeeming their shares in advance of the final liquidation).[33]

As noted above, open-end funds other than bank loan funds also hold bank loans. If the Commission suddenly deems this asset class to be technically "illiquid," funds' demand for bank loans would lessen. Open-end funds are managed to avoid breaching (or, in most cases, even *approaching*) the 15% illiquid investment limit. Even when not breaching or approaching the limit, funds likely will seek to avoid the negative perception that may accompany holding a larger percentage of fund assets in "illiquid investments" (the stigma certainly would be exacerbated by the SEC's proposed requirement for public reporting of bucketing information).

We do not know to what degree existing bank loan fund shareholders would redeem their shares prior to a liquidation or attempted conversion. To our knowledge, there is not much precedent upon which to draw. We can, however, predict net outflows would occur. Funds and advisers likely would close these funds to new investments during their wind-up periods, and existing investors to some degree would redeem prior to final liquidations. Fund flows would be entirely

---

by proxy; or (B) of more than 50 per centum of the outstanding voting securities of such company, whichever is the less."

[32] The SEC's 2022 decision to remove fund proxy reform from its rulemaking agenda was misguided and highly disappointing. For more information on why reform in this area is so urgently needed, *see* *Analysis of Fund Proxy Campaigns: 2012–2019*, ICI (December 2019); and Letter from Paul Schott Stevens, President and CEO, ICI, to Vanessa Countryman, Acting Secretary, SEC, dated June 11, 2019.

[33] A third possibility would be for a bank loan fund to significantly change its investment objective, strategies, policies, and limitations. Economically, the impacts of this choice would be similar to a liquidation because such a fund would be forced to sell most or all its bank loans to comply with the 15% illiquid limit and its new objective, strategies, policies, and limitations. And in some cases, these changes also could require shareholder approval.

in one direction—out. It would be ironic if these funds' unblemished record in meeting redemptions on a timely basis would be undone not by a global pandemic, but by SEC rule amendments.

All the above assumes that the bank loan market itself would not be disrupted by these amendments. However, funds collectively would be significant net sellers of bank loans, and their demand for loans thereafter would be sharply reduced. Even if any resulting market dislocation is short-lived, fund investors would bear the losses of sales occurring during any period of dislocation. This would result in a one-time wealth transfer from funds and their Main Street retail investors to those investors not constrained by the SEC's liquidity rule.

These amendments would harm, not protect, fund investors.

Finally, we have outlined above only the effects on funds and their investors, but the repercussions likely would extend further. Bank loans enable companies (i.e., the borrowers) to undertake a host of activities, such as:

- Expanding operations
- Managing and maintaining adequate working capital
- Merging with or acquiring other companies
- Recapitalizing their balance sheet
- Refinancing their debt

As buyers of these loans, funds (i.e., the lenders) facilitate capital flows to an array of companies, including many smaller businesses that might not otherwise have access to capital. This too is deserving of more study by the SEC, consistent with its obligation to consider whether its rulemaking will promote efficiency, competition, and capital formation.

* * * *

We appreciate the SEC's consideration of these comments.

Sincerely,

Investment Company Institute ICI Southwest

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 Birdthistle, Director
Sarah ten Siethoff, Deputy Director
Division of Investment Management