February 13, 2024

Via Electronic Submission

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

Re: File No. S7-26-22: Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting, Investment Company Act Release No. 34746

Dear Ms. Countryman:

The LSTA[1] appreciates the opportunity to submit additional comments on the proposed amendments to the rules for open-end management investment companies ("open-end funds")[2] regarding liquidity risk management ("LRM") programs and swing pricing (the "Proposed Rule").[3]

I. Introduction

We share the objective of the Securities and Exchange Commission (the "Commission") as stated in the Proposing Release – to better prepare open-end funds for stressed conditions. The Proposed Rule is designed to achieve this objective through required changes to LRM programs to ensure that funds are better prepared to satisfy redemption requests, including in stressed conditions, in a timely manner without materially diluting remaining investors. However, we

[1] The LSTA is a not-for-profit trade association that is made up of a broad and diverse membership involved in the origination, syndication, and trade of commercial loans. The 600+ members of the LSTA include commercial banks, investment banks, broker-dealers, credit funds, mutual funds, insurance companies, asset managers, and other institutional lenders, as well as law firms, service providers and vendors. The LSTA undertakes a wide variety of activities to foster the development of policies and market practices designed to promote just and equitable marketplace principles and to encourage cooperation and coordination with firms facilitating transactions in loans. Since 1995, the LSTA has developed standardized practices, procedures, and documentation to enhance market efficiency, transparency, and certainty. For more information, visit www.lsta.org.

[2] "Open-end funds" includes mutual funds and exchange-traded funds ("ETFs").

[3] *Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting*, Investment Company Act Release No. 34746 (Nov. 2, 2022) (the "Proposing Release").

366 Madison Avenue, 15th Fl., New York, NY 10017
Tel: 212-880-3000 Fax: 212-880-3040 www.lsta.org

continue to strongly believe, and reiterate here,[4] that the proposed elimination of the less liquid investment classification category (the "less liquid category") and classifying such assets as illiquid is unnecessary, unwarranted and will acutely harm retail investors. Open-end funds that own loans ("open-end loan funds") largely rely on the less liquid category for liquidity classifications of their loan investments, so the proposed change would result in significant disruption to the loan market for all market participants.[5] Additionally, the proposed change would eliminate a tried-and-true investment product that retail investors look to for meeting a variety of investment objectives, including protection in an environment of increasing or high interest rates. We recognize that loans have non-standard settlement times which understandably gives the Commission pause, but open-end loan funds have proven their ability through sound portfolio construction and management to successfully manage liquidity, including in stressed conditions. Open-end loan funds effectively use a robust set of liquidity tools in light of the settlement mismatch between fund shares and portfolio investments including:[6] active cash management and modeling, maintaining highly liquid investment minimums ("HLIMs"), using committed lines of credit[7], and interfund lending. Indeed, the efficacy of these tools was recently recognized by Commission Chair Gary Gensler.[8]

While the Proposing Release acknowledges that open-end loan funds have never failed to meet a redemption, even in March 2020, the Commission remains concerned that open-end loan funds may not be able to meet redemptions in future stressed conditions, especially as the asset class grows. In light of the Commission's concerns, the LSTA and the open-end loan funds it represents have suggested alternative approaches to the proposed elimination of the less liquid

---

[4] Letter from LSTA to File No. S7-26-22: Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting (Feb. 14, 2023) ("First LSTA Letter"), https://www.sec.gov/comments/s7-26-22/s72622-20157336-325683.pdf; Letter from LSTA to File No. S7-26-22: Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting (Oct. 3, 2023) ("Second LSTA Letter" and, together with the First LSTA Letter, the "LSTA Letters"), https://www.sec.gov/comments/s7-26-22/s72622-267259-642842.pdf.

[5] *See* First LSTA Letter at pp. 11-14 (discussing the significant harms that would be caused by eliminating the less liquid category).

[6] *See* First LSTA Letter at pp. 7-9.

[7] As set out in the First LSTA Letter, committed lines of credit are very affordable. *See* First LSTA Letter at p. 9 ("Using the Commission's numbers, we calculated the dilution impact of the 2021 line of credit draws on fund investors. The cost of drawing on a typical line of credit for an open-end loan fund is approximately 1.2% over SOFR. With SOFR averaging 0.04% in 2021…the cost of the entire industry drawing in 2021…created dilution of .001 cents per dollar of AUM of the overall market). *See also* First LSTA Letter at note 30, p. 9.

[8] SEC Chair Gary Gensler Speech, "Time is Money. Time is Risk": Prepared Remarks before the European Commission, January 25, 2024, https://www.sec.gov/news/speech/gensler-speech-prepared-remarks-european-commission-012524?utm_medium=email&utm_source=govdelivery ("Mutual funds and ETFs have used a variety of tools to address settlement time mismatches between fund shares and portfolio investments, including cash reserves, lines of credit, and interfund lending facilities. What we've learned from such settlement mismatched is, while there are costs, the markets have been able to handle them.")

category. First, as expressed in the LSTA Letters, we support the 10% HLIM as defined in the Proposed Rule for open-end loan funds. We understand that open-end loan funds are unique in this regard. Second, the LSTA convened a working group of investment advisers to open-end loan funds and the banks that make markets in loan interests ("dealers") to develop and promote more formality and standardization in the documentation of expedited settlement arrangements. Where contractually implemented between a fund and a dealer, these arrangements enable a fund to settle a loan sale in a short amount of time, *e.g.*, three business days after the trade date.[9] The LSTA continues to believe that a mandatory 10% HLIM together with the broader availability of expedited settlement arrangements represent tailored measures that adequately address liquidity risk and enhance LRM programs. Accordingly, the LSTA does not believe removing or modifying the less liquid category is necessary.

Nevertheless, in this letter the LSTA offers an additional approach if the Commission is compelled to impose additional constraints on the ability of loan assets to be classified as less liquid. The approach is designed to address any lingering concerns about an open-end loan fund's ability to meet redemption requests in stressed conditions. Rather than eliminate the less liquid category as suggested in the Proposed Rule, the less liquid category should be retained with respect to loans only if settlement of a loan sale is reasonably expected to occur within a specified amount of time.[10] Currently, this category is available with respect to a portfolio asset if the open-end loan fund reasonably expects that the asset can be sold or disposed of in seven calendar days but takes longer to settle.

The LSTA respectfully requests that the Commission retain the less liquid investment category and for loan assets, restrict its availability to loan assets that a fund reasonably expects can be *sold by five business days*[11] *and settled by ten business days* after the trade date ("T+10") (the "T+10 proposal"). The LSTA recognizes that the Proposed Rule, like current Rule 22e-4, uses "calendar days" in the relevant liquidity classification calculations. The LSTA strongly recommends that "business days" be used instead as a more appropriate and reliable day count convention. To that end, the T+10 proposal and the comments below use the "business day" convention.

In connection with this proposal, the LSTA has prepared aggregated loan trade settlement data, discussed in detail below, based on data submissions by advisers to open-end loan funds ("participating advisers") regarding loan sales by their open-end loan funds. This data, which represents more than 75% of the open-end loan fund universe, supports the feasibility of this proposal while, critically, underscoring the need for certain considerations, described below, to be taken into account.

---

[9] Second LSTA Letter at p. 2.

[10] We focus our comments on the less liquid category as it applies to loans. As we noted in the First LSTA Letter, the changes in the Proposed Rule may adversely impact other asset classes and multi-asset class funds.

[11] Five business days is equivalent to the seven calendar days referenced in Rule 22e-4.

II. Comments

A. The LSTA recommends that the definition of the less liquid category be retained for loans that can be sold within five business days and settled by T+10.

Rule 22e–4 currently allows funds to classify as less liquid those investments "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 . . . but where the sale or disposition is reasonably expected to settle in more than seven calendar days."[12] The current rule does not require an asset to be sold *and settled*, *i.e.*, converted to cash, within a predetermined amount of time. Where the full elimination of the less liquid category would cause significant disruption in the loan market and harm retail investors, such disruption and harm can be avoided *and* the Commission's concerns can be addressed by maintaining the ability of funds to categorize loans in the less liquid category, subject to an outer bound on their expected settlement time. **The LSTA recommends that Rule 22e-4 be amended so that the less liquid category remains available for loan assets that the fund reasonably expects can be converted into U.S. dollars by T+10 business days.** Note that, based on the data we have collected, a shorter settlement period for loans is not feasible and would effectively eliminate the viability of open-end funds that utilize a loan investment strategy or allocate a meaningful portion of their assets to loans as part of a broader investment strategy.

B. The feasibility of the T+10 proposal requires that (1) the final rule provides for a substantial compliance period; and (2) the Commission provides guidance on the factors that may be considered by a fund in determining a loan asset's liquidity classification.

1. Data shows that loan sales can and do routinely settle by T+10 but settling by T+10 would need to occur more frequently than it does today.

In January 2024, the LSTA collected data files from 11 participating advisers *with respect to their open-end loan funds*. Participating advisers submitted loan sales by their open-end loan funds ("loan sales") that settled in March 2020 and loan sales that settled in October 2023 which the LSTA aggregated and analyzed.[13] The results are set forth below.

The data here shows that settlement times are grouped around a relatively short period of time with a long, thin tail, meaning that the tail represents only a handful of trades at extended settlement times.[14] For this reason, median settlement time, which measures how long 50% of

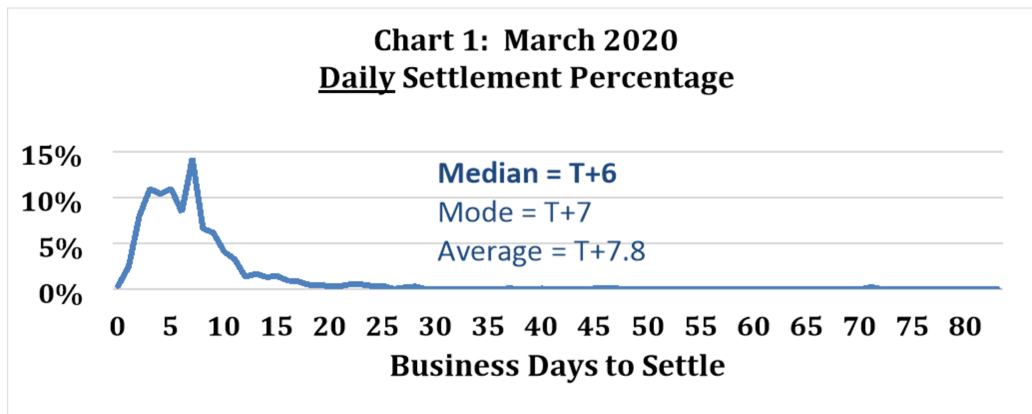
---

[12] Rule 22(e)-4(a)(10).

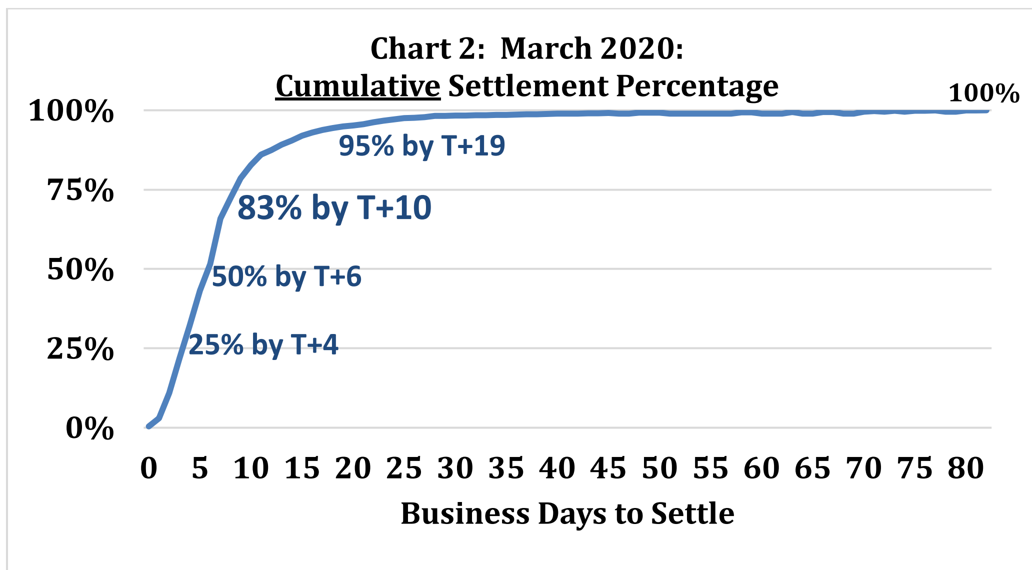
[13] March 2020 is an example of a month with extremely high trade volume (and fund outflows) while October 2023 is a more recent example of a month with normal trade volume (and minimal fund outflows).

[14] When analyzing the aggregated data, we note that loan trade settlement has a strongly "non-normal" distribution, *i.e.*, not a bell-shaped curve. This is because loan trades do not have standard settlement times.

trades in the data set settled, is more instructive than average settlement time, which can be affected significantly by small changes to the tail without wider impact. We would appreciate the Commission providing guidance that median settlements times are an appropriate metric for funds to use when assessing a reasonable expectation for settlement times.



Looking at March 2020, a month of increased trading volume and fund outflows that were large by historical standards, Chart 1 shows that the median settlement time for loan sales was six business days after the trade date, *i.e.*, T+6.[15]



[15] Loan market custom is to measure settlement times using a business day convention with the trade date being T+0 rather than T+1, *i.e.*, the trade date is not counted in the settlement times.

Chart 2 shows that, of all loan sales that settled in March 2020, 83% settled by the tenth business day after the trade date, *i.e.*, T+10.[16] As proposed, the trade date (or the date the classification is made) is not included in the day count, *i.e.*, T=0, and the count is measured in business days.[17]

Looking at October 2023, a month of low trading volume and outflows, in comparison to March 2020, we see that loan sales took slightly longer to settle but are generally in the same range.

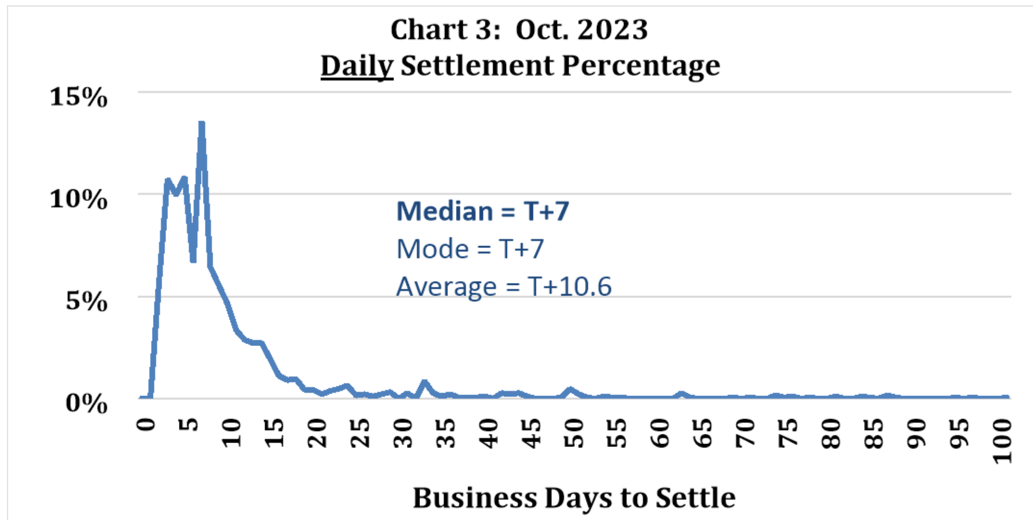


Chart 3 shows that the median settlement time for loan sales was seven business days after the trade date, *i.e.*, T+7.

[16] LSTA supports the counting start the day after the trade date.

[17] Rule 22e-4 and the Proposing Release use calendar days as the relevant unit of measurement where the custom in the loan market is to use business days.

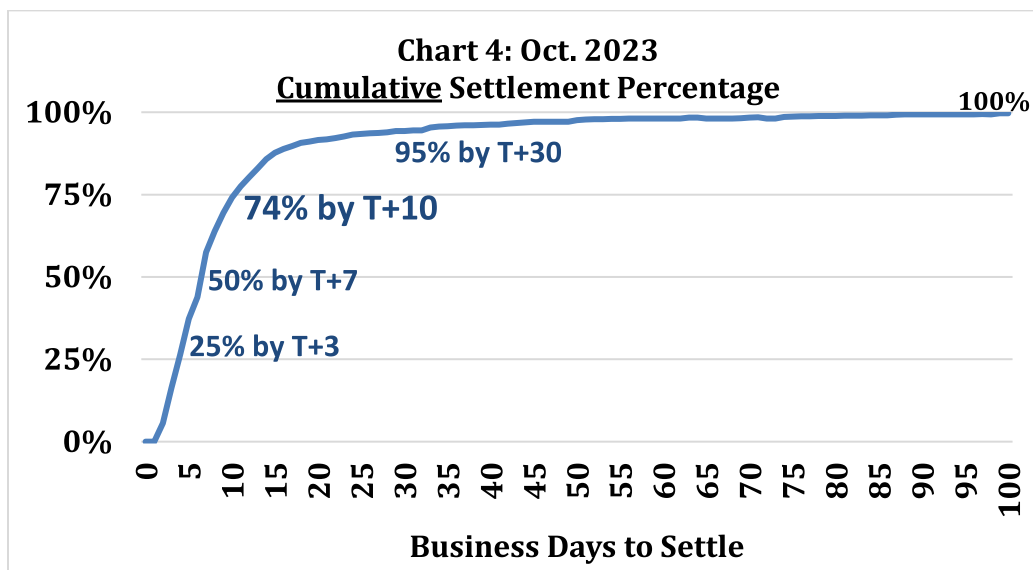


Chart 4 shows that, of all loan sales that settled in October 2023, 74% settled by the tenth business day after the trade date, *i.e.*, T+10.

Taken together the settlement data indicates that loan sales can and do routinely settle within ten business days, but a significant portion take longer to settle. Given where settlement times are today it would not be feasible to require open-end loan funds to form a reasonable belief that a loan asset can be convertible to U.S. dollars in less than ten business days. Thus, if the Commission desires to preserve the access of retail investors to open-end loan funds by amending the definition of the less liquid category, a standard of a reasonable belief that a loan asset can be convertible to U.S. dollars by least T+10 should be adopted provided the Commission allow a substantial compliance period as discussed in greater detail below.

2. A substantial compliance period of at least 24 months is necessary to prevent disruption.

With respect to the amendments to Rule 22e-4, the Proposing Release suggests a compliance period of 12 months after the effective date of the adopted proposals.[18] But the Commission specifically asks for comments on the appropriateness of this compliance period and whether a longer period is needed.[19] We strongly encourage the Commission to include a compliance period of no less than 24 months after the effective date of the final amendments to Rule 22e-4.

As demonstrated in Section B.1. above, open-end loan funds will have a significant amount of work to do to prepare for compliance with amended Rule 22e-4. In addition to

[18] *See* 87 FR 77234.

[19] *See* 87 FR 77235.

implementing any changes that apply to all open-end funds, open-end loan funds must have sufficient time to work with their boards to determine the rationale for evaluating investments and whether loan assets can continue to be classified as "less liquid" under our proposed settlement standard. Open-end loan funds will likely have to work with third party industry partners, *e.g.*, dealers and service providers, to take the necessary steps for compliance. For instance, where a fund looks to use expedited settlement arrangements to support its liquidity classification, that fund will need to stand up these programs across dealers and be confident that the fund can perform its operational responsibilities. In addition, where funds wish to support a less liquid classification of loan assets with their own settlement performance data, funds will likely find that they need the passage of time to build a track record that shows consistent settlement of loan trades by T+10.

3. Open-end loan funds would greatly benefit from specific guidance from the Commission on the factors that can be considered by a fund in classifying an asset as less liquid.

Open-end loan funds (and their boards) would greatly benefit from specific guidance on how a fund should assess an asset to arrive at a reasonable expectation that such asset is appropriately classified as less liquid.[20] Given the variability of loan settlement times, open-end loan funds will need to look at a number of factors in determining a loan asset's classification. These factors may include a fund's settlement time history, settlement time history for the individual or similar investments, the existence of expedited settlement arrangements, median settlement times, and certain industry level loan settlement data. Specific guidance from the Commission on the factors which can be considered in this determination, for example, recognizing the appropriateness of median settlement times, will not only help open-end loan funds complete their liquidity classifications and comply with amended Rule 22e-4, but also bring efficiency and consistency to the process by reducing the need for funds to rely on their subjective judgment.

III. Conclusion

We continue to believe open-end loan funds have proven to be a resilient product in stressed conditions with a demonstrated ability to meet redemptions in a wide range of economic and market environments without dilutive effects thanks to existing LRM tools. We believe that eliminating the less liquid category would create significant harm to investors. Accordingly, we propose to maintain the less liquid category for loan assets that a fund reasonably expects can be sold within five business days and settled within T+10. We believe with a reasonable compliance

[20] *See* Question 18 in Proposing Release ("Would funds need additional guidance on how to assess the period in which a bank loan or other investment is *reasonably expected* to be convertible to U.S. dollars? For example, should we revise the proposed rule to require that funds consider, or provide guidance suggesting that funds may wish to consider: settlement time history for the individual or similar investments, average settlement times for the market, and guarantees for settlement or expedited settlement, as well as the contractual settlement period?").

period that open-end loan funds will be able to continue to be a valuable investment option for retail investors while providing more sound liquidity protections.

The LSTA appreciates this opportunity to provide further comment and stands willing to provide additional information in person or in writing. Please feel free to contact Tess Virmani at (212) 880-3006 (tvirmani@lsta.org).

Sincerely,

Theodore Basta
Executive Vice President - Analytics & Strategy

Tess Virmani
Deputy General Counsel & Executive Vice President - Head of Policy