STATE STREET GLOBAL ADVISORS

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Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Submitted via email: rule-comments@sec.gov

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

Dear Ms. Countryman:

State Street Global Advisors, the investment management arm of State Street Corporation[1], appreciates the opportunity to provide feedback on the Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting proposed rule (the "Proposal") issued by the United States Securities and Exchange Commission (the "Commission").

With $3.481 trillion in assets under management, State Street Global Advisors is the world's fourth-largest asset manager and sponsors the SPDR® family of exchange traded funds ("ETFs").[2] While we support sound liquidity management for mutual funds and ETFs, we oppose the overly-prescriptive approach of the Proposal regarding liquidity management, which will fundamentally alter the open-end fund ecosystem and have a profound impact on certain asset classes, especially bank loan funds. With respect to the swing pricing portion of the Proposal, we believe the Commission should reconsider both the proposal to make swing pricing mandatory and the proposed hard close, and instead permit use of anti-dilution measures other than swing pricing, with swing pricing remaining optional and not being mandatory. As such, we do not support the Proposal as currently drafted and recommend the Commission not move it forward.

[1] Headquartered in Boston, Massachusetts, State Street Corporation is a global custodian bank which specializes in the provision of financial services to institutional investor clients. This includes the provision of investment servicing, investment management, data and analytics, and investment research and trading. With $36.743 trillion in assets under custody and/or administration and $3.481 trillion in assets under management as of December 31, 2022, State Street operates in more than 100 markets globally.
[2] As of December 31, 2022.

Liquidity Rule Amendment Proposal

Open-end funds have a long history of providing reliable daily liquidity and stable returns to investors. Since the 2016 adoption of Rule 22e-4 (the "Liquidity Rule") under the Investment Company Act of 1940 as amended (the "1940 Act"), liquidity risk management programs and related disclosures have resulted in meaningful benefits to the industry and investors. During that same timeframe, cases of 1940 Act registered funds failing to make timely payment on shareholder redemptions have been extremely rare. The manner in which 1940 Act registered funds responded to the March 2020 financial market turmoil, with limited liquidity issues and satisfying investor redemption demand with few issues, is a testament to their increased liquidity resiliency in the midst of a real life, actual stress test. We would cite that recent experience as evidence of the effectiveness of the Liquidity Rule as currently structured by the Commission. Neither that experience nor any other current or past circumstances involving 1940 Act registered funds justify the far-reaching amendments to the Liquidity Rule set out in the Proposal.

We believe that several aspects of the Proposal are overly-prescriptive, misguided and threaten to affect 1940 Act registered funds' ability to fully pursue their investment strategies, which ultimately will be affecting investors by limiting investment products and strategies available to them without adding clear benefits for funds' liquidity management programs.

The case of bank loan funds is emblematic of these shortcomings. The Proposal does not consider the successful track record that bank loan funds have had in meeting investor redemptions, nor the rigorous and comprehensive liquidity management programs they have put in place to face scenarios of market stress, including strong mitigants for short-term liquidity needs. Without sufficient cost-benefit analysis, the Proposal would eliminate bank loan funds as a valuable investment option and asset class. Bank loan funds are a very useful income generating asset class that can help diversify investors' portfolios.

Swing Pricing

While we do not oppose the swing pricing proposal in absolute terms, for example we have used it with success in the European context, we do not consider it a silver bullet to address dilution risks in all circumstances. Therefore, we do not believe that swing pricing should be mandated in all circumstances. In addition, we are opposed to the imposition of a hard close, because we feel that the Commission has underestimated the impact that a hard close would have on investors' ability to purchase and sell fund shares through intermediaries, particularly through retirement accounts.

For the reasons described in more detail below, should the Commission decide to proceed with the Proposal, we urge the Commission to: 1) revise the liquidity section

of the rule to more appropriately address liquidity for bank loan funds, and 2) retain the current optional use of swing pricing for open-end funds.

I. Proposed Changes to the Liquidity Rule

State Street Global Advisors broadly opposes the proposed changes to the Liquidity Rule as its overly prescriptive amendments do not support effective fund liquidity management. We believe that liquidity risk management programs should remain fund-specific. Any effective liquidity risk management requires consideration of a fund's strategy, liquidity of its portfolio, fund liabilities, its shareholder base and availability of certain liquidity tools. Our concern with the Proposal as drafted is that it goes in the opposite direction by eliminating the current fund-specific approach.

In 2016, when the Commission first adopted the Liquidity Rule, State Street Global Advisors supported the introduction of flexible and fund-specific liquidity risk management programs, including the codification of the Commission's guidance in establishing a 15% limitation on illiquid assets and the liquidity classification "buckets" approach. The significant limitations that the Proposal introduces do not seem justified in light of the robust liquidity framework already achieved by the Liquidity Rule, and especially given the costs that the new liquidity requirements will have, both individually and on a cumulative basis. We believe that the proposed changes will structurally overestimate illiquidity, forcing a painful and coordinated repositioning of portfolios across funds, and in some cases eliminating entire investment strategies and asset classes.

Given these concerns, we would like to focus the Commission's attention on the following four issues that we consider the most critical areas of focus with respect to the Proposal:

- The Proposal's likely elimination of bank loan funds as an asset class;
- The beneficial role bank loan ETFs play in the bank loan market by increasing liquidity, especially in stressed scenarios, through secondary market trading of ETF shares;
- An alternative approach to manage liquidity risk in bank loan funds, based on a strong set of mitigants and a higher mandatory highly liquid investment minimum ("HLIM"); and
- The negative impact of proposed changes to the value impact assumption.

We will focus on these concerns in this letter and leave the other proposed changes to the Liquidity Rule (especially amendments to the HLIM for all mutual funds) to industry associations, most notably the Investment Company Institute ("ICI"), the Securities Industry and Financial Markets Association ("SIFMA") and the Loan Syndications and Trading Association ("LSTA"), whose comments we broadly support.

A. Bank Loan Funds

State Street Global Advisors strongly believes that the elimination of the "less liquid investments" bucket is unnecessary and will negatively impact investors. Our letter focuses on open-end loan funds, including ETFs, which invest in broadly syndicated institutional loans and other senior debt instruments. These type of loans are adjustable-rate loans[3], often from below investment grade companies. Mutual funds and ETFs are important investors in this market. These financing instruments provide important and significant funding to U.S. companies.

The Value of Loan Funds for End Investors

The Proposal does not fully consider the benefits of diversifying a portfolio with exposure to bank loans and other senior debt instruments. Over the past few years, we have seen an increased interest in the loan asset class, as a result of the potential benefits an allocation can have to investors' portfolios. As of the end of 2022, there were $1.4 trillion in the Morningstar/LSTA loan index and a $3.2 billion in daily average trading volume.[4]

Due to the variable interest rate feature of bank loans, bank loan funds may provide for a reduced portfolio duration and interest rate sensitivity, without sacrificing on yield, especially in rising interest rates environments. Holders of bank loan funds are likely to benefit more during periods of rising rates as a result of the resetting coupon, contrary to investment-grade bonds or U.S. Treasuries which normally see their values decline when interest rates rise. Relative to other credit instruments, bank loan funds have a more defensive profile that is less correlated to equity markets – a relative benefit for diversification. Moreover, bank loans owned by a fund normally have a higher credit priority compared to bonds and common stock. The difference to other forms of debt is that holders of these loans normally have a priority claim over other creditors in the event of a default, meaning that bank loans would be repaid first with any remaining assets in the company. Overall, these features make bank loan funds a valuable contributor in delivering positive risk-adjusted returns to investors in such funds.

Finally, bank loan funds are a crucial component of the loan market that provides significant funding to U.S. companies. As of December 2022, mutual funds and

[3] The cash flows of bank loans are similar to most other fixed income securities in that investors receive interest payments (also known as coupons), typically on a quarterly basis, and repayment of principal at maturity or redemption. Coupons payments fluctuate as they are tied to a reference rate and a fixed spread is added on top of the reference rate to compensate investors for the additional credit risk they assume. Moreover, the reference rate may sometimes have a "floor" which protects investors from the coupon falling below a certain level if interest rates decline. As the reference rate fluctuates daily, the coupon payment resets, generally every quarter.

[4] Source: "LSTA 4Q22 Secondary Trade & Settlement Data Study", available at: https://www.lsta.org/content/secondary-trading-settlement-study-fourth-quarter-2022/, pg.16.

ETFs held 9% of outstanding broadly syndicated institutional loans[5] and provided substantial secondary market liquidity compared to other lenders.

Liquidity of Bank Loans

State Street Global Advisors believes that the liquidity of bank loans are not appropriately measured simply by the number of days to settlement. Bank loans have the following attributes which generally serve as proxies for liquidity:

- Size of an Issue: Bank loans of $300 million or more in issuance are typically quite liquid. Sizes can range from this level to over $3 billion. Bank loans of $300 million or more will have multiple market makers and typically multiple institutional holders. The breadth of the market makers and holders promotes secondary market liquidity.
- Bid/Ask Spreads: Standard bid/offer spreads are generally tight across market makers for bank loans of $300mm or more in issuance, which generally demonstrates the willingness of dealers to trade in the market.
- Broad Dissemination of Trading Information: There is significant transparency with dealers updating investors on trades and trading activity throughout the day. Dealers update their “trading runs” of bank loans throughout the day and distribute these via electronic messaging to the institutional investor community.

As a result, two major indices rank bank loans on the basis of size and/or market depth as a measurement of liquidity: (1) the Morningstar LSTA US Levered Loan 100 Index and (2) the Markit IBOXX USD Liquidity Levered Loan 100 Index.[6]

Bank Loan ETFs are important liquidity facilitators in stressed markets

It is important to note the existence of bank loan funds has allowed for a wider ecosystem to develop around the bank loan asset class. We have seen how that ecosystem has benefited investors in stressed markets.

During the COVID-19 pandemic volatility, volume in bank loan ETFs increased by 60%, as measured by the trading volume in the first six months of 2020 relative to the last six months of 2019. During March of 2020, trading volumes doubled the volumes in February of that year. Since then, volumes have significantly increased, as more investors utilize the bank loan ETFs to obtain exposure to the asset class. During the double bear market in stocks and bonds in 2022, senior loan volumes hit

[5] See LSTA Comment Letter - Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting dated February 14, 2023 (“LSTA Comment Letter”).
[6] In the Morningstar LSTA US Levered Loan 100 Index, size is used as a proxy for liquidity, noting that senior loans with the most institutional holders will create the largest natural base of buyers and sellers. The Markit IBOXX USD Liquidity Levered Loan 100 Index measures in addition to size also liquidity, in part, based on the number of market makers who trade a specific senior loan and the number and size of transactions in the context of the prevailing bid/offer spread.

a record, totalling over $117 billion for the year – almost matching the combined volumes from 2021 ($65 billion) and 2020 ($53 billion).[7]

The secondary market trading around bank loan ETFs has led to additive liquidity to the asset class. For instance, by using the secondary to primary market ratio, a measure of trading volume of asset flows totals on the secondary market (i.e., where the shares of the ETF are traded) relative to the primary market (i.e., where authorized participants transact with the ETF issuers to create or redeem ETF shares based on market demand), we can see how much loan-related buying/selling was executed between willing buyers and sellers without a trade having to impact the primary market.

In 2022, the industry average secondary to primary market ratio was 5.02, indicating that for every $5 traded on the secondary market, only $1 hit the primary market.[8] This shows how secondary market trading in bank loan ETFs provided an additional layer of liquidity in the market for bank loans. That is why bank loan ETFs are invested in by other funds as part of their liquidity management. For example, based on the current Form 13F filings[9] for SPDR® Blackstone Senior Loan ETF (ticker SRLN), there are multiple fund investment managers listed as holders of that ETF. Given all of the above, we ask the Commission to consider what unintended liquidity risks will be presented in the market if the Proposal is adopted as drafter and that results in the elimination of bank loan ETFs as an asset class for retail, institutional and fund investors.

Bank loan funds have effective liquidity management in place

To date, no 1940 Act registered fund investing primarily in bank loans has suspended redemptions, even during the market crisis at the beginning of the COVID pandemic in March 2020. As shown by data from the LSTA, bank loan mutual funds redemptions soared from $1.85 billion (2% of Loan Mutual Fund AUM) in February 2020 to $14.4 billion (13% of AUM) in March 2020.[10] Despite this unprecedented stress, 1940 Act registered funds investing in bank loans met all redemption requests due to a number of actions taken, starting with the sale of loan assets.

It is an error to conflate illiquid investments with investments that have protracted settlement times. The illiquid bucket under the current Liquidity Rule is and should remain reserved for investments that truly cannot be sold or disposed of in seven days or less. Moreover, as shown by LSTA, the average market settlement time for all trades in the bank loan market and the time a bank loan fund needs to sell and settle a loan to meet redemptions are not the same. Looking at the median buyside sales better reflects the experience of bank loan funds when selling to meet

[7] Bloomberg Finance L.P. as of January 31, 2023, based on Bank Loan ETF category per Bloomberg classification.
[8] *Id.*
[9] Bloomberg Finance L.P. as of January 31, 2023.
[10] LSTA Comment Letter.

redemptions. Data produced by the LSTA shows the median buyside sale settlement time is nine days and it shortens in times of market stress. For example, in March 2020, the median buyside sale settlement time was seven days.[11]

However, selling loans is not the only tool for funds to meet redemptions, and in fact lags in settlement times have historically been "bridged" through the use of additional tools and mitigants. The first of such tools is cash, and bank loans generate substantial cash from frequent repayments and prepayments of the loans held by a fund. The ICI has reported that bank loan funds held almost 6% of their assets in cash equivalents as of June 2022.[12] Secondly, it is common practice for bank loan funds, to adopt a HLIM, which helps ensure that fund managers have other sources of readily accessible cash to meet redemptions. Thirdly, fund managers also commonly resort to lines of credit, used when needed, not to create leverage but to bridge the short time between the sale and settlement of loans. Finally, fund managers retain the ability to contract for expedited settlement with their dealer counterparty, thus further shortening the settlement period for loans.

All these tools are intended to address exactly the concerns the Proposal was drafted for, namely stress in the market and a sudden uptick in redemptions, so we question what additional benefits the Proposal provides beyond the measures that are currently available to bank loan funds and which have worked effectively under the current Liquidity Rule.

An alternative approach to bank loan fund liquidity management

State Street Global Advisors recommends that the Commission take an alternative approach to the liquidity management of bank loan funds. No fund can be run as if extreme stress events were the norm. If the Commission's goal is to reduce bank loan settlement periods, it should not assume that the Proposal will achieve this objective, as fund managers are not unilaterally able to shorten settlement periods. The Commission should instead seek to collaborate and support efforts by LSTA and others to develop standard terms for shortening settlement times, recognizing that this cannot be achieved during the implementation timeframe of the Proposal.

If, instead, the Commission is concerned about funds' liquidity and ability to meet redemptions in stressed market conditions, then it should require funds to better incorporate stressed scenarios into their liquidity risk management programs or by requiring funds to develop plans to address worst-case scenarios, starting with implementing the full set of mitigants mentioned above. State Street Global Advisors agrees with the fundamental principle that bank loan funds should meet investors' redemptions within the seven required days, and we wish to remain responsive to

[11] LSTA Comment Letter.
[12] See ICI Comment Letter - Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting dated February 14, 2023 ("ICI Comment Letter").

the Commission's concerns. To that end, we remain open to consider ways to strengthen our already robust liquidity management, and we would support:

- new mandatory requirements for credit lines for bank loan funds, and
- establishment of a minimum HLIM for bank loan funds at 10%.

We believe that a 10% HLIM would be considerably higher than current market practice, and high enough to withstand any sudden and extreme surge in redemptions. A percentage higher than 10% HLIM should not be considered as it would create serious obstacles in meeting funds' investment strategies and providing investors with the desired loan exposure. We believe that this new HLIM proposal of 10% for bank loan funds, together with the other current requirements in Rule 22e-4 under the 1940 Act, would be sufficient to meet extreme redemption scenarios and support the continuation of the less liquid investment bucket.

Recommendations

- *Retain the less liquid investment bucket.*
- *Introduce mandatory requirements for credit lines for bank loan funds to bridge the lags in settlement times.*
- *Introduce a minimum mandatory HLIM at 10% for bank loan funds.*
- *Support the industry's efforts to develop standard terms for shortening settlement times.*

B. Minimum value impact standard

State Street Global Advisors recommends that the Commission revise its approach to the minimum value impact standard that funds are using to classify investments. The Commission seeks to make more specific the definition of the value impact to be used when a fund analyses whether a sale would significantly change the market value of an investment. The Commission seems concerned that variations on how a fund may determine a value impact could lead to an over-estimation of the liquidity of a fund's investments.

The Proposal defines the value impact standard to be a fixed metric of 100 bps for all asset classes (except equities) regardless of market conditions or specificities of the security. Value impact standard for equities is defined to be any sale or disposition of more than 20% of average daily volume of those shares over the preceding 20 business days defined according to the U.S. trading calendar.

We believe that a fixed value impact standard will not be effective, since determining whether a trade would significantly change the market value of an investment is intimately dependent on current market conditions (which fluctuate continuously) and on the specific nature of the instrument. For instance, a 100 bps liquidation cost for U.S. treasuries or other highly rated government debt would be characterized as a fire sale by most market participants in most market conditions. Similarly in some

fixed income high yield markets, liquidation costs can exceed 100 bps routinely during non-stressed market conditions where liquidity conditions are otherwise healthy. This would effectively permanently classify these liquid instruments as illiquid simply because of the liquidity premium, which is normal for this asset class and, more importantly, specifically sought after by investors who want exposure to this asset class.

A fixed value impact standard can also lead to a positive feedback loop contributing to more fragility and an exacerbation of market liquidity stress for the broader market. In situations of moderate to severe stress, liquidation costs will rise undoubtedly and acutely since market participants will re-price risk. A flat 100 bps cost limit can be breached for investment grade corporate bond debt and will likely be breached for the high yield sector. Most funds investing in these assets could breach their 15% illiquid maximum fairly quickly and then be prohibited from buying additional debt, even though they did not experience significant outflows and have no specific need to sell assets.

Although we support the Commission's approach of standardizing the use of 20 business days for estimating a market value impact standard for equities, we believe that using U.S. trading days for calculation of average daily volume to estimate trading capacity for all global exchange listed stocks would be a mistake, since it requires the industry to factor in zero volume days in the average when U.S. markets are open, but foreign markets are closed for holidays. This would lead to artificial fluctuations in trading volume capacity despite the capacity estimate itself having remained unchanged through the holiday period.

Recommendations

- *Allow for a value impact standard limit to be based on asset classes and fluctuate with market conditions.*
- *Revise the proposed requirement to use only U.S. business days in determining the value impact standard for equities and require the use of the most recent 20 business days where the number of observations will be based on the local holiday schedule for each stock.*

II. Swing pricing and hard close

State Street Global Advisors strongly opposes both the mandatory use of swing pricing and the proposed related hard close elements of the Proposal. The Proposal would require mutual funds to adopt swing pricing and a hard close for trade orders to help operationalize the swing pricing tool. State Street Global Advisors' position on swing pricing has not changed since the Commission first proposed it in 2016 as an optional fund practice. We have generally had a good experience with swing pricing in the European fund context and we consider it a useful anti-dilution tool in certain specific circumstances, but we are not in favor of swing pricing being made mandatory for U.S. mutual funds.

We are concerned that with this Proposal the Commission would be implementing a blunt, one-size fits all approach, which seeks to impose swing pricing to all 1940 Act registered mutual funds with no attempt at tailoring the measure to fund-specific needs. Europe's experience is not instructive for the United States marketplace given that the swing pricing framework in Europe is far less prescriptive, remains optional, and leaves funds with the ability to set their own swing factors and thresholds. In addition, the European shareholder base, fund operating models and fund distribution infrastructure differ significantly from those in the United States.

Conversely in the United States, daily fund pricing, relationships between mutual funds and their extensive intermediary networks, and shareholders' ability to purchase and sell fund shares on a timely basis would all be dramatically and negatively impacted as a result of the Proposal.

We particularly oppose the hard close element of the proposed amendments due to the disruption that would bring between funds and their intermediaries. While we appreciate the Commission's efforts in trying to facilitate faster order submission, we believe that the Proposal would create a different treatment for investors. A small minority of investors who place orders directly with a fund will continue to have the ability to trade until 4:00 p.m., whereas the vast majority of investors, including retail investors investing through intermediaries and retirement plans, will see their ability to trade significantly curtailed since they will have to place their orders much earlier in the day, without the ability to potentially respond in a timely manner to market events that take place after their intermediary or recordkeeper's designated earlier cut-off time.

We believe the proposed swing pricing for 1940 Act registered mutual funds is operationally flawed, inconsistent with existing liquidity risk management practices and unlikely to address the Commission's "first mover" or "dilution" concerns. We believe such an approach will ultimately harm investors and U.S. financial markets, and we urge the Commission not to move forward with either the swing pricing or the hard close proposals and to maintain instead the flexibility under current Rule 22c-1 under the 1940 Act to permit U.S. mutual funds to utilized swing pricing, but not mandating those funds to use swing pricing.

Recommendations

- *Maintain swing pricing as an* ***optional*** *tool to address dilution risks at the fund-level.*
- *Withdraw the hard close proposal.*

III. Conclusions

State Street Global Advisors remains open to further discuss with the Commission the lessons learned during recent stress market events and how to improve current liquidity risk management programs, but we continue to believe that this should be approached in a principle-based way, avoiding one-size fits all and overly

prescriptive rules that restrict the ability of investment managers to implement flexible liquidity risk measures.

We would like to offer the Commission the following recommendations:

- Retain the less liquid investment bucket.
- Require bank funds to have credit lines where necessary to bridge the lags in loan transaction settlement times.
- Introduce a minimum mandatory HLIM at 10% for bank loan funds.
- Support the industry's efforts to develop standard terms for shortening bank loan settlement times.
- Allow for a value impact standard limit to be based on asset classes and fluctuate with the market conditions.
- Revise the Proposal to require the use of the most recent 20 business days where the number of observations will be based on the local holiday schedule for each equity.
- Maintain swing pricing as an optional tool to address dilution risks at the fund-level.
- Withdraw the hard close proposal.

We welcome the opportunity to further engage with the Commission on the topics raised in the Proposal. Please feel free to contact me at Sean_O'Malley@ssga.com should you wish to discuss the contents of this submission in greater detail.

Sincerely,

Sean O'Malley
General Counsel
State Street Global Advisors