MEMO# 35567

December 22, 2023

ICI Files Comment Letter on SEC Liquidity Proposal's Impact on Funds Investing in Bank Loans

[35567]

December 22, 2023

TO: ICI Members
Investment Company Directors SUBJECTS: Compliance
Disclosure
Exchange-Traded Funds (ETFs)
Fixed Income Securities
Fund Accounting & Financial Reporting
Fund Governance
Investment Advisers
Operations
Portfolio Oversight
Risk Oversight
Transfer Agency RE: ICI Files Comment Letter on SEC Liquidity Proposal's Impact on Funds Investing in Bank Loans

Linked below is the comment letter that ICI filed today with the SEC, which expresses serious concerns with how the SEC's proposed amendments to the liquidity rule[1] would affect mutual funds and ETFs investing in bank loans. This letter elaborates on points made about bank loan funds in our February comment letter.[2]

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, especially in rising interest rate environments. 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.

Matthew Thornton
Associate General Counsel

Notes

[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).

[2] Available at https://www.sec.gov/comments/s7-26-22/s72622-20157306-325651.pdf.