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Submitted electronically through: https://www.sec.gov/rules/submitcomments.htm

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

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

Dear Ms. Countryman,

Fidelity Investments ("Fidelity")[1] appreciates the opportunity to provide comments to the Securities and Exchange Commission ("SEC" or "Commission") on its proposed rule and form amendments relating to liquidity risk management programs and swing pricing (the "Proposal" or "Proposed Rule").[2]

Fidelity has been an active participant in the industry dialog on liquidity risk management programs and swing pricing for a number of years, including submitting comment letters on the original liquidity risk management and swing pricing proposals as well as on the SEC's proposals on money market fund reform. In response to the current liquidity risk management rule, Fidelity (like other asset management firms) built a comprehensive liquidity risk management program in support of our mutual funds and fund shareholders. Based on our experiences with that program during normal and stressed market conditions, notably the events of March 2020, Fidelity does not believe that significant changes to the rules regarding liquidity risk management are necessary. Further, Fidelity does not believe that swing pricing will improve liquidity practices among funds, or act as an effective anti-dilution mechanism.

In our view, the current principles-based requirements have provided a standard framework for liquidity practices across the industry while also allowing funds to tailor the specifics of their liquidity risk management programs to their particular risks and circumstances. While Fidelity is supportive of certain changes that the SEC has proposed, we oppose the SEC's proposal to replace the current principles-based regime with a highly prescriptive, one-size-fits-all approach. Such an approach will have negative consequences for funds and will misrepresent funds' liquidity profiles, by limiting investor choice and potentially undercutting fund

[1] Fidelity's mission is to inspire better futures and deliver better outcomes for the customers and businesses we serve. With assets under administration of $10.6 trillion, including discretionary assets of $4.0 trillion as of November 30, 2022, we focus on meeting the unique needs of a diverse set of customers. Privately held for over 75 years, Fidelity employs more than 60,000 associates who are focused on the long-term success of our customers. For more information about Fidelity Investments, visit https://www.fidelity.com/about-fidelity/our-company. Fidelity submits this letter on behalf of Fidelity Management & Research Company LLC, the investment adviser to the Fidelity family of mutual funds.
[2] *See* Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting, Release Nos. 33-11130; IC-34746, RIN 3235-AM98; File No. S7-26-22 (November 2, 2022) ("Proposing Release"), *available at* https://www.sec.gov/rules/proposed/2022/33-11130.pdf.

performance, all to the detriment of the millions of retirees and savers who rely on mutual funds to achieve their financial goals.

In addition, the application of swing pricing to mutual funds along with the introduction of the hard close will be two of the most significant changes to the structure and operation of mutual funds that the SEC has introduced in decades. In our view, these changes will have significant negative consequences on fund shareholders, which will reduce the attractiveness of the mutual fund product for investors. Mutual fund investors currently benefit from professional investment management, have access to a broad range of markets through mutual funds and have the flexibility to make buy, sell and hold decisions for mutual funds as they would if they invested in securities directly. Such substantial changes should only be undertaken after first collecting and analyzing robust data that demonstrates that a problem exists and is of a magnitude sufficient to justify such disruption. It is imperative that the SEC only move forward after adequately considering the intricacies of professional asset management, the operational complexities of fund distribution, the overwhelming benefits that the current structure of mutual funds has had for individual investors and the capital markets, as well as the significant negative consequences that the Proposal will have.

I. EXECUTIVE SUMMARY

In the remainder of our letter, Fidelity evaluates each of the primary components of the Proposal, discussing in detail the points summarized below.

Swing Pricing and Hard Close

1. ***Fidelity continues to strongly oppose swing pricing*** and believes – based on decades of experience operating in the industry, and more importantly our engagement with tens of millions of U.S. mutual fund investors – the Proposal, if adopted, will negatively impact the mutual fund market and hinder capital formation. This will, in turn, have detrimental effects on the more than 100 million Americans who have put their hard-earned money into mutual funds (for the benefits of professional investment management and diversification at low cost) in order to achieve their financial goals, such as enjoying a dignified retirement, saving for a family member's college education, or buying a home.

2. ***The SEC has failed to meet its cost-benefit analysis obligations*** for imposing swing pricing and the hard close on the mutual fund industry. The SEC offers no rigorous, data-driven analysis of the harms that the Proposal is seeking to address. In addition, the SEC's assertions that the Proposal is necessary to increase operational resilience are spurious at best and its claims that the hard close will prevent late trading are not grounded in fact.

3. ***Fidelity is deeply concerned*** with the SEC's willingness to drive forward with the Proposal without fully considering the complexities inherent in professional investment management.

4. ***Fidelity strongly objects*** to the SEC's proposal to institute a hard close as it will upend decades of standard mutual fund operations, especially the operations of broker-dealers and of retirement plan recordkeepers, in a manner that would significantly harm investors and retirement savers, decrease the attractiveness of mutual funds as an investment vehicle and drive many investors to other, less regulated products.

Liquidity Risk Management

1. ***Fidelity supports*** current Rule 22e-4[3] and its stated objective to promote effective liquidity risk management throughout the open-end investment company industry. We further believe that the Commission has already instituted a workable rule that recognizes that different funds may have varying levels of liquidity and exposure to liquidity risk, and that funds should be allowed to tailor their liquidity risk management programs to their particular risks and circumstances.

2. ***Fidelity opposes*** replacing current Rule 22e-4's principles-based approach with the Proposal's standardized, one-size-fits-all prescriptive approach. The proposed changes are not supported by historical data, will not benefit shareholders, and will add unnecessary cost and complexity.

3. ***The SEC should not eliminate the Less Liquid Investment category.*** Fidelity believes the elimination of the Less Liquid Investment category in the liquidity classification framework will create an unworkable structure for open-end bank loan funds. As a result, such funds will need to be closed and liquidated, thus limiting mutual fund investor access to an important asset class.

4. ***Fidelity strongly opposes*** the proposed substitution of a fund's reasonably anticipated trade size with a stressed 10% trade size ("STS") to determine a fund's liquidity classification. We believe that this change is unjustified, will have broad unintended consequences, and will disproportionally disadvantage larger funds and underlying fund shareholders.

5. ***The SEC's proposed definition of value impact standard is overly simplistic*** and creates a binary framework that will not produce more meaningful classification outcomes, will misrepresent the liquidity of certain securities, and will be unworkable for many. Funds should continue to be permitted the necessary flexibility offered under Rule 22e-4 to make this determination using a principles-based approach to provide the best outcomes for investors.

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[3] 17 CFR 270.22e-4 ("Rule 22e-4") under the Investment Company Act of 1940.

II. SWING PRICING

Fidelity has actively participated in the industry dialog on swing pricing since it began, including submitting comment letters on the SEC's suite of liquidity risk management rules in 2016[4] and on the SEC's 2021 proposal to implement swing pricing for institutional prime money market funds.[5] Fidelity also submitted comment letters in response to the PWG[6] and FSB[7] Reports proposing money market fund reform options. Furthermore, Fidelity has engaged in a series of direct discussions with regulators and has participated in trade association working groups on swing pricing. Based on those efforts, Fidelity continues to be concerned with regulators' attempts to impose a construct that may be appealing as an academic matter but that is inconsistent with professional investment management practices and the mechanics of fund distribution and servicing.

We are equally concerned by regulators' tendency to dismiss the very real concerns expressed by the industry over the years regarding why swing pricing is incompatible with the U.S. mutual fund market. By moving forward despite these inherent incompatibilities, the Proposal (if adopted) will have the effect of harming the mutual fund market, negatively impacting individuals who are seeking the benefits of professional investment management and diversification at a low cost, disrupting the critical role that mutual funds play in allowing individuals to save for retirement and other needs, and hindering capital formation.

A. The SEC has Failed to Make the Case for Swing Pricing

The SEC asserts in the Proposing Release that in the open-end fund structure, "fund shareholders share the gains and losses of the fund, as well as the costs."[8] This concept of the mutualization of costs and benefits has been a feature, rather than a flaw, of the mutual fund model since 1940. In return for accepting a small degree of mutualization of costs, shareholders benefit from obtaining low-cost professional management along with the diversification that can only come with the scale offered by collective vehicles such as mutual funds. In addition, mutual funds are a critical component in the process of capital formation allowing companies, the federal and state governments, and organizations such as hospitals and universities to access capital in an efficient and orderly manner.

Individual shareholders understand this value proposition when investing in open-end mutual funds and accept this concept of mutualization of costs and benefits to allow them access to professional investment management, diversification, and investment returns at low cost. When purchasing shares of a mutual fund, investors recognize there is a tacit understanding with

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[4] *See* Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release, Release Nos. 33-9922, IC-31835 (Sept. 22, 2015) *available at* https://www.sec.gov/rules/proposed/2015/33-9922.pdf. Fidelity's comment letter in response to the 2015 liquidity risk management proposal is available at https://www.sec.gov/comments/s7-16-15/s71615-45.pdf.

[5] *See* Money Market Fund Reforms, Release No. IC-34441, RIN 3235-AM80 (December 15, 2021) ("Money Market Fund Proposal"), *available at* https://www.sec.gov/rules/proposed/2021/ic-34441.pdf. Fidelity's comment letter in response to the Money Market Fund Proposal ("Fidelity Money Market Fund Comment Letter") is available https://www.sec.gov/comments/s7-22-21/s72221-20123329-279620.pdf.

[6] Fidelity's comment letter in response to the PWG Report is available at https://www.sec.gov/comments/s7-01-21/s70121-8662947-235324.pdf.

[7] Fidelity's comment letter in response to the FSB Report is available at https://www.fsb.org/wp-content/uploads/Fidelity.pdf.

[8] Proposing Release at 15.

other fund shareholders that shareholder activity will nominally impact the holdings of that asset for the investor. Shareholders also understand the underlying mechanics related to the purchase and sale of mutual funds, and in Fidelity's experience, are not concerned with the immaterial dilution associated with open-end mutual fund ownership because this process provides investors with the benefit of access to professional investment management and diversification.

The SEC further claims in the Proposing Release that "there are circumstances in which the transaction activity of certain investors leads to costs that are distributed across all shareholders, unfairly reducing the value (or "diluting") the interests of shareholders who did not engage in the underlying transactions."[9] The SEC includes no data on the costs imposed on non-transacting shareholders, acknowledging in the Release that the SEC has no "specific data about the dilution fund shareholders experienced in March 2020 because funds do not report information about their trading activity and the prices at which they purchase and sell each instrument."[10] Furthermore, the sections of the Proposing Release containing the economic baseline and the costs and benefits of swing pricing contain similar conclusions without supporting data. Rather than performing the required economic analysis based on conclusive, fact-driven evidence, the SEC hopes that the industry can provide the data sufficient to justify conclusions they have already reached.[11] Nowhere in the Proposing Release does the SEC include data quantifying the amount of trading costs or the amount of dilution typically incurred by non-transacting shareholders at any point in time. Without any such data and analysis, the SEC's basis for adopting swing pricing is built on conclusory statements and assumptions rather than sufficient evidence of a problem in need of a solution. The assertion of problematic dilution without sound evidence is not the basis upon which the SEC should regulate.

It is understandable that the SEC has been unable to quantify the amount of costs imposed on other shareholders, and, thus, the extent of the dilution created from redemptions, because open-end funds are designed and constructed to provide nearly immediate liquidity to shareholders. Rule 22e-4's already extensive liquidity requirements provide the very reason why dilution is not a material issue in open-end funds. In normal market conditions, funds can easily satisfy redemptions with liquidity on hand, even the relatively large redemptions that can occur in large funds.

Nonetheless, in addition to positing that material dilution exists, the SEC also claims that this dilution creates a first-mover advantage among investors. Without knowing the significance or materiality of the dilution based on data, the SEC claims "in times of liquidity stress, there may be incentives for shareholders to redeem fund shares quickly to avoid further losses, to redeem fund shares for cash in times of uncertainty, or to obtain a "first-mover" advantage by avoiding anticipated trading costs and dilution associated with other investors' redemptions. This perceived advantage may lead to increasing outflows, further exacerbating the effect on remaining shareholders and incentivizing increased shareholder redemptions."[12] In our view,

[9] Proposing Release at 15.
[10] Proposing Release at 23, footnote 40.
[11] Proposing Release at 293, footnote 478.
[12] Proposing Release at 16.

without knowing the scale of dilution, attributing such a motivation to a shareholder is pure conjecture.

In our view, this notion of a first-mover advantage is inherently flawed because it is based on a misunderstanding of the motivations that drive investor behavior and because, as noted above, the dilutive costs of investor behavior are not an issue in open-end funds. In our experience managing a wide array of mutual funds for more than 75 years and interacting directly with investors through our broad and extensive distribution businesses, investors in mutual funds are not motivated to redeem by the potential of bearing a portion of the costs that others' redemption behavior may impose on the fund. This is simply not an impetus that drives investors' redemption behavior. Instead, investors redeem for a variety of other reasons, such as needing to deploy their assets for other uses or adjusting their investment portfolios based on changes in market conditions, personal circumstances, or risk tolerances. The SEC's reliance on first mover advantage as a justification for the implementation of swing pricing is merely speculative.

B. <u>Swing Pricing Proposal is Inconsistent with Investment Management Practices</u>

As noted above, Fidelity has actively participated in the dialogue regarding swing pricing for some time. For example, in our comment letter on the SEC's Money Market Fund Proposal, we opposed the application of swing pricing to institutional prime money market funds for a number of reasons, including that in nearly all instances, these funds meet redemptions with immediately available liquidity.[13] In both the Money Market Fund Proposal and in the current Proposal, we are concerned with the SEC's willingness to impose on mutual funds the blunt instrument of swing pricing in a manner that seems to ignore, or at least demonstrate a lack of appreciation for, the realities of the investment process.

The rationales that drive portfolio managers of mutual funds to make buy, sell and hold decisions every day for the benefit of shareholders are multifaceted and complex. The SEC's proposal to apply swing pricing to mutual funds presumes that there is a one-to-one correlation between shareholder activity on a particular day and these investment decisions. For example, in the case of net redemptions, regardless of the magnitude of those redemptions, the fund would be obligated to adjust its NAV downward on the assumption that every day in which a fund experiences any net outflow no matter how small, the portfolio manager automatically sells securities in response. Underlying shareholder activity does not necessarily result in trading activity. In fact, satisfying shareholder redemptions using liquidity on hand rather than selling securities is a routine portfolio construction practice.

While we acknowledge that shareholder flows can serve as one input to the investment process, it is one of many. More often than not, it is difficult to trace a portfolio manager's investment decisions on a particular day to shareholder flows occurring on the immediately preceding days. Instead, the decisions that portfolio managers make are a function of a litany of

[13] *See* Fidelity Money Market Fund Comment Letter at p. 14.

factors, including the attractiveness of particular securities or sectors, recent favorable or unfavorable business indicators involving an issuer, broader portfolio construction, macroeconomic trends and economic indicators, an upcoming benchmark rebalancing, technical supply and demand for a sector or security, geopolitical risks, forward-looking portfolio strategy, changes in investment thesis, or changes in the regulatory or geopolitical landscape. Similarly, it may be the case that even when flows do occur, the portfolio manager may choose to take no action, which can serve as a means to rebalance the fund's portfolio. It is not the case that the portfolio manager reflexively adjusts his or her portfolio solely in response to every instance of net inflows or outflows.

Further, if a portfolio manager has net inflows or outflows from his or her fund on a given day, in Fidelity's experience, the portfolio manager does not then buy or sell a vertical slice of the fund portfolio to keep the fund's positioning unchanged following the inflow or outflow. The portfolio manager considers current valuations across the various market sectors and makes an asset allocation decision as to what action will, in the portfolio manager's opinion, deliver the best outcome for all shareholders over time. There are numerous examples that one could cite to demonstrate the inconsistences between the proposed swing pricing requirement and portfolio management practices. We offer one such example involving a fixed income fund managed by Fidelity during the period of market volatility at the onset of the COVID-19 pandemic. In this instance, the portfolio manager of the fund used a net outflow as an opportunity to rebalance the portfolio for the benefit of shareholders at minimal cost. The portfolio manager did not seek to recreate the same portfolio after the redemption, as the SEC's conception of swing pricing would presume.

During March 2020, a diversified core bond fund managed by Fidelity experienced a 2% net outflow on a single day. Because of the market volatility, the bond market over the previous few weeks had experienced significant volatility resulting in widening credit spreads across corporate bonds and agency mortgage-backed securities (i.e., an increase in the difference in yield between the risk-free return of a Treasury security and the return of a corporate or agency mortgage-backed security). The widening credit spreads were caused primarily by higher interest rates offered by corporate issuers in the primary market and discounted corporate bond prices available in the secondary market. In the view of the portfolio manager, the widening credit spreads presented the most attractive valuations since the depths of the global financial crisis in 2008.

Coming into this period of COVID-19 induced volatility, the portfolio manager had intentionally underweighted corporate bonds in the portfolio due to narrow credit spreads and expensive valuations. The volatile environment presented a compelling opportunity to increase the portfolio's future returns by increasing its exposure to corporate bonds at highly attractive prices. The portfolio manager did not have perfect insight into the market changes and would acknowledge that corporate spreads could have widened further. If spreads had continued to widen driven by even higher rates on new issuances and deeper discounts on existing bonds, then the value of the corporate bonds purchased by the portfolio manager would decrease because of the inverse relationship between a bond's yield and its price. However, given the portfolio manager's analysis, inclusive of spread levels at that time, the portfolio manager felt confident that over the next six to twelve months, credit spreads would tighten, and corporate bonds would outperform Treasury bonds. The portfolio manager made the decision to sell Treasury securities to fund the outflow, and in doing so, increased the fund's portfolio exposure to corporate bonds without incurring any additional transaction costs for its shareholders. Over the following six-to-twelve-month period, corporate bonds outperformed Treasury securities and all shareholders in the fund benefited from the portfolio manager's active decisions during the March 2020 period.

It is also not uncommon for funds to have small amounts of net inflows one day, followed by small amounts of net outflows the next. Even in a fund with a stable investor base, there can be normal shareholder net inflows and net outflows over a period of a few days. As we note above, the SEC has not provided sufficient evidence that the existence of these flows creates such a negative and unfair consequence for non-transacting shareholders that the drastic changes now under consideration are warranted. Furthermore, there may be no trading costs at all from these flows. For example, if a fund has a net inflow on one day followed by a roughly equivalent net outflow on the next day, it is very likely that the portfolio manager, especially for an actively managed fund, will not have made corresponding changes in the investment portfolio. There is often no need for the portfolio manager to liquidate positions to meet shareholder activity because in many instances there will be sufficient liquidity already in the fund to meet the redemption, particularly in light of the current requirements of Rule 22e-4, which obligate funds to manage their liquidity appropriately. In addition, for unexpected large shareholder redemptions, funds have access to additional resources such as interfund lending facilities, in-kind transactions and committed and uncommitted lines of credit.

Swing pricing, however, is based on the assumption that there are real trading costs that are borne by the fund every time there are net inflows or net outflows. In our example of offsetting net inflows and net outflows, the SEC's Proposal assumes that there are real costs incurred from the net inflow on day one and that there are separate and distinct costs that are borne by the fund from the net outflow on day two. In reality, these offsetting flows likely would yield no requirement for trading by the fund and, thus, no costs would be imposed on the fund. Despite this fact, the Proposal would still require the fund to adjust its NAV upward on day one (assuming it crossed the two percent threshold) and downward on day two, even though the portfolio manager did not react to the flows by engaging in any buy or sell transactions. By requiring a fund to swing its NAV even when there were no costs incurred by the fund and non-transacting fund shareholders and, thus, no dilution, swinging the NAV merely serves to penalize transacting shareholders unfairly.

The Proposal also does not account for scenarios in which portfolio managers receive large inflows and deploy the proceeds over several days. To require the swing pricing administrator to apply a swing factor to adjust the NAV up is extreme on the first day of the transaction. Nothing in the portfolio management process forces a fund to deploy newly arriving cash in a single day. More commonly, the portfolio manager decides it is better for fund shareholders to transact over several days based on where he or she believes the broader market is moving. Taking the full impact to the NAV on day one of the transaction does not reflect the realities of investment management.

Furthermore, the introduction of swing pricing ignores the benefits that already accrue to funds and shareholders from liquidity risk management programs. Even before official programs were mandated by the SEC beginning in 2016, mutual funds had competitive incentives to ensure that they engaged in prudent liquidity risk management practices. Funds with sufficiently liquid assets on hand to meet expected redemptions would face less disruption and, thus, negative consequences for shareholders, than funds that did not do so. The SEC's 2016 rule provided further benefits to funds and shareholders by introducing a consistent framework for liquidity risk management programs across funds. These programs, in their current form, help ensure that funds have sufficient liquidity available to mitigate any material disruption to shareholders that may arise from shareholder redemptions. Further, portfolio managers are motivated to ensure sufficient fund liquidity not only to meet shareholder redemption activity, but also to carry out investment thesis ideas and take advantage of attractive market opportunities.

As we note in our introduction above, the application of swing pricing to mutual funds would be one of the most significant changes to the mutual fund structure that the SEC has introduced in decades. It is imperative that, in doing so, the SEC fully account for the operations of the market it is seeking to disrupt. We are deeply concerned with the SEC's willingness to proceed with the Proposal without fully considering the complexities that underlie the asset management process. By assuming in all cases that there is a direct causal link between investment decisions and shareholder flows, the SEC has missed the mark and is not upholding its mission to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation.

C. Vertical Slice Ignores Industry Practice and Will Result in Overly Large Swing Factors

Our concerns with the disconnect between the blunt force application of swing pricing and the nuanced process of investment management are magnified by the SEC's proposed use of a "vertical slice." Fidelity does not support the use of a vertical slice of the fund when calculating a swing factor. The only funds that would buy or sell a pro rata slice of every holding in a portfolio in response to shareholder flows would be funds that fully replicate an index. All other funds (including many index funds) would never buy or sell a vertical slice in response to shareholder flows. To require the fund's swing pricing administrator to "make good faith estimates, supported by data, of the costs the fund would incur if it purchased or sold a *pro rata* amount of each investment in its portfolio to satisfy the amount of net purchases or net redemptions"[14] bears no resemblance to the actions that a portfolio manager would take and imposes significant burdens on swing pricing administrators. The concept of the vertical slice is even more troubling in the context of multi-manager funds where each sub-adviser independently exercises full discretion on how it responds to flows. Moreover, advisers to multi-

[14] Proposing Release at 113.

manager funds typically use shareholder flows to shift their overall portfolio to achieve a desired positioning, leading to a subset of sub-advisers receiving inflows while others are being redeemed.

The SEC starts with the premise (albeit one that is unquantified) that there are real costs imposed on a fund by virtue of shareholder flows, which in turn translate into dilution for other, non-transacting shareholders. As discussed at length above, we do not believe this to be the case to any extent that would justify such a drastic change as swing pricing. That said, assuming otherwise for the moment, the SEC's solution is to force funds to deploy a theoretical cost estimation based on a hypothetical purchase or sale of a vertical slice of the fund portfolio. Fidelity is concerned with such a mechanism because nearly all fund managers would never buy or sell a vertical slice of an entire portfolio in response to shareholder flows. As discussed above, active investment managers currently have the ability to manage shareholder activity effectively through the normal course of business with available tools such as liquidity on hand, in-kind transactions, large trade notifications, interfund lending facilities and committed and uncommitted lines of credit.

In addition, by charging transacting shareholders based on the purchase or sale of a pro rata slice of every holding in the fund's portfolio, as required by the Proposal, transacting shareholders will inevitably be over-charged. This can occur for a few reasons, most notably because the vertical slice requires swing pricing administrators to factor in the purchase or sale of less liquid holdings in the portfolio even though the portfolio manager would be unlikely to buy or sell these securities in response to shareholder flows. While we question whether dilution is material in funds to begin with (as noted above), we recognize that buying or selling a less liquid security can be more costly to a fund than buying or selling a more liquid security. When an investment manager purchases a less liquid security, however, he or she does so with the understanding that the security will not be sold to meet shareholder redemptions but will be used for some other purpose within the fund portfolio. Buying, selling or holding a less liquid security can represent an important, market-driven opportunity to meet or enhance a fund's (and, thus, shareholders') returns. By basing the calculation of the swing factor on a vertical slice, and thus requiring administrators to include the purchase or sale of less liquid investments, even though very few funds trade in this manner, swing factors will be unnecessarily large. This serves as an undue tax on transacting shareholders that overcompensates the fund.

Our concerns with penalizing transacting shareholders by requiring the consideration of the vertical slice are part of a broader set of concerns we have with the inherent unfairness of swing pricing. Investors do not have the ability to know whether other investors are transacting on a particular day. If a purchasing investor is lucky enough to submit a buy order on a day of net redemptions (information he or she would not have at the time the investment decision is made), that investor will pay less for the shares than if he or she had happened to buy on a day of net purchases. Similarly, small retail shareholders could be penalized based on the activities of large institutional shareholders. For example, if an individual making a small purchase just happens to submit his or her order on the same day that large institutional shareholders are also purchasing the fund, the individual will pay more for the shares than if he or she had purchased on a day when others are also not buying shares. Swing pricing arbitrarily creates winning shareholders and losing shareholders on any given day depending on the aggregate activity within the fund. The result is that certain individual shareholders will be unfairly charged a different amount for buying or selling their holdings of a fund solely due to the activity of other transacting shareholders.

D. Concerns with Market Impact Factor

Should the SEC proceed with requiring swing pricing for mutual funds, Fidelity believes the industry would benefit from additional clarity on how swing pricing administrators should calculate the market impact factor. We discussed these concerns in our comment letter in response to the SEC's proposals relating to money market funds and reiterate those concerns here. In the Proposal, the SEC indicates that the market impact factor would "reflect good faith estimates of the market impact of selling… or purchasing… a vertical slice of a fund's portfolio."[15] In addition, the swing pricing administrator is to determine the "percentage change in the value of the investment if it were purchased or sold."[16] This raises a number of questions, including:

- Over what time period? Should the swing pricing administrator estimate the market impact factor assuming the full vertical slice of the portfolio is purchased or sold on the current trading day? In exercising their fiduciary duties to funds and shareholders, advisors often determine that it is optimal to purchase or sell securities in tranches over several days.

- If the swing pricing administrator should account for multiple trading days in estimating the factor, should the administrator base its estimate on its expectations of what the market price for a security may be on subsequent days if that is when a portion of a security is most likely to be sold?

- Should the swing pricing administrator's estimation of the factor assume that the act of selling the securities does not itself drive price changes for the securities? Or, alternatively, should the estimate of the factor include a determination of the extent to which the sales by the fund will themselves drive changes in market value? If it is the latter, how should that determination be calculated?

In addition, Fidelity cautions the SEC that the market impact factor would be a highly subjective estimate based on information available at that time, but it is likely that much will not be known. Fund companies cannot be held responsible for developments arising after the time the market impact factor is calculated. For example, fund companies and others have information available on market moves of publicly traded securities in nearly real time. However, if the market impact factor should include analysis over more than one day, the swing pricing administrator will not be in a position to factor in what happens in the broader market

[15] Proposing Release at 117.
[16] Proposing Release at 117.

over the coming days. As professional money managers, fund companies are compensated for having a view into what *may* happen, but geopolitical, market and issuer-specific developments are often unpredictable and unknowable until they occur.

Furthermore, the consideration of a market impact factor will impose on fund companies a burden to calculate the factor every day for every fund even though, in the SEC's estimation, such factors would only be applied approximately one percent of the time.[17] Fund companies will not be able to wait until they know with certainty the flows for that day in order to begin calculating a market impact factor. Instead, fund companies will be forced to calculate two factors preemptively (i.e., one assuming a purchase of the vertical slice and one assuming a sale of the vertical slice) and then wait until flows are known with certainty to decide whether it must be applied. If it is the case that market impact factor is applied one percent of the time, then 99 percent of the time, the efforts to calculate the factor serve no purpose. This additional calculation introduces new processes that, in nearly all cases, will not add value for shareholders.

III. <u>HARD CLOSE</u>

Fidelity strongly objects to the SEC's proposal to institute a hard close in which an order to purchase or redeem from a mutual fund would be honored at the NAV calculated by the fund on that day only if the order is received by the fund, the fund's transfer agent or the NSCC by the time of the NAV calculation, normally 4 p.m. Eastern for most U.S. mutual funds. The hard close will upend decades of standard mutual fund operations, especially the operations of broker-dealers and of retirement plan recordkeepers, in a manner that would significantly harm investors, decrease the attractiveness of mutual funds as an investment vehicle and drive many investors to other, less regulated products.

Over the past several decades, investors have benefitted greatly from the ability to make buy, sell and hold decisions on mutual funds until just prior to the close of the U.S. equity markets at 4 p.m. Eastern. This ability has allowed investors to treat their mutual fund investments, whether being made directly with the fund, through a broker-dealer or in a retirement account, no different than their other investments. This feature properly recognizes that for many investors, their mutual fund holdings are a part of a larger portfolio of investments that may also include individual stocks or bonds as well as bank deposits and other investments. Shareholders benefit from this feature because SEC guidance has for many years allowed for the processing of trade orders after 4 p.m. Eastern provided that the order had been submitted to the fund, a broker-dealer or a retirement plan recordkeeper prior to 4 p.m. Eastern. As a result, operational processes have been built and systems have been coded in a manner that enables investors to submit orders up until the 4 p.m. Eastern deadline with the processing of these orders occurring later in the evening.

A. <u>The SEC has Failed to Make the Case for Hard Close</u>

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[17] Proposing Release at 104.

The Proposing Release cites only a few justifications for requiring a hard close. Firstly, the SEC argues that the hard close is necessary to "support the proposed swing pricing amendments by facilitating the more timely receipt of fund order flow information."[18] While we acknowledge that a hard close allows a fund to have more timely flow information for purposes of determining whether its NAV should swing on any given day, in the sections below we discuss in detail the significant disruptions and negative consequences that the hard close will impose on funds and fund shareholders.

The SEC's second justification for the hard close is that it would "help prevent late trading of fund shares."[19] In addition to offering a comprehensive suite of mutual funds, Fidelity is also a leading provider of brokerage and retirement plan recordkeeping services, which includes the sale and distribution of mutual funds offered by other fund complexes. Based on our vast experience in mutual fund operations, we do not believe that the late trading of fund shares exists. We acknowledge, as the Proposing Release does, that instances of late trading did occur two decades ago and that the SEC adopted rules at the time "to address concerns about late trading."[20] It is telling that in the Proposing Release the SEC has not cited to instances of late trading in the intervening two decades. If late trading remained a concern, one would expect that the SEC's exam protocols as well as the oversight of broker-dealers by the Financial Industry Regulatory Authority ("FINRA"), which in turn is overseen by the SEC, would have brought even some instances of late trading to light.

To our knowledge, late trading has been eradicated due to the adoption of rules by the SEC[21] and the implementation of industry-wide best practices. For electronic trade orders, as an example, Fidelity's systems have settings that ensure trades submitted prior to the "fund close" (i.e., the time of the fund's NAV calculation, normally 4 p.m. Eastern) receive the NAV calculated that day. Orders received after the fund close are coded to receive the next day's NAV unless a user takes a secondary step to override the system. An example of when a necessary override could occur is when a Fidelity transfer agent receives a paper order request prior to the fund close that is not processed (likely due to volume) until after the fund close. This override allows not for late trading, but rather the late processing of orders received prior to 4 p.m. Eastern and is subject to secondary reviews. Fidelity also has processes in place to ensure that paper orders received after the fund close automatically receive the next day's NAV. This combination of controls, which are similar to controls used by others in the industry, ensure that Fidelity does not disadvantage shareholders by engaging in late trading of mutual fund shares.

Lastly, in the Proposing Release, the SEC claims that the introduction of the hard close will "modernize and improve order processing and reduce operational risks" in addition to allowing funds to implement swing pricing.[22] As noted above, Fidelity operates a diversified fund distribution business, and we have extensive experience processing orders for Fidelity and third-party mutual funds. In our experience, the systems and processes that the industry relies

[18] Proposing Release at 129.
[19] Proposing Release at 130.
[20] Proposing Release at 130.
[21] Proposing Release at 130.
[22] Proposing Release at 131.

upon for processing mutual fund orders work effectively. While there may be minor, localized malfunctions from time to time, the industry is able to process an enormous volume (millions of individual orders each day) and dollar amount of mutual fund orders on a daily basis seamlessly. In the absence of evidence to the contrary, the SEC's claims of reducing operational risk and enhancing resilience are insufficient justifications for a change as drastic as the hard close.

We are greatly concerned that a hard close, as well as the earlier internal cut-off times that will be used by intermediaries to facilitate a hard close, will introduce greater instability and more operational risk to investors as intermediaries and mutual funds will have less time to process shareholder orders before the fund's NAV is struck. If the SEC could point to ongoing systemic breakdowns in the current processing of mutual fund orders, then reducing risk and improving resilience may have some credence. Based on the lack of any significant concerns with the current processes for handling mutual fund orders, the SEC's claims that the hard close will reduce operational risk and enhance resilience ring hollow.

B. Negative Consequences of Hard Close Outweigh any Benefits from Swing Pricing

In the Proposing Release, the SEC claims that they understand the various implications that the hard close would have on broker-dealers, retirement plan recordkeepers and ultimately fund shareholders. For example, the SEC acknowledges that "…funds and intermediaries would need to make significant changes to their business practices, including updating their computer systems, altering their batch processes, or integrating new technologies."[23] Elsewhere, the SEC acknowledges that "retirement plan recordkeepers may face particular challenges with adhering to the hard close requirement"[24] and that "[i]ntermediaries may use earlier cut-off times to provide time to transmit order flow information."[25]

Fidelity is concerned that the SEC does not fully appreciate the disruptions and negative consequences the proposal will create. Fidelity also strongly believes that because of these consequences and their resulting harm to shareholders, the SEC should not move forward with the adoption of a required hard close. In our view, these consequences far outweigh any benefit that shareholders may receive from swing pricing. As described below, the implementation of swing pricing with a hard close will negatively impact shareholders. These negative repercussions will be borne out of the systematic and operational impacts to retirement plan processing, fund of fund processing and broker-dealer processing.

Retirement Plan Processing

Several comment letters being submitted by trade associations, including those from the Society of Professional Asset Managers and Recordkeepers ("SPARK"), the Investment Company Institute ("ICI") and the Securities Industry and Financial Markets Association ("SIFMA") discuss in detail the operational complexities of retirement plan processing and the

[23] Proposing Release at 140.
[24] Proposing Release at 140.
[25] Proposing Release at 141.

impacts that the hard close will have on these processes. Fidelity agrees with the descriptions of these matters in the SPARK, ICI and SIFMA letters.

In short, similar to broker-dealers, retirement plan recordkeepers over the years have developed platforms that include processing systems and operating procedures that enable retirement plan participants to make decisions regarding the investments in their plans (including mutual funds) until 4 p.m. Eastern. Participants can submit, cancel, or resubmit orders to the recordkeeper until just prior to 4 p.m. Eastern and the recordkeeper will then submit those orders to the fund's transfer agent, using its late processing order flow, after the NAV is struck, normally in overnight cycles. This feature allows participants to react to, and make trading decisions based on, a full day's market events, as well as their own individual, often changing, personal circumstances.

In Fidelity's 30 years of experience, participants investing for retirement place great value on the current ability to transact right up until the 4 p.m. Eastern fund close time. These participants want to ensure that they receive the greatest return for their retirement income. The introduction of a required hard close will compress the time in which these participants are able to make trading decisions, resulting in several negative repercussions.

Currently, retirement plan recordkeeping systems handle the processing of mutual fund trade orders in units of share amounts, while a participant's contribution to his or her retirement plan is made in dollars. As a result, there is a conversion that must take place between the dollar contribution into the retirement plan and the share order of the mutual fund. The key variable in this conversion is the fund's NAV. Without first knowing the fund's NAV, it is not possible for recordkeepers to submit orders into the fund. Under the proposed amendments, however, a mutual fund's swing pricing administrator must make a highly confident estimate of the fund's investment flows for that day to determine whether a swing factor must be used to calculate the fund's NAV for the day. Requiring swing pricing (with or without the hard close) will thus force the retirement recordkeeping industry to spend an enormous amount of resources and time to rearchitect their systems to enable the swing pricing factor determination to be made and the NAV to be calculated.

A mutual fund hard close will force retirement plan recordkeepers, as well as broker-dealers, to adopt earlier internal cut-off times, resulting in a shortened trading window for participants. Recordkeepers must aggregate orders across participants and across particular funds before these orders can be submitted to the fund's transfer agent for processing. If the SEC persists in mandating that only fund orders received by the fund, the fund's transfer agent or the NSCC by 4 p.m. Eastern receive that day's NAV, the inevitable consequence will be to cause retirement plan recordkeepers to mandate earlier cut-off times for orders. These earlier cut-off times would be unavoidable and required to enable recordkeepers to then perform the necessary processing mechanics, such as the dollar to share conversion discussed above, for the orders to be submitted.

These earlier cut-off times could also lead to greater risk of error if a recordkeeper cannot complete all required processes prior to the 4 p.m. Eastern hard close or result in an inequal opportunity for fund shareholders whose retirement plans use different recordkeepers. For example, a retirement plan participant whose plan uses recordkeeper A with an internal cut-off time of 1 p.m. Eastern will have more time to trade than another retirement plan participant investing in the same fund whose plan uses recordkeeper B with an internal cut-off time of 11 a.m. Eastern. Based on our own experience as a retirement plan recordkeeper, as well as working with third party recordkeepers who handle the processing of Fidelity mutual funds, we anticipate that these cut-off times are likely to vary somewhat and could be as early as 10 a.m. Eastern and no later than 1 p.m. Eastern.

Furthermore, the current systems and processes enable retirement plan participants to transfer their investments between funds on the same day. These transactions are routine and are commonly known as 'exchanges.' The processing of exchanges on the same day requires knowing the funds' NAVs for that day. For example, if a retirement plan participant wishes to exchange his or her investment in Fund A (whether fully or partially) for an investment in Fund B, the redemption out of Fund A will be accomplished at today's NAV, resulting in proceeds that will be invested into Fund B. Once the amount of proceeds is known, the investment in Fund B can occur using its NAV the same day. Currently, both components of the transaction are processed at the same day's NAVs in overnight cycles once both funds' NAVs have been issued, provided the request for all orders was received by the recordkeeper before 4 p.m. Eastern.

With the introduction of a required hard close, it will not be possible to conduct the second component of the exchange (i.e., the investment into Fund B) on the same day. Even if the retirement recordkeeping industry were to invest in massive systems enhancements and adopt cutting edge technology for the instantaneous processing of retirement plan orders, it will never be possible for the proceeds from the liquidation of Fund A to flow into Fund B on the same day as the NAVs of Fund A and Fund B will both be calculated as of the same time (4 p.m. Eastern). As a result, exchanges that currently can be accomplished on the same day will now take two days to process, the effect of which is to introduce market risk for participants.

In addition, by moving the second component of the exchange transaction (i.e., the investment into Fund B) to the following business day, the SEC is forcing unnecessary changes to the structure of retirement plan investments generally. Currently, there is no functionality in place enabling retirement plans to hold uninvested cash because all transactions can be accomplished in one day. The changes that the SEC is mandating will force every retirement plan holding mutual funds to require this functionality, opening retirement plan participants to unnecessary risk and operational instability. The SEC acknowledges the "particular challenges" that its Proposal will pose retirement plan recordkeepers.[26] Developing this functionality would certainly qualify as one of many of the challenges that recordkeepers will face. In our view, these challenges are acute, will require the enormous expenditure of resources to solve, and will

[26] Proposing Release at 140.

negatively impact the experience and increase risk for investors, all for the alleged benefit of swing pricing.

We anticipate plan sponsors who are able to do so will move away from open-end mutual funds entirely and into collective investment trusts (or, "CITs") as plan investment options in order to avoid the foregoing negative impacts. Despite the enormous benefit that the mutual fund structure has had for retirement plan participants over the last three decades, the hard close is likely to cause sponsors to move away from funds into less regulated products to circumvent the aforementioned challenges.

Those sponsors whose plans are large enough to support the offering of CITs are likely to begin offering only CITs because of the significant negative feedback they are likely to receive from plan participants from being forced to comply with early cut-off times, from losing the ability to complete exchanges on the same day and from now being exposed to unnecessary market risk that these outcomes will introduce. The net effect of the move to CITs and away from mutual funds, in addition to participants' losing the benefit of the comprehensive set of regulatory protections that a mutual fund affords, will be the reduction of the participants' range of available investment options.

At the same time, CIT offerings are typically only viable for larger plans and, thus, not all plan sponsors will be able to shift to CITs. Moreover, we believe it is likely that retirement plan recordkeepers will impose early cut-off times, and that same-day exchanges will be unavailable, for both mutual funds and CITs when they are made available in the same plan. It will not be feasible for recordkeepers to have separate processes for mutual funds and CITs offered in the same plan because of the complexity of communicating, let alone administering, separate cut-off times and order dates for each separate investment option in a plan.

By requiring a hard close, the SEC will create two classes of retirement plans – (i) those who can make the shift fully to CITs and, thus, can continue to offer investment decision authority until just prior to 4 p.m. Eastern time as well as same-day exchanges and (ii) those who will be forced to remain in mutual funds and, with respect to mutual funds and any other investment options held in their plans, implement early cut-off times, eliminate same-day functionality for processing exchanges, and introduce unnecessary market risk for plan participants.

Fund of Fund Processing

Shareholders who invest in funds of funds will be negatively impacted by the hard close in a manner similar to participants in a retirement plan. Currently, the industry processes orders into and out of funds of funds after the close of the market at 4 p.m. Eastern provided the orders were submitted to an entity (normally, a broker-dealer or a retirement plan recordkeeper) prior to 4 p.m. Eastern. For purposes of the following discussion, we use the terminology of the investor buying or selling the top-level or "acquiring fund" in a fund of funds structure and the acquiring fund then investing in several bottom-level or "acquired funds."[27]

Transactions in funds of funds involve two sets of orders. First, shareholders submit orders to purchase or redeem shares of the acquiring fund. Second, based on the net aggregation of the shareholders' orders of the acquiring fund, the acquiring fund will then submit orders to purchase or redeem the acquired funds. For example, if the acquiring fund experiences a net inflow (based on the netting of the various purchase and redeem orders received from shareholders that day), the acquiring fund will then submit orders to purchase additional amounts of each of the acquired funds that it holds. As noted above, the processing of these transactions currently occurs after the close of the market provided that the orders to purchase or redeem from the acquiring fund were received prior to 4 p.m. Eastern.

If the SEC imposes the hard close, funds of funds are likely to adopt early cut-off times similar to retirement plans – perhaps as early as mid-morning Eastern time. These early cut-off times will be necessary to provide the funds, their transfer agents, and administrators time to receive and net the orders of the acquiring fund and then submit the orders to purchase the acquired funds, all of which must be complete by 4 p.m. Eastern. As we discuss in detail below, earlier cut-off times change the value proposition for mutual funds and introduce unnecessary market risk for mutual fund shareholders, the combined effect of which will be to decrease the attractiveness of mutual funds as an investment vehicle.

Broker-Dealers

The SEC acknowledges in the Proposing Release the impact that the introduction of the hard close will have on broker-dealers. For example, the SEC states that, to implement the hard close, "funds and intermediaries would need to make significant changes to their business practices, including updating their computer systems, altering their batch processes, or integrating new technologies that facilitate faster order submission."[28] We agree with the SEC that broker-dealers, who serve as intermediaries between the end investor and the fund company, will have to make drastic modifications to their business practices and systems in order to implement the hard close. We also agree with the recitation of the challenges that broker-dealers will face described in the ICI and SIFMA letters.

It is difficult to overstate the magnitude that the hard close will have on the financial services industry, including broker-dealers. The hard close will impact nearly every component of mutual fund trade order processing, result in years and years of implementation work (far beyond the unrealistically short compliance dates that the SEC has proposed), require the expenditure of vast sums of money, drive industry consolidation and significantly and negatively impact mutual fund investors. It is important to note that this industry, which the Proposal would significantly disrupt, efficiently handles the processing of *millions* of mutual fund trade orders every day without issue.

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[27] This terminology matches the use of similar terms by the SEC in Rule 12d1-4 under the 1940 Act. *See* 17 USC 270.12d1-4.
[28] Proposing Release at 140.

If the SEC moves forward with the hard close, broker-dealers will adopt earlier order cut-off times to allow time for the various processes that broker-dealers must complete before they can submit orders to the fund company. This includes, among other processes, the aggregation of orders, compliance testing, monitoring for and processing the application of contingent deferred sales charges and monitoring for cancelation of orders received earlier on the same day. In addition, earlier cut-off times are necessary to allow broker-dealers to submit the aggregated orders by fund to the NSCC prior to 4 p.m. Eastern. As we describe in detail below, we are deeply concerned with the SEC's cursory treatment of the consequences of earlier cut-off times for investors. In the case of broker-dealers, these cut-off times are likely to be at least several hours earlier than the market close of 4 p.m. Eastern.

Based on data from Fidelity's brokerage operations, earlier cut-off times will impact a significant portion of the mutual fund orders submitted each day. Approximately 35% of any given day's mutual fund orders on Fidelity's primary retail website are submitted between the hours of 2 p.m. and 4 p.m. Eastern. Further, approximately 30% of any given day's mutual fund orders submitted through Fidelity client representatives occur between the hours of 2 p.m. and 4 p.m. Eastern. It is clear investors rely upon and utilize these late afternoon hours to submit trade orders. The SEC's hard close requirement will eliminate this option for shareholders.

Negative Impacts to Investors

The net effect of the proposed hard close will be the adoption of earlier cut-off times at intermediaries, as well as the processing of certain retirement plan transactions over multiple days. Both outcomes will expose shareholders to additional market risk and eliminates a key feature of mutual funds – the ability to trade into and out of mutual funds each day until just prior to the market close at 4 p.m. Eastern and receive same-day pricing. In our view, these consequences alone significantly outweigh any perceived benefits that mutual fund shareholders may experience from the implementation of swing pricing.

The SEC recognizes that this is a likely outcome in the Proposing Release. In a brief section of the Release, the SEC discusses the effects of the proposed hard close on investors. The cursory treatment of these effects alone underscores the degree to which the SEC misunderstands the significance of the impacts that the hard close will have on investors.

First, in just one sentence the SEC concludes that most mutual fund shareholders are long-term investors and, thus, their orders are not time sensitive.[29] No further explanation of this rationale is provided. While it is true that many shareholders do invest for the long term, that does not imply that their orders are not time sensitive and is not a sufficient justification for exposing shareholders to additional market risk. We caution the SEC against relying on such generalities when the decisions that each investor makes on when and what to buy and sell are personal and unique to each investor. In addition, it is fair to assume that investors prefer to buy

[29] Proposing Release at 145.

at lower prices and sell at higher prices. Even when investing for the long term, shareholders wish to maximize their returns, and many will submit orders on the day (and the time of day) they believe is most advantageous based on their circumstances.

Second, the SEC claims that intermediaries are likely to set cut-off times that "are only incrementally earlier than current cut-off times."[30] As noted above, cut-off times are likely to vary by intermediary. In our view, broker-dealers are unlikely to establish cut-off times any later than 1 p.m. Eastern (10 a.m. Pacific). Retirement plan recordkeepers may set cut-off times as early as mid-morning Eastern time. The earlier in the day that the cut-off time is set, the greater the market risk that investors are forced to bear. Either the investor meets that cut-off time and is exposed to no less than three hours of market uncertainty (in the case of a 1 p.m. Eastern cut-off time) or the investor does not meet the cut-off time and the person's order is held until the NAV is calculated over 24 hours later. In addition, the cut-off times that we anticipate impact investors to a greater degree as one moves from east to west. With cut-off times as early as 10 a.m. Eastern, investors residing on the West Coast may only have until 7 a.m. Pacific to make investment decisions for the day.

Third, the SEC posits that investors who are concerned with receiving same-day pricing for a mutual fund order will be able to submit that order directly to the fund's transfer agent.[31] Before brokerage accounts grew in popularity, it was possible to submit orders directly with the fund's transfer agent through a mutual fund only account. That is no longer the case. Trading directly with a fund's transfer agent is not a practice that exists with any scale or regularity in the industry and will not serve as a solution for fund shareholders wishing to submit their fund orders after 1 p.m. Eastern. Furthermore, mutual fund only accounts have been supplanted by brokerage accounts for a number of reasons, including that brokerage accounts allow an investor to buy, sell and hold their mutual fund investments alongside their other security holdings (stocks, bonds, etc.) in one account. Mutual fund only accounts require investors to establish separate accounts for each fund company. In addition, brokerage accounts have features that customers value, including the use of cash sweep vehicles for the temporary investment of cash, check-writing, and debit cards, among other features. These features were not available to mutual fund only accounts.

Rather than brushing past the real and negative consequences to shareholders from the adoption of the hard close, we encourage the SEC to consider these impacts in detail. In our view, any benefits that may arise from swing pricing (if any in fact do exist) are far outweighed by the risks imposed on mutual fund shareholders from earlier cut-off times. Currently, investors can decide to take a certain degree of market risk by choosing to submit their orders earlier in the day. (Normally, however, those investors have the ability to cancel these orders prior to 4 p.m. Eastern.) If an investor decides to accept that risk, that is that person's choice. The SEC's Proposal will effectively *require* shareholders to take that market risk if they wish to invest in a mutual fund, removing investor choice and flexibility. Furthermore, as noted above, in some

[30] Proposing Release at 145.
[31] Proposing Release at 145.

instances such as certain retirement plan transactions, the market risk could last for several days, further disadvantaging these investors.

The risk the SEC is requiring shareholders to accept by adopting the Proposal will result in greater market exposure over longer periods of time as intermediaries implement internal cut-off times, increasing the likelihood of risk of loss for shareholders over time. In Fidelity's experience, missing even just a small number of market days can be extremely detrimental to an investor. For example, a shareholder who invested $100,000 on January 1, 1990, and stayed fully invested until February 28, 2022, would have earned $951,000 using the S&P 500 Compound Annual Growth Rate. If that same shareholder was not invested on the five best performing market days over that time period, he or she would only have earned $590,000. The investor would have lost an additional $155,000 if they were not invested on the five next best performing market days over that time period.

The inevitable result of the SEC's Proposal will be to disrupt the smooth and efficient functioning of the mutual fund industry that has benefitted investors and the capital markets so well for many years. As earlier internal cut-off times are established, it is likely that different intermediaries (as well as different retirement plan recordkeepers) will have differing cut-off times based on their own internal processing capabilities. This will lead to further confusion for investors and an inconsistent experience in which an investor could place an order to purchase a mutual fund in their brokerage account as well as in their retirement account on the same day, only to find that they will receive different prices due to each transacting intermediary's cut-off time.

In an attempt to impose on transacting shareholders the costs of their transactions, costs that the SEC admits they are unable to quantify, the SEC has introduced a complicated formulation of swing pricing that bears no resemblance to actual investment management practices. Knowing that swing pricing is incompatible with the industry's current practices for the processing of mutual fund orders, millions of which are processed every day with no issue, the SEC has proposed the hard close, which eliminates a key beneficial feature of mutual funds – the ability for investors to make investment decisions until just prior to the market close. The net effect of the SEC's Proposal, if adopted, will be to impose on mutual fund shareholders additional risk and force the industry to spend enormous resources rearchitecting the processes for handling mutual fund orders, which in turn will decrease the attractiveness of mutual funds and drive investors away from the product.

IV. LIQUIDITY RISK MANAGEMENT

Fidelity supports Rule 22e-4 and its stated objective to promote effective liquidity risk management throughout the open-end investment company industry. Most particularly, we support the current requirement that funds adopt and implement a written liquidity risk management program. We further believe that the Commission already has in place a workable rule that recognizes that different funds may have differing levels of liquidity and exposure to liquidity risk, and that funds should be allowed to tailor their liquidity risk management programs to their particular risks and circumstances. Each fund's individually tailored liquidity risk management program also allows these funds to take on risk according to shareholder expectations and risk tolerances. The liquidity classification framework currently required by Rule 22e-4 has provided clarity and standardization to guide industry participants in measuring the liquidity of portfolio investments. Additionally, while Rule 22e-4 does specify certain standards, it also provides funds with an appropriate amount of flexibility in implementing those standards.

Fidelity agrees with the Commission's desire for improved comparability and consistency across funds. However, as described more fully below, we emphasize that replacing the current Rule 22e-4 principles-based approach with a standardized, prescriptive approach will not produce more meaningful outcomes for fund shareholders and will misrepresent funds' liquidity profiles, add unnecessary costs, and diminish fund returns to the detriment of fund shareholders.

A. Sweeping Amendments to Rule 22e-4 Are Not Necessary

Fund Liquidity Levels Have Proven Sufficient in all Market Environments

Fidelity's funds have a longstanding and unblemished track record of meeting shareholder redemptions through a variety of market conditions. Our fund managers focus on the liquidity needs of their funds as an integral part of portfolio construction and fund structure, considering both normal and stressed market conditions.

The adoption of Rule 22e-4 introduced a standard framework for registered open-end funds, excluding money market funds, for assessing and managing liquidity risk. Based on Fidelity's experience, this rule has served to promote stronger and more effective liquidity risk management practices and we fully support its objectives. Pursuant to Rule 22e-4, Fidelity funds have adopted and implemented a robust liquidity risk management program. The program has uncovered liquidity risk factors that are common across most funds as well as other less prevalent factors and has provided a platform for such factors to be managed and mitigated. The current liquidity risk management requirements under Rule 22e-4 provide suitable flexibility for funds to assume investment risk according to their mandates and investors' expectations. Rule 22e-4 also supports investor access to investments with a broad range of risk-return profiles while allowing funds to play the important role of supporting capital formation for the development of businesses and economic growth.

Rule 22e-4 defines "liquidity risk" as "the risk that [a] fund could not meet requests to redeem shares issued by the fund without significant dilution of remaining investors' interests in the fund."[32] Liquidity risk is therefore dynamic in nature and varies across asset classes, within various market conditions, and among different types of funds. Investor risk tolerance, personal financial needs, and investment expectations help inform how to allocate their investments among a variety of stocks, bonds, and mutual funds. As risk tolerance, financial need, and investment expectation levels change, including during times of market stress, the various fund

[32] Rule 22e-4(a)(11).

types are affected differently. Indeed, during periods of acute market stress, including the recent market stress experienced in March 2020, Fidelity observed shareholder outflows in some of its funds and inflows in others. Over this period, all Fidelity funds prudently managed their unique liquidity risks and met shareholder redemption requests without issue. Considering the dynamic nature of fund management and shareholder flows, we strongly oppose the Proposal's overly prescriptive, formulaic, and one-size-fits-all approach to fund liquidity risk management. The current liquidity management structure under Rule 22e-4 sufficiently supports the SEC's mission for effective liquidity risk management and the amendments under the Proposed Rule are therefore unnecessary.

B. Fidelity Opposes a Number of Highly Disruptive Proposed Amendments

Fidelity supports the current Rule 22e-4 liquidity risk management framework and believes the Proposed Rule does provide some effective enhancements as discussed below in Section C. However, we are equally concerned that other key elements of the Proposal will not improve liquidity risk management, including during periods of market stress, such as the market events of March 2020. Moreover, certain proposed changes will individually and collectively interfere with a fund's ability to effectively manage its liquidity resulting in fund shareholder harm. Fidelity does not believe the amendments discussed below are necessary and will not provide the SEC with its desired result of enhancing fund liquidity risk management during times of market stress.

Elimination of the Less Liquid Investment Category

Fidelity strongly opposes the SEC's proposal to remove the less liquid investment category from the liquidity classification framework and the treatment of those securities as illiquid investments. Like other proposed changes to the liquidity classification framework, this change will relegate many securities with active and accessible marketplaces to the illiquid investment category and thereby distort fund liquidity profiles. However, even more concerning is the highly detrimental impact to funds investing in bank loans and the consequence of making dedicated open-end bank loan funds unworkable.

The less liquid category in today's framework consists of investments that can be sold in seven calendar days but that may take longer to settle. While the current liquidity classification framework can result in many types of investments being classified as less liquid, this category most often consists of bank loan investments due to their non-standard and typically longer settlement conventions.

(a) Consequences Are Fatal to Open-End Bank Loan Funds

Bank loans are debt securities issued by companies or other entities with floating interest rates that reset periodically. Bank loans are often issued in connection with recapitalizations, acquisitions, leveraged buyouts, and refinancings and therefore provide a vital source of capital for businesses. Bank loans also provide an important balance sheet management tool used by banks and other financial intermediaries to hedge block loans made to consumers. They offer a unique risk-return profile relative to other asset classes and can be an important element of portfolio diversification for mutual fund investors. Bank loan funds are a critical segment of the floating rate market benefiting shareholders when central bank policy rates are rising, and other asset classes are underperforming. In fact, for the twelve months ending October 31, 2022, bank loans outperformed nearly all other fixed-income asset classes in a turbulent period of rising interest rates and widening credit spreads.[33] Further, mutual fund investors are unable to obtain the type of market exposure bank loans provide from any other investment vehicle. Bank loans are typically structured and administered by a bank that acts as the agent of the lenders participating in the loan. Bank loans are readily tradable in the public marketplace; however, to minimize the risk of loss and misappropriation, the agent's documentation of the transfer process is often extensive and longer than traditional investment types. This fact pattern regularly assigns bank loans to the less liquid investment category.

Despite their longer trade settlement conventions open-end funds can invest in bank loans while also managing liquidity risk. Fidelity has managed open-end bank loan funds for over 20 years and currently offers four dedicated bank loan funds to various investor bases. These four funds represented a total of $14.67 billion in assets under management as of the year ending 2022 and have had a proven record of continuously meeting shareholder redemption requests since their inception through all manner of market environments. In the current regulatory regime, most securities held in Fidelity's bank loan funds are categorized as less liquid. The proposed amendments to remove the less liquid investment category would cause these funds to drastically exceed the limitation on funds' illiquid investment holdings. Based on a recent analysis, Fidelity estimates that eliminating the less liquid investment category will cause each of these funds' portfolios to hold illiquid investments in excess of 90% of their respective total net assets, drastically exceeding the 15% limitation. As a result, bank loan funds will no longer be viable in their current open-end structure, and they will need to be liquidated or restructured. Furthermore, we do not believe that closed-end fund or other alternative fund structures are suitable, preferable or accessible to most existing shareholders. The forced closure of these funds will reduce overall investor choice by eliminating investors' ability to access a highly desirable asset class.

(b) HLIMs Effectively Manage Bank Loan Fund Liquidity

Fidelity supports the current Rule 22e-4 requirement for funds that do not primarily hold assets that are highly liquid investments to determine and maintain a highly liquid investment minimum ("HLIM").[34] Due mainly to the extended settlement times required for bank loan investments, Fidelity's bank loan funds have each established and maintain an HLIM. The HLIM requirement under Rule 22e-4 is consistent with Fidelity's prudent portfolio management practice of maintaining a balance of cash equivalents and other highly liquid investments, such as Treasury and high-quality corporate bonds, as a readily available source of portfolio liquidity for these funds' typical and reasonably foreseeable cash flow needs. The current rule

[33] *See* Fidelity Advisor Floating Rate High Income Fund Annual Report ending October 31, 2022.
[34] Rule 22e-4(b)(1)(iii).

requirements also allow each fund to consider its unique liquidity risk factors and historical shareholder redemption patterns in determining an appropriate HLIM. Since the adoption of Rule 22e-4 and the imposition of the HLIM requirement, Fidelity's bank loan funds have consistently remained compliant with their respective HLIM levels and have successfully met shareholder activity.

(c) Other Readily Available Liquidity Sources Can Bridge Settlement Periods

In furtherance of our views expressed above, we would like to emphasize to the Commission that along with the current required HLIM, bank loan funds have other means of accessing liquidity during unexpected times of market stress or shareholder activity. These sources can be used as a temporary measure to finance the redemption requests of shareholders or for other short-term liquidity needs. As discussed below, and consistent with many other Fidelity funds, Fidelity's bank loan funds have established various liquidity sources outside of typical highly liquid investments. These sources include borrowing arrangements made via an interfund lending facility, and both uncommitted and committed bank lines of credit. We disagree with the SEC's assertion that the costs of these borrowings dilute the value of the fund for remaining investors. Rather, we consider these arrangements to be important secondary sources of liquidity and a component of prudent and effective liquidity risk management. These secondary sources of liquidity render the SEC's proposed amendments unnecessary as all types of open-end funds, including bank loan funds, are able to manage and access liquidity during times of market volatility or unexpected shareholder activity.

(d) Recommended Alternative

Fidelity believes the Proposal's mandated 10% HLIM is arbitrary and dramatically overstates the amount of highly liquid investments that a fund should reasonably hold each day, as supported by the Commission's data.[35] Consistently managing funds to a perceived worst-case scenario could jeopardize shareholder returns as funds are forced to reposition their portfolios to comply with a rule requirement that is not grounded in fact. Nevertheless, in the interest of preserving the viability of dedicated open-end bank loan funds and in recognition of their unique liquidity risk factors, Fidelity proposes that the Commission adopt a standard 10% HLIM exclusively for bank loan funds. We believe that a required 10% HLIM for bank loan funds accompanied with the liquidity program administrator's discretion to assess each fund's liquidity risk factors and determine a higher HLIM if appropriate, is a reasonable alternative to eliminating the less liquid investment category.

Assumed Trade Size

Fidelity strongly opposes the proposed substitution of a fund's reasonably anticipated trade size with a stressed 10% trade size to determine a fund's liquidity classification. We

[35] Proposing Release at 47.

believe that this change is unjustified, will have broad unintended consequences, and will disproportionally disadvantage larger funds and their shareholders.

(a) Support of the Current Standard

Fidelity believes that market depth is a necessary consideration when making liquidity classification determinations and supports the current Rule 22e-4 principles-based requirement that funds consider the sizes of investments that the fund would reasonably anticipate trading and whether trading in such sizes could significantly affect the investment's liquidity. This framework aligns liquidity classification methods with the practices used by portfolio managers to construct a fund's portfolio of investments and manage the liquidity risk factors applicable to the fund.

We consider each fund's historical shareholder subscription and redemption activity over time, including over periods of market stress, and believe this historical data to be the most effective consideration in determining a fund's anticipated future shareholder activity and its corresponding liquidity needs. Therefore, in practice, Fidelity currently establishes each fund's reasonably anticipated trade size based on its historical shareholder activity, while also considering other fund specific liquidity risk factors including shareholder ownership and concentration, investment objectives and strategies, portfolio concentration, borrowing arrangements and other funding sources, and in-kind or other shareholder transition management activities employed by the fund. This is a hybrid principles-based approach that uses objective data inputs to distinguish funds with highly stable shareholder flows and relatively minimal cash outflow projections from funds with more volatile shareholder flows and less predictable cash outflow projections. We believe this type of hybrid approach provides the best outcome for fund shareholders as each fund determines its reasonably anticipated trade sizes on an individual basis and does not treat the shareholders of any one fund unfairly.

We acknowledge the SEC's desire to further standardize the classification framework while also promoting more deliberate consideration of reasonably foreseeable stressed conditions. However, we are concerned that a 10% STS is not only unsupported in fact and does not accurately reflect portfolio management practices, it also oversimplifies the liquidity determination to the detriment of shareholders. If the SEC is determined to move forward with a framework change, we suggest that the assumed trade size classification variable be required to be determined based on a fund's actual flow history excluding flows satisfied through in-kind transfers of securities (e.g., a fund's 95th percentile highest week net outflows over the most recent 3-years).

(b) A 10% Stress Level is Unreasonable and is Not Supported in Fact

The level of stress the SEC proposes incorporating into a fund's liquidity classifications is unjustified and unreasonable. In the Proposal, the analysis conducted by the SEC staff indicated that weekly (not daily) outflows greater than 6.6% occurred 1% of the time in a pooled sample across funds over a period of more than ten years.[36] Even on its face this analysis would not justify requiring every open-end mutual fund to operate under the assumption of a daily outflow of 10%. Furthermore, the weekly fund flow data utilized in the SEC's historical flow analysis would inherently include regular and occasionally outsized asset reallocation events that skew any estimations. These outsized asset reallocation events are typically highly coordinated events that utilize advanced trade notifications to manage liquidity and dilution risks. In other cases, shareholder flows of significant size are routinely satisfied through in-kind transfers of securities thus avoiding the need to sell portfolio investments.

In Fidelity's experience, daily shareholder outflows of such a magnitude are exceedingly rare when not associated with planned fund events or transitions, even in the most volatile and stressed market conditions. The SEC's own data reported in the Proposal indicates that a daily 10% STS is a gross overcalculation of shareholder outflows, even when including times of market stress in the analysis. The SEC's premise also fails to consider shareholder behavior when redeeming fund investments. In Fidelity's experience, shareholders are not taking redeemed proceeds completely out of the market. Rather, and especially during times of market volatility, investors become more risk averse and typically reinvest redemptions in more conservative mutual funds (e.g., short term bond funds). Fidelity's analysis of shareholder activity from January 2020 through June 2020 revealed that 298 Fidelity funds had net outflows over the period, while 297 Fidelity funds had net inflows during the same period. Even during the onset of the COVID-19 induced market volatility, investors were investing just as often as they were redeeming from funds.

Fidelity's analysis of daily shareholder outflow information for each of our funds over a five-year period spanning from 2018-2022 shows that outflows of over 7% on any given day occurred only 0.08% of the time. Based on this analysis, it is clear the SEC's proposed requirement to include a 10% STS in a fund's daily calculation of liquidity only serves to harm shareholders. The SEC makes the unreasonable and unnecessary leap from their weekly analysis of shareholder outflows to a daily requirement which is almost double the amount borne out of the SEC's own data. Fidelity's analysis of actual daily shareholder outflow information further evidences the point that a 10% STS is a startling overestimation. To propose that funds should be subject to such a high level of stress on a daily basis is based solely on an assumption not supported by fact. The negative consequences for shareholders include potential loss of return and a potential misalignment between shareholder expectation and actual experience.

(c) The Proposal Misrepresents Portfolio Liquidity Levels and Will Have Damaging Consequences to Investors

Through an internal analysis of the Fidelity family of funds applying the proposed 10% STS, we observe that this change will distort the liquidity risk profile of most funds and will require many funds (including several Fidelity flagship funds) with longstanding track records of successful liquidity risk management to rebalance their portfolio compositions to comply with

[36] Proposing Release at 47.

the Proposal's liquidity limits and alter their portfolio management strategies. The rebalances will be a necessity to comply with the 10% STS, not because of any tangible liquidity concerns within these funds.

This required fund rebalancing will inevitably result in a fund unnecessarily dedicating a higher percentage of its portfolio to more liquid securities in order to meet the 10% STS. As a result, shareholder returns are likely to be diminished over time as portfolio managers are forced to override prudent fund management guided by the fund's stated strategy in exchange for liquidity standards influenced by an unsubstantiated 10% STS. In addition to a loss of return, adopting a 10% STS could also result in a disconnect between shareholder expectations and what mutual funds constrained by higher liquidity are able to provide. In Fidelity's experience, mutual fund investors generally seek to create an investment blend that considers their personal time horizon as well as their risk tolerance. These investors understand the inverse relationship between return and risk and appreciate Fidelity's ability to strike the proper balance when providing investment services. Adopting a 10% STS will challenge Fidelity's and our peer manager's ability to provide shareholders with active, long-term balanced investment management.

Effective fund liquidity risk management requirements must provide flexibility for funds to be able to assume investment risk according to their mandates and investors' expectations, for investors to have access to investments with a range of risk-return profiles, and for funds to play the important role of supporting capital formation for the development of businesses and the economy. Mandating a 10% stress level and the consequential changes to how funds must be managed thereafter will negatively affect the performance of many funds and adversely alter the options available to investors without any supported justification.

(d) The Proposal Will Disproportionately Impact Larger Funds Without Justification

The proposed 10% STS will have a negative impact on most open-end mutual funds, but this proposed amendment taken in combination with the proposed updates to the value impact standard will create acute challenges for funds with considerable assets under management. Take for instance, an existing Fidelity fund that was analyzed internally using the proposed amendments and that currently has approximately $24.4 billion in total net assets under management. Since January 1, 2020, on days when this fund has had net shareholder redemptions, the average net redemption amount was just 0.031% of the fund's net assets. Furthermore, the fund's largest single day of net redemptions was only 1.297%, which occurred on April 6, 2020, at the height of the COVID-19 pandemic-induced stressed market conditions. Given the fund's size, the impact of the Proposed Rule's 10% sale assumption and the value impact standard calculation will result in a significant portion of the fund's investments being classified as other than highly liquid, solely because the assumed sale of 10% of the fund's underlying securities will result in a significant market impact. In some cases, a large fund may breach the maximum illiquid investment ownership limit of 15% as a result. To require such a fund to operate under the assumption of a daily 10% redemption amount would fundamentally change the fund without justification. The fund would be prevented from aligning investments with its stated investment objective and strategies and forced to be managed in a way that is more conservative than is necessary to the detriment of shareholders.

(e) Other Readily Available Liquidity Sources Mitigate Stressed Conditions

Current Rule 22e-4 requires that funds consider borrowing arrangements and other funding sources when assessing and managing their liquidity risks. As mentioned earlier, many Fidelity funds have established various liquidity sources outside of typical highly liquid investments. These sources, such as borrowing arrangements made via an interfund lending facility, or uncommitted and committed bank lines of credit, represent other sources of liquidity which are available to temporarily finance the redemption requests of the fund's shareholders or for other short-term liquidity needs. Fidelity funds also generally maintain a certain level of cash holdings on a day-to-day basis to ensure shareholder redemption requests are met. We believe fund shareholders are better served by using these types of safeguards against extraordinary and unanticipated levels of shareholder redemptions rather than a 10% STS and its detrimental consequences.

Value Impact Standard

Rule 22e-4 requires that funds classify the liquidity of portfolio investments based on the time it will take for the security to be sold and/or converted to cash without the sale or disposition significantly changing the market value of the investment. Within Rule 22e-4's FAQs the SEC acknowledged "that these price impact assumptions are subjective, due to the variety of inputs that may reasonably be used by any fund or portfolio manager. Accordingly, the staff believes that what constitutes a significant change in market value may vary by fund, asset class, or investment. Therefore, the staff believes that a fund does not need to employ as a price impact assumption a fixed amount or percentage, and a fund may have differing standards for different investments and/or asset classes, although a fund may also choose to use a fixed number if reasonably determined."[37] Fidelity supports this measured approach by the staff and believes that a one-size fits-all approach to calculating a security's value impact standard does not provide any benefit to shareholders.

Simply put, the proposed amendments to the definition of a security's value impact standard would impose an overly simplistic binary framework that will not produce more meaningful classification outcomes, will misrepresent the liquidity of certain securities, and will be unworkable for many. These proposed prescriptive changes should not be adopted, and funds should continue to be permitted the necessary flexibility to make this determination using a principles-based approach.

The adopting release of Rule 22e-4 contains guidance on liquidity classification factors that a fund could consider as part of its process for classifying the liquidity of portfolio

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[37] *See* Investment Company Liquidity Risk Management Programs Frequently Asked Questions (February 21, 2018) ("FAQs"); *available at* https://www.sec.gov/investment/investment-company-liquidity-risk-management-programs-faq.

investments. These nine factors appropriately recognize that the liquidity of portfolio investment can and often does require consideration of a variety of factors, including trading volume as one factor.[38]

While Fidelity agrees that average daily trading volume is often an appropriate input in assessing a listed security's market depth and liquidity, it must be taken into consideration with other qualitative and quantitative factors. These factors can include observations about price volatility, market elasticity, bid-ask spreads, concentration of ownership, the primary and secondary markets in which the security trades, the quality and number of market participants, and many other relevant variables. A standard that imposes a single, simplified percentage of trailing average daily trading volume calculation disregards these other considerations and most certainly will routinely generate anomalous and unreliable results. For example, securities that trade primarily in a foreign market that observed an extended market holiday would appear less liquid than they are in the days immediately following the closure. In other cases, a determination made based on trade volume alone may relegate many otherwise very liquid mid- and small-cap securities to lower liquidity categories, as these securities have lower volume trading markets. Even more counterintuitive, given that many stressed market periods induce heightened trading activity, many listed securities could have atypically higher trading volume and therefore, appear more liquid than they are in times of stress when measured by this variable alone.

As it relates to securities that are not exchange-traded, Fidelity similarly does not support the proposed 1% price impact standard. Fundamentally, the proposed standard assumes that "price impact" is a measurement that can be calculated with exacting precision. In fact, the irregularity of trading and variability of market transparency for many non-exchange traded securities necessitates that a constellation of liquidity classification factors be examined and that elements of subjective judgement be applied to estimate the potential price impact of hypothetical trades of various sizes. For this reason, liquidity risk program administrators, often assisted by vendor models and data, have implemented a variety of classification techniques to support compliance with the established rule. Furthermore, the fact remains that what constitutes a significant change in the market value of unlisted securities often varies by asset class, investment size and the market climate. Indeed, a 1% price impact standard may objectively be too high for certain securities and too low for others, ultimately leading to unfair outcomes for shareholders. To assume that a one-size-fits-all standard can be implemented and will be universally appropriate is impractical, imprudent and not in the best interest of shareholders.

Other Liquidity Classification Framework Changes

The adoption of an assumed trade size and a predetermined calculation for the value impact standard will misrepresent a fund's liquidity profile and result in unnecessary harm to shareholders. Beyond these harmful changes, the Proposal also includes other classification framework changes that will intensify the disruptive impact. The proposed liquidity

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[38] *See* Investment Company Liquidity Risk Management Programs; Release Nos. 33-10233; IC-32315; RIN 3235-AL61; File No. S7-16-15 (October 13, 2016), *available at* https://www.sec.gov/rules/final/2016/33-10233.pdf.

classification framework changes discussed above will individually and collectively cause many securities that would be classified as highly liquid under existing Rule 22e-4 to become categorized as moderately liquid, and in some cases, illiquid. The resulting classification migration will distort the true liquidity profiles of many funds and create the unnecessary need to adjust the portfolio holdings of funds in some instances. Fidelity believes that any benefit of the Proposal is outweighed by the highly detrimental impact to shareholders, which includes the associated diminution of fund returns and added costs borne by the funds and fund investors.

(a) Modifying the Illiquid Investment Definition

Rule 22e-4 codified a 15% limit on funds' illiquid investments consistent with long-standing Commission guidelines. The rule also introduced a new definition of an illiquid investment that generally maintained the industry standard. To date, an investment is considered illiquid based on the fund's ability to dispose of the investment in the ordinary course of business within seven calendar days. This definition provides a clear, consistent standard for all funds to apply. Funds have incorporated this standard into their liquidity risk management practices and in certain cases the investment industry has structured trading practices and security demand features to conform to the standard.

Fidelity opposes the proposed change to the definition of illiquid investments because it will fundamentally change a well-established industry norm, be disruptive and costly to implement, and not serve to improve the classification of investments or liquidity risk management practices. Shareholders will derive no benefit from the proposed alternative definition, as it will only result in disruption.

(b) Introduction of a Convertible to U.S. Dollar Standard

Fidelity opposes the proposed change to the settlement period definition requiring all classification standards to include convertibility and settlement to U.S. dollars. Introducing this change without also including commensurate settlement time to the definition unjustly reformulates the currently accepted industry standard and will unnecessarily distort fund liquidity profiles.

The Proposal amends the settlement period of every liquidity classification category to require that funds include the additional time needed to convert any sale proceeds into U.S. dollars. It also amends the illiquid classification category to require funds to include the additional time needed to settle a sell trade. As a result, a fund will have less time to sell a security in order to qualify the security as liquid. This additional time is not included in the current industry standard used to classify liquidity and the amendment modifies the calculation without justification. While industry efforts have realized, and continue to seek, improvements in the settlement times through advances in technology, settlement conventions continue to vary across investment types and in most cases take one to several business days.

Furthermore, many foreign securities may not qualify as highly liquid investments despite a fund's ability to sell the security in one or two calendar days. Under the proposed settlement framework, these securities will become moderately liquid when the additional time is included to convert the sale proceeds to U.S. dollars. Investors in these funds will be unfairly disadvantaged by the definitional change as these underlying securities will no longer be categorized as highly liquid.

The proposed changes will also introduce complicated analysis of the differences and interaction between the U.S. market and international market trading, settlement calendars and market closures beyond what is done currently. Under today's classification framework, there is considerable operational adjustment required when foreign markets recognize extended holiday closures that the U.S. market does not. The Commission has acknowledged that extended holiday closures do not present the type of liquidity risk that Form N-RN was designed to flag. The proposed changes would give rise to more frequent technical breaches of a similar type.[39] For example, consider occasions when the U.S. markets and funds are closed on a Monday in observance of a market holiday. In these cases, most securities classified as moderately liquid securities under today's standard would be considered illiquid on the Friday preceding the long weekend using the proposed framework. Consider also instances in the U.S. financial markets when bond markets are closed, and equity markets are open on the same day. When the U.S. Bond market and banks observe a holiday closure, but the U.S. stock markets and mutual funds remain open, such as Indigenous People's Day or Veteran's Day, the liquidity classification standard for all U.S. bonds will shift by a business day, causing many liquidity classifications to be altered unnecessarily. These classification changes may even necessitate the adjustment of a fund's portfolio, causing unnecessary transaction costs and potentially leading to reduced returns for shareholders.

Further, in many cases these reclassifications will result in false-positive, technical violations of the 15% illiquid limit or proposed 10% HLIM requirement and will give rise to unnecessary escalations and reporting. In the end, the effect of these proposed changes will not produce more meaningful classification outcomes or serve to improve liquidity risk management practices. Instead, these changes will result in many securities alternating back and forth between classification categories not because their liquidity characteristics have changed but because of the technicalities of the classification framework during otherwise routine market environments.

(c) Day Count Requirement

The proposed requirement to include the day of classification when determining the number of days a security needs to be converted to U.S. dollars is inconsistent with Fidelity's current practice and is contradictory to the standard practice of most funds throughout the mutual fund industry. By including the day of classification in the calculation, conversion timeframes

[39] *See* Investment Company Liquidity Risk Management Programs Frequently Asked Questions (February 21, 2018) ("FAQs"); *available at* https://www.sec.gov/investment/investment-company-liquidity-risk-management-programs-faq.

for purposes of liquidity classifications will be extended, resulting in the misleading classification of certain securities.

Under the new proposed framework, as explained in the Proposing Release, to classify a security as highly liquid on a Monday, it must be sold, converted into U.S. dollars and settled no later than Wednesday.[40] This is contradictory to Fidelity's process and the standard processes accepted by the broader industry. Today, that same security is classified as highly liquid on a Monday if it may be sold and settled by Thursday. The proposed amendments effectively remove a full business day from the calculation.

This change will misstate the liquidity profile of certain securities, as these highly liquid securities will be relegated to the moderately liquid category despite a fund's ability to sell and settle such security within three business days. The amendment will not serve the SEC's goal to better prepare funds for times of market volatility and will only harm shareholders by misrepresenting a fund's liquidity risk profile.

(d) Classification by Asset Class

Fidelity believes the proposed amendment to eliminate the use of classification by asset class is unnecessary. Fidelity understands that Rule 22e-4 currently does not allow asset class-based classification when a fund has information concerning any market, trading or investment-specific considerations that are reasonably expected to significantly affect the liquidity characteristics of a specific investment compared to other portfolio holdings in that asset class. We agree that asset class level classification administered in a manner that is inconsistent with this standard should be addressed by the Commission. However, many securities within an asset class or a sub-asset class are viewed by the marketplace as comparable and interchangeable with other securities within the same asset class or sub-asset class. For these types of securities, liquidity classification methods regularly consider comparable securities to determine an individual security's liquidity classification, including in estimating the individual security's market depth or the value impact of hypothetical trades of various sizes. Furthermore, it is appropriate and necessary in many cases to classify or reclassify portfolio investments based on common structural characteristics (e.g., demand features, restrictions on trading) or market conditions (e.g., market closures, trade sanctions) that broadly affect an asset class, sub-asset class or a category of securities. Fidelity recommends that any rule change that is advanced with respect to asset class-based classification should recognize and permit these practices.

C. Adopting Modest Best Practices Will Enhance Consistency and Incrementally Improve Rule 22e-4

Fidelity applauds the SEC for its efforts to continually improve shareholder protections through ongoing regulatory review and enhancement. To that end, while Rule 22e-4 promotes effective liquidity risk management, we think that certain enhancements would strengthen the

[40] Proposing Release at 68.

existing rule. Fidelity believes that the following practical amendments to Rule 22e-4 – each of which are elements of the Proposal – are broadly attainable and would strengthen an already effective regulatory framework.

Daily Classification Monitoring

Fidelity has already adopted daily monitoring of liquidity classifications for each of its funds as a means to recognize and respond to market changes that impact a fund's portfolio liquidity. Fidelity agrees with the Commission that daily classification of securities "promote[s] better monitoring by liquidity risk program administrators of a fund's liquidity and an ability to more rapidly understand and respond to changes that affect the liquidity of the fund's portfolio."[41] More specifically, in Fidelity's experience, daily classification allows for the effective management of the day-to-day compliance monitoring procedures relating to limitations on illiquid investments and highly liquid investment minimums (as applicable) for each fund.

However, consistent with Frequently Asked Questions guidance published by the SEC relating to Rule 22e-4 and the concept of "provisional classifications", Fidelity believes that a Liquidity Program Administrator should be afforded the opportunity to verify daily classification procedure results prior to concluding that a fund has fallen below its highly liquid investment minimum (as applicable) or exceeded the 15% limitation on illiquid investments.[42] Fidelity urges the Commission to adopt daily classification monitoring that incorporates the previously published guidance.

Fair Valued Investments

Consistent with the Proposal, Fidelity agrees that investments whose fair value is measured using an unobservable input that is significant to the overall measurement, such as FASB Topic 820 Level 3 securities, should be generally classified as illiquid investments. However, we do not believe, and caution the SEC against the belief, that an investment's fair value measurement leveling considerations and methods directly correspond to its liquidity classification considerations and methods, and that these considerations should be linked. Nevertheless, to support the SEC's objective to improve consistency and comparability of liquidity classifications we do not object to a requirement that Level 3 securities be deemed to be illiquid investments.

D. <u>Form N-PORT Reporting Requirements</u>

The Proposal will require reports on Form N-PORT to be filed within 30 days of month-end and made public 60 days thereafter.[43] Rule 22e-4 currently requires open-end mutual funds

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[41] Proposing Release at 42.
[42] *See* Investment Company Liquidity Risk Management Programs Frequently Asked Questions (February 21, 2018) ("FAQs"); *available at* https://www.sec.gov/investment/investment-company-liquidity-risk-management-programs-faq.
[43] Proposing Release at 200.

to file monthly information with the Commission on Form N-PORT within 60 days after the end of each quarter and only information submitted for the third month is made public each quarter. The Proposal will also require open-end mutual funds to provide information concerning the aggregate percentage of a reporting fund's portfolio represented in each of the newly proposed classification categories, which will also be made publicly available.[44]

Fidelity does not support the changes to the Form N-PORT filing requirements because we believe that the increased reporting frequency and additional publicly disclosed data will not add to the transparency that the Commission seeks. Shortening the reporting lag period from 60 to 30 days will strain the reporting process used for all funds and will most acutely challenge funds with complex investment strategies such as alternative funds and may leave insufficient time to compile all required data accurately. Additionally, we oppose the SEC proposal to report fund holdings on Part F of Form N-PORT in compliance with Regulation S-X for each month-end and note open-end fund investors currently have monthly access to portfolio holdings through fund company public websites, which in concert with current Form N-PORT public reporting requirements, provide the meaningful reporting transparency that investors require. In Fidelity's experience, existing disclosure and reporting satisfy investor needs for fulsome and timely data. There is no evidence that the proposed additional data will enhance the shareholder experience. Should the SEC decide to require such changes, we urge the Commission to adopt a filing deadline of at least 45 days to allow appropriate time for preparation and review of all Form N-PORT information.

Fidelity also does not support public disclosure of either the percentage of a fund's assets in each of the three liquidity categories or the underlying asset-level liquidity classifications because such disclosure could mislead investors and may lead to imprudent investment behavior. Paradoxically, those funds employing a conservative approach to liquidity classifications could appear less liquid than their more permissive peers, introducing a competitive disadvantage for funds whose managers seek to address liquidity risk in a prudent manner. We think the current Form N-PORT reporting requirements provide the Commission with useful non-public data to effectively monitor fund liquidity, a suitable period for all reporting, and believe no changes are necessary.

E. Conclusion

Fidelity does not support the Commission's proposed amendments to Rule 22e-4 and believes the current liquidity risk management framework addresses the concerns raised in the Proposing Release. Fidelity believes the implementation of modest best practices through regulation will enhance the current framework without disproportionately impacting certain funds and their shareholders. The proposed amendments will unnecessarily misstate the liquidity of certain funds, create an unworkable structure for bank loan funds, and disadvantage fund shareholders by requiring funds to reallocate portfolio holdings.

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[44] Proposing Release at 206.

V. COMPLIANCE DEADLINES

A. Swing Pricing and Hard Close

Implementing a new SEC rule requires time, attention and resources. As noted above, the implementation of a hard close to facilitate swing pricing is the greatest change to the mutual fund industry in decades. It is difficult to estimate accurately the time and resources required to update current technology and implement the required new processes for such sweeping modifications. However, to ensure effective compliance that will not result in unnecessary disruption to shareholder activity, we request a compliance deadline of four years.

B. Liquidity Risk Management Program

The SEC proposes a 12-month compliance period to comply with all proposed amendments to Rule 22e-4, including the removal of one liquidity category, the use of a set stressed trade size and the implementation of daily classifications. While Fidelity is supportive of the SEC's proposal to implement daily classifications within 12 months, as we believe this is currently an industry best practice, we are equally concerned with such a brief time period for the implementation of amendments we do not believe are necessary or beneficial to shareholders.

The Proposal's amendments to Rule 22e-4 discussed in Section IV, will result in several negative consequences, including the total disruption and potential elimination of bank loan funds, as well as the unjustified disproportionate adverse impact on large funds. As laid out above, the proposed amendments to Rule 22e-4 will not provide any benefit to fund shareholders. To allow for the effective transition of certain funds and their shareholders, Fidelity requests a compliance deadline of 30 months.

C. Reporting and Disclosure Requirements

The SEC proposes a 12-month compliance date for the proposed amendments to Forms N-PORT and N-CEN, except the swing pricing disclosure in Form N-PORT, and a 24-month compliance date for all swing pricing related disclosure in Forms N-PORT and N-1A. The SEC also proposes a 24-month compliance date for all hard close related requirements in Form N-1A. The proposed reporting and disclosure requirements will result in exponential increases in the volume of information reported, such that resources will need to be dedicated to the implementation of these reporting changes on a full-time basis. Fidelity requests a compliance date of 30 months for all updated reporting requirements. Additionally, Fidelity requests the filing deadline be extended to a minimum of 45 days to provide enough time to compile and verify such large amounts of complex data. We are concerned that 30 days will not provide the industry with sufficient time to ensure accurate reporting given the quantity of data at issue.

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Fidelity would be pleased to provide further information, participate in any direct outreach efforts the Commission undertakes, or respond to questions the Commission may have about our comments.

Sincerely,

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

William Birdthistle, Director, Division of Investment Management

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