INVESTMENT COMPANY INSTITUTE

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October 25, 2022

The Honorable Gary Gensler
Chair, US Securities and Exchange Commission
100 F Street NE
Washington DC 20549-1090

Re: Rule 15c2-11 and 144A Debt Securities

Dear Chair Gensler:

The Investment Company Institute[1] (ICI) is writing to reiterate our concerns about applying Rule 15c2-11 to fixed income securities. While we continue to request that the Commission not apply the rule to fixed income securities broadly,[2] we are most immediately concerned about its application to Rule 144A debt securities, especially those of private issuers ("Private 144A Debt Securities"), including those whose information may not be publicly available.[3]

Effectively limiting the current Commission staff no-action relief for Rule 144A debt securities to Phase 1 (*i.e.*, until January 3, 2023) may lead to abrupt reductions in liquidity and transparency in this market.[4] Registered funds ("funds") are important investors in Rule 144A debt securities. If broker-dealers determine that they cannot comply with the rule's requirements,

[1] The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$28.8 trillion in the United States, serving more than 100 million US shareholders, and US$8.1 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington.

[2] We previously expressed our concerns about applying Rule 15c2-11 to fixed income securities broadly. *See* Letter from SIFMA AMG, ICI, IAA, MFA, and CCMC to Gary Gensler, Chair, SEC (Sept. 23, 2021).

[3] For purposes of this letter, we refer to "Private 144A Debt Securities" as the debt securities of private issuers, which include issuers whose information is not publicly available (*e.g.*, non-reporting companies). We echo similar concerns about the expiration of relief for Private 144A Debt Securities expressed by a broad cross-section of other important market participants, including liquidity providers, fixed income investment managers, and issuers. *See, e.g.*, Letter from Kenneth E. Bentsen, Jr., President and CEO, SIFMA, to Gary Gensler, Chair, SEC (June 10, 2022) ("June 2022 SIFMA Letter"); Letter from The Credit Roundtable to Gary Gensler, Chair, et. al, SEC (June 21, 2022); Letter from Chris Netram, Managing Vice President, National Association of Manufacturers, to Gary Gensler, Chair, and Haoxiang Zhu, Director, Division of Trading and Markets, SEC (July 18, 2022).

[4] The staff no-action letter states that Rule 144A securities that do not meet the criteria in Appendix B of the letter would not qualify for relief in Phase 2 unless the broker or dealer determines that there is "current and publicly available information" about the issuer. Letter from Josephine Tao, Assistant Director, Division of Trading and Markets, SEC, to Racquel Russell, Senior Vice President and Director of Capital Markets Policy, Office of the General Counsel, FINRA (Dec. 16, 2021) at 2.

then their reduced trading activity would impair the liquidity of these securities, funds' ability to value them accurately, and advisers' ability to seek best execution for their clients. This outcome would impose costs on fund investors and be inconsistent with the Commission's longstanding goal of promoting investor protection.

Therefore, we request that Commission staff extend the relief as currently provided under Phase 1 for Rule 144A debt securities from Rule 15c2-11 until the later of (i) January 5, 2026, three years after the end of Phase 1; or (ii) the compliance date for any amendments to Rule 15c2-11 that address its applicability to fixed income securities, including Rule 144A debt securities. We strongly urge the Commission and Commission staff to use this three-year extension period to carefully revisit the issue through a formal rulemaking process that addresses the costs and benefits of applying the rule to fixed income securities in a transparent manner and allows market participants to provide meaningful comment.[5]

If the Commission still determines to move forward with applying Rule 15c2-11 to Rule 144A debt securities without engaging in a rulemaking, then we request that the Commission or Commission staff provide advance notice one year prior to the end of this three-year extension period. Such notice would be necessary to provide adequate time for (i) broker-dealers to determine how to comply with the rule for these securities, including making necessary operational and technical changes, and (ii) funds and advisers to determine how to adapt their portfolios to expected changes in market transparency and liquidity.

We explain each of our concerns further below and provide data that demonstrates the importance of Rule 144A debt securities, particularly Private 144A Debt Securities, to funds.

I. Funds are Significant Investors in Rule 144A Debt Securities

Registered funds, which include mutual funds, exchange-traded funds (ETFs), and closed-end funds that are regulated under the Investment Company Act of 1940, are significant investors in Rule 144A debt securities.[6] Many funds invest in Rule 144A debt securities, which include a significant number of high-yield corporate bonds and asset-backed securities, typically as part of portfolios sought by investors seeking a higher level of current income across a diverse group of fixed income products.

To assess the extent to which funds invest in Rule 144A debt securities overall and Private 144A Debt Securities specifically, ICI examined the latest available portfolio holdings reported on

[5] We note, as others have, that the Commission's economic analysis for the 2020 amendments to Rule 15c2-11 focused on the rule's impact related to OTC equities and does not specifically address the costs and benefits as applied to fixed income securities, including Rule 144A debt securities. *See Publication or Submission of Quotations Without Specified Information*, SEC Release Nos. 33-10842; No. 34-89891 (Sept. 16, 2020) at 215, 85 Fed. Reg. 68124, 68184 (Oct. 27, 2020).

[6] Rule 144A applies to resales of qualifying securities to "qualified institutional buyers" (QIBs), which are entities that in the aggregate own and invest on a discretionary basis at least $100 million in securities of issuers. Funds are a specifically enumerated category of QIB. Securities Act Rule 144A(a)(1)(i)(B).

Form N-PORT of 327 high-yield mutual funds and ETFs ("high-yield funds").[7,8] Using these Form N-PORT filings, we identified the securities held by high-yield funds and collected additional data on these securities, including information on security offerings and security issuers.[9] This information helped ICI estimate the extent to which high-yield funds invest in Rule 144A debt securities generally and Private 144A Debt Securities in particular.

Based on this analysis and as depicted in Table 1 below, ICI estimates that 305 high-yield mutual funds and ETFs (over 93% of all open-end high-yield funds) hold Rule 144A debt securities. These funds collectively hold $194 billion of investments in 2,236 individual Rule 144A debt securities (Table 1). Additionally, we conservatively estimate that nearly $76 billion of this amount is comprised of investments in at least 1,148 Private 144A Debt Securities.[10] This suggests that high-yield funds on average allocate over 39% of their Rule 144A debt securities investments to Private 144A Debt Securities—a significantly higher proportion than the 11% portion of Rule 144A debt securities issued in 2021 that are attributable to private issuers.[11] This highlights the importance of Rule 144A debt securities of private issuers to high-yield fund investors.

[7] These 327 open-end high-yield funds, including 243 mutual funds and 84 ETFs, correspond to all open-end bond funds whose investment objective was classified as "high-yield" by ICI in the second quarter of 2022. These high-yield funds collectively had total net assets of $410 billion as of June 30, 2022.

[8] ICI used the latest available Form N-PORT filing for each high-yield fund, which spanned May through July 2022. Approximately 25% of the funds had a filing date of May 31, 2022, 45% had a filing date of June 30, 2022, and the remaining 30% had a filing date of July 31, 2022.

[9] ICI obtained this information from Refinitiv. Security offering details allowed ICI to identify securities that were Rule 144A offerings. Additionally, ICI used each security issuer's legal entity identifier ("LEI") reported on Form N-PORT to obtain information on the issuer's corporate ownership and structure (*e.g.*, whether the issuer was publicly traded or was privately held) from Refinitiv. We note that nearly 33% of the Rule 144A debt securities, accounting for $63.1 billion in value of portfolio holdings across high-yield funds, had missing LEIs in their Form N-PORT filings, and as a result, information on issuers' ownership and corporate structure could not be obtained. We conservatively assumed that these Rule 144A debt securities were *not* issued by private companies. Accordingly, estimates of Private 144A Debt Securities in Tables 1 and 2 should be considered a conservative *lower bound* of funds' exposure to these securities.

[10] *See supra*. ICI conservatively excluded all Rule 144A debt securities with missing information on issuers' ownership structure from its estimate of Private 144A Debt Securities.

[11] *See* June 22 SIFMA Letter. SIFMA has noted that the value of total Rule 144A issuances across issuer types were approximately $1.36 trillion in 2021. SIFMA, *The Collision of Rule 15c2-11 and Rule 144A* (Sept. 19, 2022), https://www.sifma.org/resources/news/the-collision-of-rule-15c2-11-and-rule-144a/. Additionally, SIFMA has estimated that this $1.36 trillion amount includes at least $150 billion (or approximately 11%) in Rule 144A debt securities issued by private companies in 2021. *See* June 2022 SIFMA Letter.

Table 1: High-Yield Funds Hold $194 Billion in Rule 144A Debt Securities, Including Nearly $76 Billion in Private 144A Debt Securities*

Type of Fund	Rule 144A Debt Securities		Private 144A Debt Securities		Proportion of Private 144A Debt Securities**
	Number of Securities	Value of Securities ($ billion)	Number of Securities	Value of Securities ($ billion)	
Mutual Funds	2,172	156	1,111	61	38.8%
Exchange-Traded Funds	1,678	38	725	15	40.6%
Total	2,236	194	1,148	76	39.1%

* Includes high-yield mutual funds and ETFs with investments in Rule 144A debt securities as of the funds' latest Form N-PORT filings in 2022.
** Calculated as the ratio of value of Private 144A Debt Securities to value of Rule 144A debt securities.
Source: ICI calculations of Form N-PORT and Refinitiv data.

ICI also examined the proportion of assets that funds holding Private 144A Debt Securities allocated to these securities and the extent to which these allocations varied across funds. This analysis shows that

- At least 300 high-yield mutual funds and ETFs (nearly 92% of all open-end high-yield funds) hold Private 144A Debt Securities, which account for a significant portion of their assets (Table 2). For example, Private 144A Debt Securities on average account for nearly 20% of assets of these high-yield funds.

- These securities account for more than 23% of assets for half of these funds and more than 34% of assets for 10% of these funds. This further highlights the importance of privately issued Rule 144A debt securities to high-yield fund portfolios.

Table 2: Private 144A Debt Securities Account for a Significant Portion of Assets of High-Yield Funds That Hold These Securities*

Type of Fund	Number of Funds	Total Net Assets ($ billion)	Private 144A Debt Securities ($ billion)	Percent of Assets Invested in Private 144A Debt Securities				
				Average	10th percentile	Median	90th percentile	Maximum
Mutual Funds	227	320	61	19.7	1.6	23.1	34.6	47.8
Exchange-Traded Funds	73	68	15	19.6	1.5	24.3	33.4	45.2
Total	300	389	76	19.7	1.6	23.4	34.2	47.8

* Includes high-yield mutual funds and ETFs with investments in Private 144A Debt Securities as of the funds' latest Form N-PORT filing in 2022. Assets may not add to the totals presented because of rounding.
Source: ICI calculations of Form N-PORT and Refinitiv data.

II. Applying Rule 15c2-11 to Rule 144A Debt Securities Would Not Benefit Funds or Their Investors

Given funds' significant investments in the Rule 144A markets and the comprehensive regulatory framework that governs their investment activity, we see no benefit to funds or their investors in applying Rule 15c2-11 to Rule 144A debt securities. Funds are comprehensively regulated under the Investment Company Act of 1940. Among other things, the Act and its rules impose on funds specific valuation-related responsibilities[12] and (on open-end funds) liquidity risk management requirements.[13] Every fund is overseen by a board of directors, which reviews and approves contracts between the fund and its service providers (including the fund's investment adviser), approves policies and procedures to ensure the fund's compliance with federal securities laws, and oversees and reviews the performance of the fund's operations (including its valuation and liquidity risk management programs) and its key service providers (including its investment adviser).

Moreover, funds are managed by SEC-registered investment advisers subject to the requirements of the Investment Advisers Act and rules thereunder. Under federal law, an investment adviser is a fiduciary, and the fiduciary duty an investment adviser owes to its clients (including funds) comprises a duty of care and a duty of loyalty. The Commission has stated that an investment

[12] *See, e.g.*, Investment Company Act section 2(a)(41) and Investment Company Act Rules 2a-5 and 22c-1 thereunder. *See generally* ICI, *Fund Valuation Under the SEC's New Fair Value Rule* (Dec. 2021), *available at* www.ici.org/system/files/2021-12/21-ppr-fund-valuation-primer.pdf.

[13] *See* Investment Company Act Rule 22e-4.

adviser's duty of care includes "the duty to seek best execution of a client's transactions where the adviser has the responsibility to select broker-dealers to execute client trades."[14] Thus, decisions to buy or continue holding any portfolio investment—including Private 144A Debt Securities—are subject to all applicable requirements under the Investment Company Act and Investment Adviser Act and the rules and guidance thereunder, along with any fund-specific investment strategies and policies.

In light of these requirements, funds and their advisers typically do not invest in Private 144A Debt Securities where they do not receive or otherwise have access to sufficient information about an issuer to evaluate the appropriateness of an investment. In fact, while funds and advisers are entitled under Rule 144A to request and receive a meaningful amount of "reasonably current" information[15] from a non-reporting issuer, we note that they often may request even more information about the issuer than is required under Rule 144A or would be required under Rule 15c2-11. In contrast to other markets,[16] ICI members have not cited significant challenges or difficulties in obtaining sufficient and timely information about a Rule 144A issuer to inform their investment decisions.

III. Applying Rule 15c2-11 to Rule 144A Debt Securities Would Harm Funds and Their Investors

Given the Commission's current intent to apply Rule 15c2-11 to fixed income securities, the length of relief for Rule 144A debt securities is too short to address the many related legal and operational complexities of doing so. Our understanding is that broker-dealers are taking steps to identify the securities and issuers for which compliance may or may not be feasible, including whether issuer information is publicly available. However, because of the vast number of Rule 144A debt securities—including Private 144A Debt Securities—that trade in the secondary market and the review process that would be required on an issuer-by-issuer basis, we anticipate that this process and related operational changes will not be completed by the end of Phase 1. We also understand that funds have started to assess the potential impact of Rule 15c2-11 on their portfolios with respect to valuation and liquidity risk management, but they have found it challenging to do so without more certainty regarding broker-dealers' efforts prior to the end of

[14] *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, SEC Release No. IA-5248 (June 5, 2019), 84 Fed. Reg. 33669 (July 12, 2019).

[15] This information includes a brief description of the issuer's business, products, and services; the issuer's most recent balance sheet, profit and loss statement, and retained earnings statement (the financial statements must be audited if audited statements are "reasonably available"); and similar financial statements for the two preceding fiscal years. Securities Act Rule 144A(d)(4)(i).

[16] *See, e.g.*, SEC Fixed Income Market Advisory Committee, *Recommendation Regarding Timeliness of Financial Disclosures in the Municipal Securities Market* (Feb. 10, 2020) (highlighting issues with timely disclosure of financial information from municipal issuers), *available at* https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-muni-financial-disclosures-recommendation.pdf; and SEC, *Report on the Municipal Securities Market* (July 31, 2012) (highlighting issues with timeliness and scope of municipal issuers' disclosure), *available at* https://www.sec.gov/files/munireport073112.pdf.

Phase 1. As of now, we anticipate that many of them will likely either pause or restrict their market making activities—at least in the short-term—for many of these securities.[17]

Therefore, applying Rule 15c2-11's requirements will have considerable negative implications for funds' significant holdings of Rule 144A debt securities—as shown in Tables 1 and 2 above—with respect to valuation, liquidity risk management, and seeking best execution. Given the SEC's emphasis on these fund and adviser responsibilities, it would be ironic and deeply problematic if Commission or Commission staff action—or now, inaction—at diminished all three or led to divestment of these securities at impaired prices. We explain each of these consequences in more detail below.

First, fewer available indications of interest or quotes will impair price discovery and transparency for existing securities, which could create challenges with respect to fund valuation. A well-functioning valuation process is critically important to funds and their shareholders.[18] Funds and pricing services alike rely on dealer quotes to inform their valuation estimates and determinations. A reduction in dealer activity—quoting activity, trading activity, or both—would reduce the overall quantity and quality of information that funds and pricing services incorporate, which would make valuation of these securities more difficult and likely less precise.

Second, Rule 144A debt securities could become less liquid. Open-end funds issue redeemable shares, and therefore they must adequately manage the liquidity of their portfolios so that redemption requests can be satisfied in a timely manner. In the adopting release for Rule 22e-4 (the "liquidity rule"), the Commission opined that "a high frequency of trades or quotes for a particular asset class or investment tends to indicate that a particular asset class or investment has relatively high liquidity."[19] Moreover, the Commission stated that "[d]iversity of market participants, on both the buying and selling sides of transactions, may also be a significant point for a fund to consider because it tends to reduce market concentration and may facilitate a market remaining liquid during periods of stress."[20] To the extent that broker-dealers reduce their

[17] We understand that broker-dealers could seek to offer liquidity and transact in Rule 144A debt securities with investors on a bilateral basis, which we believe would not constitute the publication of quotations on a "quotation medium" pursuant to Rule 15c2-11. Our members are not aware of whether they intend on doing so after the expiration of Phase 1. We emphasize, however, that this would be an unwelcome development—bilateral trading by itself would reduce market transparency, increase trading inefficiency, and impede the recent advancements in electronic trading of Rule 144A debt securities. Electronification has led to, among other positive developments, increased availability of high-quality pre-trade data from liquidity providers across a broader range of instruments. The availability of more data has allowed fund advisers to trade on a more informed basis with better price discovery through means that mitigate information leakage, which ultimately has benefited fund investors through lower transaction costs.

[18] "Proper valuation, among other things, promotes the purchase and sale of fund shares at fair prices, and helps to avoid dilution of shareholder interests. Improper valuation can cause investors to pay fees that are too high or to base their investment decisions on inaccurate information." *Good Faith Determinations of Fair Value,* SEC Release No. IC-34128 (Dec. 3, 2020) at 5, 86 Fed. Reg. 748, 749 (Jan. 6, 2021).

[19] *Investment Company Liquidity Risk Management Programs*, SEC Release Nos. 33- 10233; IC- 32315 (Oct. 13, 2016) at 165, 81 Fed. Reg. 82142, 82189 (Nov. 18, 2016).

[20] *Id*. at 82188.

market-making activity with respect these securities, their liquidity will be diminished. Accordingly, the greater a fund's exposure to these securities, the less liquid its overall portfolio would become.

Finally, advisers' ability to achieve best execution on behalf of their clients (including funds) would be adversely affected. In connection with the duty to seek best execution, the Commission has instructed that "an adviser must seek to obtain the execution of transactions for each of its clients such that the client's total cost or proceeds in each transaction are the most favorable under the circumstances," and that an adviser "should 'periodically and systematically' evaluate the execution it is receiving for clients."[21] Advisers use information from trading platforms, dealer runs, and other activity in their best execution determinations. If dealers reduce their quoting and/or trading activity for Rule 144A debt securities, then it will become more difficult for an investment adviser to assess its execution quality. Even worse, to the extent that funds are compelled to sell these securities, they may have to do so at significantly impaired prices, which would adversely impact fund investors and could have broader market implications.

In addition to these effects on existing fund portfolios, any pullback in trading activity for these securities by broker-dealers or investors would make this category less attractive for investment advisers as a source of investment opportunities, which would ultimately harm companies relying on the Rule 144A primary market as a source of financing by disincentivizing new issuances and raising borrowing costs,[22] as well as limit investors' longstanding ability to rely on this market to achieve their investment objectives.

* * *

We appreciate the Commission's and Commission staff's consideration of this data and existing regulations applicable to funds and advisers in assessing the costs and benefits of applying Rule 15c2-11 to funds' ability to invest in Rule 144A debt securities. If you have any questions, please contact Matt Thornton at matt.thornton@ici.org, Nhan Nguyen at nhan.nguyen@ici.org, or Hammad Qureshi at hammad.qureshi@ici.org.

Regards,

/s/ Matt Thornton

Matt Thornton
Associate General Counsel

[21] *See supra* note 14 at 33674-75.

[22] We believe that this impact could be further pronounced for smaller issuers seeking to raise capital via the 144A markets.

/s/ Nhan Nguyen

Nhan Nguyen
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/s/ Hammad Qureshi

Hammad Qureshi
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