Via Electronic Submission

May 12, 2022

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Comments on FINRA Regulatory Notice 22-08 (Complex Products and Options)

Dear Ms. Mitchell:

PIMCO Investments LLC ("PI")[1] appreciates the opportunity to comment on Financial Industry Regulatory Authority ("FINRA") Regulatory Notice 22-08 concerning complex products and options.[2]

PI recognizes that there may be value to FINRA categorizing certain investment products as "complex," particularly where FINRA has specifically identified challenges retail investors actually encounter in understanding such products. It is imperative, however, that any heightened standards framework FINRA considers applying narrowly focuses on products with investment strategies or underlying asset classes that affect investment returns in complex ways, rather than designating broad categories of products as complex. Products should not be defined as complex based on non-investment strategy-related features that (i) are not inherently complicated or difficult for investors to understand (e.g., that redemptions may not occur daily or that only a certain (disclosed) quantity of shares will be repurchased during any given repurchase window); or (ii) can be adequately explained to prospective investors through full and fair prospectus (or other offering document) disclosures.

Regulatory Notice 12-03 described the characteristics of complex products as follows:

> Any product with multiple features that affect its investment returns differently under various scenarios is potentially complex. This is particularly true if it would be unreasonable to expect an average retail investor to discern the existence of these features and to understand the basic manner in which these features interact to produce an investment return.[3]

Notwithstanding the characteristics of complex products articulated in Notice 12-03, FINRA and its staff have at times appeared to view investment products as complex because of features that neither are inherently complicated nor difficult for investors to understand, such as limits on liquidity (e.g., restrictions on an interval fund's liquidity to certain periodic repurchase intervals that are clearly disclosed in the fund's registration statement and as contemplated under Rule 23c-3 under the Investment Company Act of 1940, as amended ("Investment Company Act")).[4] Clearly disclosed limitations, such as limitations on repurchases, do not render a product complex from an

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[1] PI is a limited-purpose broker-dealer that acts primarily as principal underwriter and placement agent for investment funds managed by Pacific Investment Management Company LLC ("PIMCO"), its direct parent and an investment adviser registered with the Securities and Exchange Commission ("SEC"). These funds include mutual funds, exchange-traded funds, private funds, and offshore funds offered to non-U.S. investors. PI also provides certain marketing support and shareholder services to closed-end funds, interval funds, and collective investment trusts advised by PIMCO (together, these various PIMCO products are the "PIMCO Funds"). PI acts principally as a wholesaler dealing with financial intermediaries who sell shares of the PIMCO Funds and as principal underwriter or placement agent dealing directly with certain PIMCO Fund investors.

[2] FINRA Reminds Members of Their Sales Practice Obligations for Complex Products and Options and Solicits Comment on Effective Practices and Rule Enhancements, Regulatory Notice 22-08 ("Notice 22-08").

[3] Heightened Supervision of Complex Products, Regulatory Notice 12-03 ("Notice 12-03").

[4] *See* Notice 22-08 (addressing interval funds). *See also* Notice 12-03 (describing unlisted REITs as complex because they "may present liquidity and valuation issues for a retail investor"); Investment Company Topics, 2019 FINRA Advertising Regulation Conference, *available at* https://www.finra.org/sites/default/files/2019-10/2019_AR_Investment_Co_Topics.pdf (describing interval funds as offering access to alternative investment strategies and illiquid assets and as "non-standard" vehicles for which advisor education "on the structure and operational complexity is critical"); Interval Funds—6 Things to Know Before You

investment returns standpoint. Nor do such limitations necessarily render a product higher risk for investors with respect to the possibility of incurring losses.

Notice 22-08 describes interval and tender offer funds that provide limited liquidity to investors as complex, noting that these funds "present complexities in the redemption process and in the amount of holdings available for redemption during a given period." PI strongly disagrees that limited liquidity, in and of itself, makes a product complex or is a "complex" concept that is difficult for average investors to understand and appreciate when evaluating investments.

That a product permits only periodic, instead of daily, liquidity, for example, is not a difficult concept to understand and should be comprehendible by anybody with the legal authority to open a brokerage account. For one, periodic liquidity is a single feature – not multiple features – that can, and should, be easily disclosed in a prospectus or other offering document in a manner that an average retail investor can understand. In fact, the SEC carefully considered, and adopted, the approach under Rule 23c-3(b)(2) under the Investment Company Act, which requires an interval fund to adopt a fundamental policy specifying key terms of the fund's repurchase offers that is included in the fund's registration statement and annual reports to shareholders.[5] The SEC described this requirement as, among other things, granting shareholders some authority over a fund's approach to redemptions, ensuring that shareholders have information "that is pertinent to their decision whether or not to tender," and "provid[ing] investors with predictability" as to repurchase request deadlines.[6] The SEC and its staff viewed these requirements and this information as readily understandable by investors.[7]

Indeed, interval funds are no more inherently complex than open-end funds, many of which have fee structures that are dependent on an investor's holding periods and/or investment objectives that are intended to align with a certain time horizon. We would also note that interval fund repurchases, like those of open-end funds, are made at net asset value, and even a money market fund can have a redemption gate in certain circumstances. Investors typically invest in interval funds because they have a desire for exposure to asset classes that have longer investment durations and less liquidity, such as real estate, consumer loans, debt, and other less liquid assets, and they use these products to complement a broader investment portfolio. Unsurprisingly, the vehicles through which investors can access such investments often have certain liquidity restrictions to provide for the smooth and efficient management of the vehicles' investments, including so that short-term redemptions by investors do not require maintenance of excess cash or the incurrence of additional transaction costs not in the interest of the vehicles or their investors. In this regard, the vehicle's structure is intended to match its investment strategy. It is not clear why these funds should be deemed "complex" products for one attribute – periodic liquidity – that is shared with or analogous to similar limits in other investment and consumer product terms and the terms and conditions of which are codified in SEC regulation.[8]

Over-expansive designation of products as complex may chill the development of innovative products, including funds that democratize alternative investments and respond to the stated preferences of retail investors for greater

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Invest, Investment Funds, Investor Insights, FINRA (Jan. 23, 2018), *available at* https://www.finra.org/investors/insights/interval-funds (describing interval funds as providing individual investors with "access to exotic or alternative investments typically limited to hedge funds and other institutional investors").

[5] *See* Repurchase Offers by Closed-End Management Investment Companies, Investment Company Act Release No. 19399 (Apr. 7, 1993), 58 Fed. Reg. 19330 (Apr. 14, 1993).

[6] *Id.* at 19338 & 19333.

[7] *See id.* at 19347 (regarding the SEC staff's Guide to Form N-2 ("Guide 10"), which says that graphic presentations (such as a time line or calendar) can help investors "readily understand the time periods used by the funds and the significance of the repurchase request deadline, the repurchase pricing date and the repurchase payment deadline").

[8] Investors and consumers of all kinds regularly make informed choices about transactions and arrangements that effectively limit when the investors and consumers can terminate or exit the arrangements, including annual leases of apartments, three-year leases of cars, multi-year cell phone contracts, certificates of deposit that include penalties on early withdrawal, savings accounts that limit the number of short-term withdrawals, consumer loans that limit early repayment, and mutual funds that charge redemption fees if fund shares are sold before the expiration of the holding period specified in the fund's prospectus.

exposure to such investments. With any approach FINRA takes to regulating products deemed complex, it should proceed cautiously and focus narrowly on products with investment strategies or underlying asset classes that affect investment returns in complex ways. Products should not be deemed complex based merely on limited liquidity or other non-investment strategy-related features that are not inherently complex and that can be plainly disclosed to average investors. This is particularly the case where the SEC has adopted a specific regulatory regime that it deems adequately informative to and protective of investors and provides appropriate predictability to investors with respect to liquidity, such as for interval funds under Rule 23c-3(b)(2).

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PI thanks FINRA for allowing it to comment on Notice 22-08 and appreciates in advance FINRA and its staff's diligent consideration of our comments. Please feel free to contact us if we can provide any assistance in your further evaluation of these very important issues.

Eric M. Sutherland
President, PIMCO Investments LLC