

December 13, 2022

Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F St. NE
Washington, D.C. 20549-1090

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

Dear Ms. Countryman:

I appreciate the opportunity to comment on the Commission's proposed amendments to current liquidity risk management rules for open-end investment companies and the proposed implementation of swing pricing.¹ I am supportive of the Commission's efforts to improve the ability of funds to manage liquidity risk. However, there are many aspects of the proposal that I do not support, specifically regarding the proposed hard close requirement. I will address several of those issues below.

I. Generally

The proposed hard close requirement is primarily intended to 1) support the implementation of swing pricing; and 2) curb the practice of late trading. The hard close requirement is necessary for funds to effectively implement swing pricing. Currently, fund shareholders will receive the current day's share price if their intermediary receives their purchase or redemption order before the fund's established net asset value (NAV) pricing time, which is generally 4:00 pm Eastern Time.² However, to implement a swing pricing factor, the fund (or its transfer agent or designated clearing agency) must receive flow information prior to calculating NAV, information which may not be received until the next day. The solution is a hard close requirement for purchase and redemption order processing. The proposed hard close requirement would significantly alter the way intermediaries interact with funds and investors, because the proposal would require a fund, its designated transfer agent, or a registered securities clearing agency (and not the intermediary) to have received the purchase or redemption order before the fund's NAV pricing time for that order to receive the current day's price.³ The Commission

¹ See *Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting* (Nov. 2, 2022) (Proposing Release), available at <https://www.sec.gov/rules/proposed/2022/33-11130.pdf>.

² See *id.* at 13; see also Rule 22c-1(b)(1) (requiring funds to calculate NAV at least once per day, at a time established by the fund's board of directors).

³ See Proposing Release at 132.

should consider whether this would disincentivize investors from transacting with intermediaries, as the proposed requirement would force intermediaries to set earlier cut-off times for fund trading, which may harm investors seeking to trade fund shares through intermediaries late in the day.

The other concern that the proposed hard close requirement seeks to address is late trading. Late trading violations were the subject of a flurry of enforcement actions in the early 2000s during the “market timing scandal.”⁴ While it is permissible for intermediaries to process fund shares after the close of the U.S. stock exchanges, it is illegal for such trades to be recorded as though they were executed before the NAV pricing time and the Proposing Release acknowledges that the Commission has rules in place, such as Rule 38a-1, that address late trading.⁵ The late trading risk that hard close seeks to ameliorate is the risk that intermediaries will “unlawfully alter orders” using material information gained after market close to benefit either the intermediary or its clients.⁶ As a matter of public policy, it is detrimental to fund shareholders to allow late trading, where certain investors may reap the benefits of informational asymmetry at the expense of other fund investors. Even though a hard close requirement may be beneficial to fund shareholders in a late trading scenario, the Commission should consider further clarifying why current rules do not adequately address late trading risk and why the late trading justification is more than an ancillary motivation to the primary focus of facilitating swing pricing. While there may have been several late trading enforcement actions in the aftermath of the market timing scandal, the Commission’s reasoning would be more persuasive if it pointed to more recent enforcement actions to demonstrate the necessity of addressing late trading.

II. Should we Include New Requirements for Each Designated Party to Time Stamp Order Information for Purposes of the Hard Close Requirement?

I will address the second part of Question 104, which reflects a technological problem that was at issue when swing pricing and hard close requirements were contemplated by the Commission in the early 2000s.⁷ At the time, there was significant support for time stamping mutual fund

⁴ See generally Tom Lauricella, *Fund Scandal Ripples, Even a Decade Later*, THE WALL STREET JOURNAL (Sept. 7, 2014 4:01 PM), <https://www.wsj.com/articles/mutual-fund-scandal-ripples-even-a-decade-later-1410120105>.

⁵ See Rule 38a-1 (requiring written policies and procedures reasonably designed to prevent violations of the securities laws, oversight of compliance by fund service providers, and designation of a chief compliance officer).

⁶ Proposing Release at 134.

⁷ Craig S. Tyle, Investment Company Institute, Comment Letter on Proposed Amendments to Rule 22c-1 Relating to Pricing of Fund Shares, File No. S7-27-03 (Feb. 5, 2004), available at <https://www.sec.gov/rules/proposed/s72703/s7-27-03-100.pdf> (“ICI 2004 Letter”).

orders.⁸ Not only is a time stamping requirement a simple solution, but it also provides an audit trail should there be a question of whether a late trading violation occurred.

Implementing a formal time stamping requirement for the designated parties contemplated by the proposal would operate as a prophylactic against violations the Commission discovered during the market timing scandal. In 2005, the Commission brought an enforcement action against Legg Mason Wood Walker (Legg Mason), finding that their processing of mutual fund orders resulted in Rule 22c-1 violations.⁹ Notably, Legg Mason did not keep records as to when mutual fund orders were actually received and experienced a system failure where brokers who opened Legg Mason's MFRS FAST order screen before 4:00 pm could keep the screen open and process orders until 5:30 pm, bypassing the 4:00 pm cut-off.¹⁰ Legg Mason's MFRS system was a method of processing orders through the National Securities Clearing Corporation's (NSCC) Fund/SERV system. A time stamping requirement for designated parties under the proposed rule (which would include NSCC) would operate as a check against cases like Legg Mason. A formal time stamping requirement, as proposed, would likely be a welcome prophylactic. Time stamping of fund orders found support among multiple industry commenters in response to the Commission's 2003 proposed amendments to Rule 22c-1 and, proposed alone, would be a beneficial and incremental rule change that would be relatively simple to implement given the central clearing of mutual fund shares through the NSCC.¹¹

III. Intermediary Cut-off Times

When swing pricing and hard close were proposed in the early 2000s, there was a recognition among industry commenters of the value financial intermediaries, like broker-dealers or retirement accounts, bring to investors. Investing through a broker-dealer, for example, allows investors access to a wide variety of funds through a single brokerage account, the convenience

⁸ See, e.g., Steve Bartlett, The Financial Services Roundtable, Comment Letter on Amendments to Rules Governing Pricing of Mutual Funds, File No. S7-27-03 (Feb. 5, 2004), *available at* <https://www.sec.gov/rules/proposed/s72703/s7-27-03-99.pdf>; Craig S. Tyle, Investment Company Institute, Comment Letter on Proposed Amendments to Rule 22c-1 Relating to Pricing of Fund Shares, File No. S7-27-03 (Feb. 5, 2004), *available at* <https://www.sec.gov/rules/proposed/s72703/s7-27-03-100.pdf>; John W. Bachmann, Edward Jones, Comment Letter on Proposed Amendments to Rule 22c-1 Relating to Pricing of Fund Shares, File No. S7-27-03 (Nov. 4, 2003), *available at* <https://www.sec.gov/rules/proposed/s72703/s72703-8.pdf>; Robert G. Wuelfing, The SPARK Institute, Comment Letter on Proposed Amendments to Rule 22c-1 Relating to Pricing of Fund Shares, File No. S7-27-03 (April 1, 2005), *available at* <https://www.sec.gov/rules/proposed/s72703/s72703-275.pdf>.

⁹ In the Matter of Legg Mason Wood Walker, Inc., Investment Company Act Release No. 27071 (Sept. 21, 2005), *available at* <https://www.sec.gov/litigation/admin/34-52478.pdf>.

¹⁰ *Id.*

¹¹ See *supra*, note 5.

of which may have played a significant role in the increase in mutual fund investing.¹² The NSCC submitted a letter commenting on the Commission’s 2003 proposed amendments to Rule 22c-1, noting that roughly “27% of the total daily orders are received by NSCC between 8:00 a.m. and 4:00 p.m. The other 73% are received outside of these hours, after they have been reviewed by the intermediary . . . and processed through their internal systems prior to transmission to NSCC.”¹³ The recognition made by the NSCC is reflected elsewhere in the securities industry, notably by the recent increasing demand for after-hours equities trading from brokerage platforms like Robinhood, who have responded to that demand by increasing available trading hours in a “push to eventually provide 24/7 equities trading.”¹⁴

The Proposing Release acknowledges that the hard close proposal will have a negative impact on investors who seek to obtain same-day pricing of fund shares. Because intermediaries may have to impose an earlier cut-off time for transacting in fund shares, many investors will notice that they must submit their orders earlier in the day. The justification for this is that Rule 22c-1 already impacts investors differentially depending on the time zone where the investor is located.¹⁵ The Commission seems to be prioritizing shareholders who do not seek to redeem shares in times of market stress, noting that “overall the proposal is intended to better protect shareholders’ interests by operationalizing swing pricing to combat shareholder dilution and enhancing fund resiliency.”¹⁶ Earlier cut-off times imposed in response to the hard close requirement will negatively impact investors who trade through intermediaries, as those investors will not be able to effectively trade in response to significant market events. One of the defining features of open-end funds is that investors can always redeem their shares for cash. This is particularly important during extreme market events, such as the COVID-19 market stress that is motivating this proposed rule. In times of market stress, investors need flexibility to make informed decisions about whether to convert their mutual fund shares into cash to satisfy their near-term liquidity needs. I ask the Commission to give more consideration to whether investors trading fund shares through intermediaries such as broker-dealers will be disincentivized from investing in mutual funds due to the potentially limited time window within which they can make informed trading decisions.

¹² Steve Bartlett, The Financial Services Roundtable, Comment Letter on Amendments to Rules Governing Pricing of Mutual Funds, File No. S7-27-03 (Feb. 5, 2004), *available at* <https://www.sec.gov/rules/proposed/s72703/s7-27-03-99.pdf>.

¹³ Carol A. Jameson, National Securities Clearing Corporation, Comment Letter on Amendments to Rules Governing Pricing of Mutual Funds, File No. S7-27-03 (Feb. 6, 2004), *available at* https://www.sec.gov/rules/proposed/s72703/nsc020604.htm#P30_600.

¹⁴ Maggie Fitzgerald, *Robinhood Adds Four Additional Hours to Extended Trading for Clients*, CNBC, <https://www.cnbc.com/2022/03/29/robinhood-adds-four-additional-hours-to-extended-trading-for-clients-.html> (last updated March 29, 2022 6:51 PM).

¹⁵ Proposing Release at 149, note 242.

¹⁶ Proposing Release at 150.

IV. Conclusion

The Commission should consider whether the potential benefit of implementing a hard close requirement outweighs the harm to investors that may arise from disincentivizing investors from transacting with funds through intermediaries such as broker-dealers, which is an effect that may materially harm fund inflows, given that broker-dealers are one of the main channels through which investors may purchase and redeem open-end fund shares.¹⁷ The Proposing Release itself recognizes the value broker-dealers provide to investors as intermediaries, noting that Rule 15c6-1 under the Securities Exchange Act of 1934 imposes a two-day (T+2) settlement period for trades effected by broker-dealers.¹⁸

Furthermore, while the impact of COVID-19 created significant market turbulence, the Proposing Release focuses narrowly on the volume of redemptions, rather than suspensions, which is a metric that may be more indicative of a liquidity issue.¹⁹ One analysis showed that only 0.11% of global assets under management was subject to suspensions during the COVID crisis.²⁰ Increased redemptions was a natural response to market turbulence, as investors prioritized near-term liquidity needs over long-term fund investments. The question that the proposed rule seeks to answer is how to ensure that open-end funds manage liquidity sufficiently well to meet investor redemptions, not to prevent investor redemptions altogether.

Finally, the hard close requirement may operate to the detriment of investors who purchase or redeem fund shares and wish to receive the same day's price but cannot transact with the fund until late in the day. The Proposing Release recognizes that Rule 22c-1 impacts investors in different time zones differently. A hard close requirement would force intermediaries to apply earlier cut-off times, which would likely have the effect of reducing the number of investors who transact in open-end fund shares on a given day. Even if investors choose to purchase or redeem fund shares, they will be unable to react to material market events that happen late in the day.

There are aspects of the proposal that could be implemented in isolation to the benefit of the fund industry, such as a time stamping requirement for placing mutual fund orders. However, implementing a swing pricing requirement and an associated hard close requirement together will change the way that investors interact with funds, potentially causing investors harm.

I appreciate the opportunity to provide feedback on this important proposal.

¹⁷ Investment Company Institute, *Understanding the Regulation of Exchange-Traded Funds Under the Securities Exchange Act of 1934* (Aug. 2017), available at https://www.ici.org/doc-server/pdf%3Aappr_17_etf_listing_standards.pdf.

¹⁸ Proposing Release at 12-13.

¹⁹ Proposing Release at 11.

²⁰ BlackRock, *Liquidity Risk Management is Central to Open-Ended Funds* (January 2021), available at <https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-addendum-lessons-from-covid-liquidity-risk-management-is-central-to-open-ended-funds-january-2021.pdf>.

Sincerely,

/s/ Thomas Archer