February 13, 2023

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

Re: Proposed Hard Close (File No. S7-26-22)

Dear Ms. Countryman:

On behalf of the millions of families saving for their children's higher education expenses through qualified tuition plans established under Internal Revenue Code (Code) section 529 (529 Plans) and the disabled individuals and their families who save through accounts established under Code section 529A (ABLE Plans), the College Savings Foundation (CSF) writes to express our significant concerns about the proposal by the Securities and Exchange Commission (the Commission) to impose a "hard close" requirement on Americans investing in mutual funds through intermediaries such as state-sponsored 529 Plans and ABLE Plans. We believe this proposal, if adopted, will harm families saving for college, and the states that sponsor 529 Plans, and that this harm outweighs any gains to be had by the Commission's related "swing pricing" proposal. Accordingly, we strongly urge the Commission not to adopt the hard close proposal.

CSF is a not-for-profit organization with the mission of helping American families achieve their education savings goals by working with public policy makers, media representatives, and financial services industry executives in support of 529 Plans. CSF serves as a central repository of information about college savings programs and trends and as an expert resource for its members as well as for representatives of state and federal governments, institutions of higher education, and other related organizations and associations. CSF members include state 529 Plans; investment managers; broker-dealers; law firms; accounting and consulting firms; and non-profit agencies that participate in the sponsorship or administration of 529 Plans.

Mutual Funds and 529 Plans. States establish 529 Plans to allow families to save for college and related educational expenses. Generally, contributions are made on an after-tax basis (although a state income tax deduction or credit may be available), but distributions from the plan are tax-free if used for qualifying educational expenses. ABLE Plans are a similar state-sponsored account for qualified disabled beneficiaries, for the purpose of supporting and maintaining their health, independence, and quality of life. After saving for retirement, saving

for college is often a household's most critical savings goal. In CSF's most recent survey of parents, 86% of parents believed that children will need continued education or additional skills throughout their lives. We found that 65% report that they are saving for their children's education, and 29% report saving in a 529 Plan. Of those who do save in a 529 Plan, 75% are making annual, quarterly, or monthly contributions.[1]

It is not surprising then, that 529 Plans are very popular. According to recent data, there are 15.9 million 529 Plan accounts, with over $400 billion in assets. [2] Importantly, however, most account balances are modest: according to CSF data, the median account size is approximately $10,000.

There are variations in design among the states in how their 529 Plans are structured, but mutual funds are an important component of the investment options in most 529 Plans. In some cases, the investment option is a registered mutual fund. In other cases, the account will hold an interest in a trust fund maintained by the 529 Plan, but that trust fund then invests in an underlying mutual fund. Thus, for example, the account holder may hold Trust Fund A, which is a municipal security, but Trust Fund A's only investment is Mutual Fund A. The net asset value (NAV) of Trust Fund A is tied to the NAV of Mutual Fund A on the same day.

Many 529 Plans offer "target date"-type investments that include a mix of asset classes that become more conservative as the expected date of college entrance approaches, and these investments typically hold, directly or through a trust, a mix of different mutual funds. ABLE Plans offer similar options.

Because 529 Plans have various tax and other requirements that must be complied with, an account holder does not make direct investment transactions. In other words, 529 Plans act as intermediaries for parents and others saving for college expenses, because contributions, account rebalancings, and distributions are processed by giving instructions to the program administrator, which processes those transactions, broadly similar to a 401(k) plan or IRA. The program administrator, like other intermediaries, can process transactions in bulk and send a single trade instruction to the mutual fund, which nets all the transactions during a single day. And like other intermediaries, the program administrator generally processes transactions after the close of trading based on those transactions received during the day. The program administrator can do so only because the NAV of each mutual fund is known. Thus, the millions of transactions conducted yearly in 529 Plans and ABLE Plans are processed efficiently and can settle quickly.

One unique aspect of 529 Plans is that, under IRS rules, account owners are significantly restricted in their ability to make investment elections. The Code requires that an account owner may not, directly or indirectly, direct the investment of contributions to the program more than twice per year.[3] Thus, an account holder is not able to rebalance the account by selling one investment and then buying another one a week later after the first trade has settled. A

[1] CSF 2022 Parent's Survey Data, available at https://www.collegesavingsfoundation.org/wp-content/uploads/2022/10/Unknown-1.pdf.

[2] National Association of State Treasurers, available at https://nast.org/wp-content/uploads/529_factsheet-september-2022.pdf.

[3] Code section 529(b)(4).

rebalancing of the account must occur all at once. This makes a 529 Plan account very different from a brokerage account holding mutual funds: in a brokerage account, an individual can sell one mutual fund, wait to see what the NAV is for the day the sale was made, and then use the cash to purchase another mutual fund later to achieve the intended mix of investments.

Significant Negative Impact of the Commission's Proposal. Currently, 529 Plan program administrators can allow contributions, account rebalances, and distributions made up until the close of the trading day to receive the current day's NAV. As long as the transaction is placed by the mutual fund's cut-off (typically 4 p.m.) the program administrator can process the transaction after 4 p.m. but give the account holder same-day pricing. This also allows transactions to be processed efficiently—contributions can be invested quickly, account rebalances can occur quickly, and distributions to pay for educational expenses can be sent quickly.

The Commission's hard close proposal will *completely disrupt* this process. Under the proposal, a direction to purchase or redeem mutual fund shares would only be eligible to receive the current day's price if the order is received by the fund, its designated transfer agent, or a registered securities clearing agency before the fund's pricing time, which is generally 4 p.m. ET. Consequently, this hard close would prevent current day pricing, as permitted under the SEC's existing rules, when a direction to purchase or redeem mutual fund shares is received by an intermediary – such as a 529 Plan – before the 4 p.m. deadline, and is subsequently transmitted to the fund after such deadline. If adopted, the Commission's proposal will have a number of negative and costly impacts:

- **Earlier Cut-Off Times**. First, 529 Plans will be required to impose a deadline for transactions that is much earlier than the actual deadline imposed by the mutual fund, because of the processing time to ensure a contribution, account rebalancing, or distribution is in good order and compliant with the 529 Plan's rules. Although the actual time will vary by program, all 529 Plans will need many hours to process transactions. This means that 529 Plan account holders will be forced to make transactions much earlier in the day. For some 529 Plan savers on the West Coast, time zone restrictions might mean needing to make a transaction before breakfast. Moreover, they must do so with less information than investors that hold mutual funds directly with the fund company, because those investors can wait until 3:59 p.m. ET to make a trade and receive the same day price. In short, the Commission's proposal turns Americans investing in 529 Plans (and others holding mutual funds through intermediaries) into ***second class investors***, perpetually forced to make important financial decisions with less information than other investors.

- **Omnibus Processing Impossible**. As explained earlier, currently, program administrators can process transactions after the 4 p.m. close because they have access to the NAV of the mutual fund. Like other intermediaries, 529 Plans can "net" and "batch" trades received during the day, a process sometimes called "omnibus" processing. Omnibus processing allows for the processing of transactions in one day that otherwise would take multiple days to process. An example is a rebalancing of an account. It is very common for a 529 Plan account holder to wish to rebalance their account to bring the asset allocation back to a predetermined mix of asset classes. For example, the

account holder might direct the program administrator to rebalance the account so that it is 25% Fund A, 30% Fund B, 15% Fund C, and 25% Fund D, and 5% Fund E. This is particularly important as the account beneficiary approaches his or her freshman year of college, and the account is moved into more conservative investments. Currently, this can be done all at once, because the program administrator *knows* the price for Funds A, B, C, D, and E—the program administrator knows to sell 14.7 shares of Fund A, buy 35.2 shares of Fund B, and so on. But if the program administrator must send instructions before 4 p.m. *not knowing the price of each Fund*, then the program administrator cannot actually process the rebalancing all at once, and must guess at how much of each Fund should be traded. A similar problem is created when an account holder makes a contribution and directs that the contribution be invested 25% in Fund A, 25% in Fund B, etc., or when the account holder requests a distribution be made pro rata from each fund in the account. None of these transactions would be possible in their current form if the Commission's proposal is adopted.

Many savers who invest through intermediaries will be negatively impacted. ***But as noted above, the ability to rebalance an account all at once is uniquely important to 529 Plan savers because of the restriction in the Code from making more than 2 investment directions in a year.*** In other words, if omnibus processing goes away, the restriction on investment direction will make it much harder for 529 Plan account holders to maintain an appropriate asset class mix.

- **Delays in Receiving Funds for College Expenses**. Even with an earlier cut-off in place, because of the end of omnibus processing, a hard close requirement will mean that requests for distributions will likely take many more days to settle, especially if the account holder has multiple mutual funds in the account. This means that access to assets needed to pay tuition bills, buy books and supplies, and pay for housing and food will be delayed. College students are not flush with extra cash to bridge these delays. This could mean students incur credit card debt or otherwise suffer hardship while waiting for access to 529 Plan account balances.

- **Delays in Having Contributions Invested in the Market**. We also believe that there will be delays in getting contributions actually invested, because a contribution that will be invested based on a predetermined asset allocation cannot be fully processed overnight. And while a day of having that contribution out of the market may not seem like a lot, compounding that over the more than 15 million Americans who are making contributions to a 529 Plan in a year means a substantial loss in college savings available to fund education.

- **Costs to States**. In the preamble to the proposal, the Commission actually acknowledges the costs that will be borne by recordkeepers of 401(k) and similar plans, stating that "retirement plan recordkeepers would need to substantially update or alter their processes and systems to accommodate the proposed hard close requirement."[4] The Commission's discussion does not mention 529 Plans at all, and the economic analysis completely ignores the proposal's impact on the more than 15 million 529 Plan accounts and over

[4] 87 Fed. Reg. 77172, 77212 (Dec. 16, 2022)

$400 billion in assets held in 529 Plans. Nor does the Commission make any attempt to assess the cost of implementing the hard close on states that administer these programs. We believe that the cost ***will be substantial***. Nearly every transaction involving a mutual fund will need to be processed differently than it is now. States will need to renegotiate contracts and service models with program administrators. 15 million account holders will need to be educated on a significant change in how their contributions, account rebalancing, and distributions will be processed. Ultimately, these costs will be absorbed either by taxpayers or, more likely, by Americans trying to provide an education for their child or a better life for a disabled relative.

Benefits Do Not Justify Costs. The Commission states that the imposition of a hard close requirement is necessary to allow for implementation of *another* aspect of the proposal, namely, requiring mutual funds to impose "swing pricing." The Commission asserts that mutual funds need information on "flows" no later than the cut-off time to make adjustment to the NAV. The Commission believes that "swing pricing" will provide benefits to shareholders because it allows a fund to impose on shareholders selling the fund certain transaction costs. The swing pricing procedure would be imposed only when the net purchases or redemptions on a day exceed a set threshold, such as 2%. In such a case, the mutual fund would adjust the NAV by a small factor to take into account the transaction costs, which, presumably, has some benefit to remaining shareholders. Nowhere in the economic analysis of the proposal does the Commission ever give a clear indication of what this would mean in increased savings to those saving in 529 Plans. But, even assuming there are some benefits to swing pricing, what is clear is that, for the average family saving for college expenses whose median account balance is approximately $10,000, this savings likely ***means mere pennies or single digit dollars*** during the 20 or so years the account is being funded. That benefit is completely outweighed, however, by the costs, tangible and intangible, that will befall these savers and the states that offer these programs if the hard close requirement is imposed. If every contribution is delayed in getting invested in the market, that alone would be more harmful to a parent than any value gained by swing pricing. Perhaps there are some large institutions and wealthy individuals who stand to gain from swing pricing, but for a parent working hard to put aside savings for a child's education, the costs of this proposal do not justify the benefits—not even close.

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We know that the Commission will hear many concerns from others about the impact on 401(k) and IRA retirement savers, and from those holding mutual funds through other intermediaries such as annuities. It is *critical* that the Commission take into account the negative impact this proposal will have on 529 Plans. For the reasons described above, CSF urges the Commission not to adopt a hard close requirement.

Sincerely,

Vivian Tsai
Chair
College Savings Foundation