February 14, 2023

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

Submitted via email to rule-comments@sec.gov

Re: Proposed Rule, Securities and Exchange Commission; Open-End Fund Liquidity Risk Management Programs and Swing Pricing; RIN 3325-AM98 File Number S7-26-22

Dear Ms. Countryman:

We represent a client group that includes a number of the nation's leading providers of recordkeeping, administrative and custodial services to 401(k) and other types of employer-sponsored defined contribution retirement plans ("Plans"). Our clients serve tens of millions of defined contribution plan participants. On a combined basis, our clients process millions of monthly trades in shares of open-end registered investment companies, a majority of which involve transfer activity (*e.g.*, purchases and sales). Billions of dollars in daily trading volume are generated by these transactions. This letter comments on the Proposed Rule's hard close requirement, which would amend Rule 22c-1 under the Investment Company Act of 1940 to limit those transactions processed at the current day's price to purchase and redemption orders received by the fund's transfer agent or by a registered securities clearing agency (collectively, "designated parties") prior to pricing time (typically, 4:00 p.m. ET).

If implemented, the hard close requirement would have far-reaching and deleterious effects on the nation's Plans and on the millions of working Americans who rely upon them as a source of retirement savings. The Proposal inappropriately discounts or overlooks a number of concerns that would confront the nation's retirement system under a hard close environment. The comments provided below detail the injurious effects that a hard close requirement would inflict on the Plan community. It also details some of the likely unintended consequences of a hard close requirement.

We urge that the final rulemaking not include a hard close requirement. As described below, a hard close requirement would undermine the operating foundations upon which the nation's Plans rely.

1. **Prohibitively Expensive Re-Design and Re-Engineering of Plan Recordkeeping Systems and Technologies Would be Necessitated by a Hard Close.** Most Plan recordkeeping systems in operation today are "price dependent." The systems are programmed to process daily Plan transaction

activity only after that day's NAVs have been received from the funds available as Plan investment options. Following receipt of those daily NAVs, participant accounts and investment positions are valued. The systems assign values to each Plan or participant transaction received in good order prior to that day's close and reflect those transactions on Plan and participant records. In addition, the trading platforms through which recordkeepers transact with funds made available as Plan investment options typically "net" offsetting purchase and redemption orders involving a particular CUSIP (which may involve hundreds or thousands of individual orders), to generate a single fund purchase or redemption order that is placed with the fund's designated party. This may take the form of either a single "omnibus" trade on behalf of all of the participants transacting within a particular Plan or as single super-omnibus trade on behalf of a group of Plans; netting generates cost savings by minimizing the number of transactions needed to satisfy orders within and across Plans.

A hard close regime would render all of these systems inoperable, and would necessitate a complete re-design of existing recordkeeping and trading technologies. Not only would the costs of such an overhaul be prohibitive (estimated by our clients to involve billions of dollars in capital expenditures across the industry), but would result in a vastly less efficient system that would provide dramatically reduced levels of service relative to what is in place today. In addition to these hard dollar costs, significant opportunity costs would attend such a re-design project. Resources that are currently dedicated to improving the resiliency of Plan-related information technology systems in response to ongoing and growing cybersecurity concerns and to implementing significant pieces of new retirement industry legislation enacted by Congress in recent years would need to be re-allocated to support hard close re-design needs.

Ultimately, these expenses would be borne by Plans and participants who would confront increased service fees and potentially less resilient systems. As such, implementing a hard close would mark the reversal of the trend in overall reductions in Plan fees that has benefited the Plan community for much of the past decade. As noted and as further discussed below, despite these costly outlays of resources, Plan service levels would be inferior to those provided currently.

2. A Hard Close Would Impede the Processing of Plan Transactions, Impose New Investment Risks on Plan Participants, and Could Ultimately Reduce the Incentive to Participate in and Contribute to a Plan.

a. Deterioration in the Efficiency of Plan Servicing Capabilities, Including Exposure to Out of Market Risk. Modern Plan recordkeeping systems capabilities deliver timely, efficient processing and execution of participant and Plan-level transactions. Plan sponsors and participants have come to expect and rely upon these services. As an

example, today a participant can log onto the Plan's website – generally at any time prior to the day's close of trading – and enter one or more investment transactions, including transactions related to the provision of Plan benefits (*e.g.*, the receipt of loans, hardship or retirement withdrawals) with confidence that each such transaction will be processed accurately and correctly at that day's closing price, subject to applicable Plan rules and Code requirements. Similarly, Plan sponsors or other investment fiduciaries with responsibility for oversight of Plan investment menus may issue instructions for the de-selection and replacement of investment options and/or transition from one recordkeeping platform to that of a successor provider, seamlessly and on a same day basis.

All of these fundamental servicing expectations would be overturned under a hard close regime, which would have the effect of reversing decades of improvements in servicing capabilities. A hard close requirement would force plan recordkeepers to transition away from daily omnibus or super-omnibus trades in favor of "sequential trading." Sequential trading could take several different forms. Under one approach, batches of individual trade orders would be packaged and delivered to the fund's designated party throughout each trading day in an effort to obtain same day pricing. Alternatively, a recordkeeper forced to engage in sequential trading may choose to aggregate daily redemption orders and place them at the end of each trading day to be processed at the next day's NAV. Under either approach, a shift to sequential trading would introduce multiple new dependencies into the system for transmitting and reconciling Plan and participant-level trades and would delay the efficient processing and settlement of exchange transactions. Under either scenario, Plan participants will suffer significant loss of access to investment opportunity and erosions in their levels of control over the investment holdings of their account.[1]

It is unclear how Plan administrators would be afforded any opportunity to validate participant transaction requests against applicable Plan and Internal Revenue Code ("Code") requirements given the exigencies associated with submitting every transaction to a fund's designated party prior to close to receive the day's price. Even if a recordkeeper were to delay the submission of participant transaction requests until the following business day, the unavailability of pricing information at the time of submission would make validation of certain transactions (*e.g.*, loans, or

[1] As the nation's retirement system has shifted away from defined benefit designs in favor of defined contribution plans, responsibility for saving *and investing* for an adequate retirement has shifted to individual workers. The hard close element of the Proposal would leave workers with responsibility for investing their account balances, while effectively denying them the means to do so on reasonable terms.

qualified domestic relation order account segregation) impossible to complete except on a post-transaction basis.

Under a hard close system, exchange orders (*i.e.*, instructions to redeem a stated number of fund units and to re-invest the redemption proceeds in units of one or more alternative funds) would require multiple trading days to fulfill. Only after the dollar amount of redemption proceeds was determined (on day 2, or, if the recordkeeper delays the initiation of a transaction by one business day, day 3) could purchase instructions be placed for successor funds. During the interim, redemption proceeds would remain uninvested. To take another example, Code and Plan rules require the liquidation of specific dollar amounts to process participant loan, hardship withdrawal, and required minimum distribution transactions. Without fund pricing information, it would be necessary to estimate the number of fund units to redeem so as to realize that dollar amount. Where the number of fund units redeemed on the basis of the estimate is insufficient, additional units would have to be redeemed on the next day, delaying the completion of the transaction. In cases where the number of units is overestimated, the participant would bear out of market risks with respect to the excess redemption, pending the re-investment of that excess on the next day.

Hence, a hard close requirement would herald a return to days long past when daily trading activity was either not allowed or was limited, and to the imposition of "blackout" periods when plan participants would be unable to trade and would be required to accept exposure to the losses associated with foregone investment opportunities. These declines in service would not only be inconvenient, but would also create enormous levels of investment risk that plans and participants are not exposed to today. During these periods of delay, as further described below, Plans and participants would be required to remain uninvested and to risk the significant economic risks that attend being out of market.

We strongly disagree with the view expressed in the preamble to the Proposal that since Plan participants are generally long term investors, their interests in exercising control over their investments are somehow less relevant than those of other investors. ERISA section 404(c) and the Department of Labor's implementing regulations emphasize the importance of affording Plan participants the means to exercise actual control over their account balances. That emphasis reflects the fact that under a defined contribution-based retirement Plan system, each participant is individually responsible for achieving retirement security by saving adequately and by investing those savings in a manner consistent with their own risk/reward preferences. Some Plan participants trade their

accounts regularly and place a high degree of value on those trading rights. The hard close requirement would unduly restrict participant rights to re-allocate their account balances, and in doing so would effectively assign second class investor status to that population.

b. **Re-Balancing Difficulties.** Fund re-balancing transactions of all types would be confronted with new and difficult challenges and complexities under a hard close regime. Target date and risk-based funds maintained at the Plan-level and organized as "funds-of-funds" would confront difficulties in re-balancing back to target allocations, as the proceeds from redemptions of overweight allocations would remain out of market for at least a day before the reinvestment transactions could be placed.[2] The same would be true of participant-level managed account program re-balancing. All of this would have the effect of introducing increased levels of uninvested cash into the system. The introduction of uninvested cash into the system would impose opportunity costs on Plans and participants who would bear associated out of market risks. Congress has encouraged the development of default investment options that provide for professional rebalancing of investments; a hard close would decrease the efficacy of Congressionally approved default investments.

c. **Processes for Accruing and Collecting Plan Fees Would be Rendered Inoperable.** Fees owed by Plans to service providers, including recordkeepers and investment advice or investment management service providers, are generally accrued against and collected from Plan assets by applying a daily accrual factor reflecting the annualized amount of the fee to daily valued Plan holdings. In order for fee collection utilities to run, the recordkeeper must be in possession of that day's closing prices. Under a hard close regime, fund prices and account valuations would not be known until after the time that fee collection utilities run today. This would likely result in a lag in the accrual of applicable fees until the next following business day, when prices would be known. The accrual and collection of applicable fees on a delayed basis could require additional delays in the processing of transactions, since final movements of funds would need to await the processing of applicable fees. In turn, these delays would add to the level of inefficiencies and investment risks that Plans and participants would confront under a hard close regime.

---

[2] Target date and risk-based funds made available as Plan investment options settle trades on T+1 basis and are frequently fully invested in underlying open-end funds that also settle on a T+1 basis. A hard close requirement would negate the ability of these "funds-of -funds" to maintain fully invested positions in underlying funds, requiring maintenance of a position in cash or cash equivalents sufficient to meet any net redemption activity on T+1. The introduction of these cash/cash equivalent positions represents an added layer of investment inefficiency that would diminish the long-term returns available to retirement investors.

d. **The Risks of Being Locked In or Out of Market.** As noted, most trading activity within a Plan is attributable to transfer activity (*i.e.*, from orders to redeem a particular holding and to re-invest the redemption proceeds in an alternative fund, either at the level of an individual participant account, a participant managed account program, or within a fund-of-funds offered on the Plan's investment line-up, such as a target date fund). A hard close rule would put the Plan and its participants "out of market" for a period of time. The potentially disastrous and disruptive consequences of this should not be overlooked. While it is not possible to predict future price movements, studies have shown that the most substantial investment returns are concentrated on relatively few days. For example, being out of market on only 10 of the market's best days over the past 30 years could cut an investor's returns by half.[3] Being out of market on even a single day poses a serious threat to Plan participants' retirement security.

Similarly, under a hard close system, participants may be unable to timely redeem fund positions at times when other market participants can trade. Even if recordkeepers were able to completely redesign their recordkeeping and trading platforms to operate under a hard close regime, they would need to impose deadlines for the submission of trades in advance of the market's closing time. Those prior to close deadlines would be needed to allow for delivery of those same trades to designated agents prior to close, and would likely place participants at 4-5 hour disadvantage relative to non-Plan investors for placing transaction orders eligible for that day's price. Given the need to apply Code and Plan rules to participant transaction requests, it is entirely possible that under a re-designed system *no* participant trading instructions will receive same day pricing. In up markets this "lock in effect" would have the effect of causing participants to miss opportunities for gains. Similarly, in down markets, a lock-in would disable participants from avoiding those losses. In turbulent markets, these effects could be catastrophic. Other investors who transact directly with designated parties would be empowered to control their investment outcomes by placing trades prior to market close at that day's price. But retirement plan investors, who hold fully 54% of all mutual fund assets on a combined basis, will be relegated to a subordinated status where they are frequently disallowed from obtaining same day pricing and are forced to ride out market changes while awaiting

[3] *See, e.g.*, Hartford Funds, Timing the Market Is Impossible (accessed Jan. 19, 2023), *available at* www.hartfordfunds.com%2Fpractice-management%2Fclient-conversations%2Fmanaging-volatility%2Ftiming-the-market-is-impossible.html&psig=AOvVaw2SF1Sw7uW5CfC__bvTwuLN&ust=1674231372096447; Time, not Timing, Is the Best Way to Capitalize on Stock Market Gains, Putnam Investments (Feb. 2022), available at https://www.putnam.com/literature/pdf/II508-ec7166a52bb89b4621f3d2525199b64b.pdf.

trade processing over multiple days. The Commission's proper focus should be on the fair treatment of all investors. Enacting a hard close that so unduly penalizes the holders of 54% of fund interests misses the mark.

e. **Potential Dis-Incentives to Plan Participation.** As a result of introducing new inefficiencies in the processing of Plan transactions and imposing new investment risks from being out of market or locked in during market turmoil, a hard close requirement carries with it the potential for retirement savers to turn away from employer-sponsored plan participation altogether in favor of individual savings arrangements that do not have the same risk exposures. Participants may reasonably conclude that they face greater investment risks by investing through a Plan than they would if they invested through a brokerage account. For instance, an individual could, as an alternative to contributing to a Plan, avoid these inefficiencies and risks by investing in exchange-traded funds through an individual brokerage account or a mutual fund account maintained with the transfer agent of the individual's chosen mutual fund. However, incentivizing the establishment of, and individuals' contributions to, Plans is a key Congressional priority, as evidenced by legislation known as SECURE 2.0, which was enacted on December 29, 2022.[4] Weakening Plans by introducing new inefficiencies and investment risks contravenes Congressional intent.

3. **New Systemic Risks to the Mutual Fund Industry Would Accompany a Hard Close Requirement.** Current Plan recordkeeping and fund platform designs generate enormous efficiencies not only for Plans and participants but also for mutual fund complexes. Modern 401(k) trading platforms support trading activity for tens of thousands of CUSIPs. Through the process of netting offsetting purchase and redemption activity to generate a single omnibus or super-omnibus trade with each fund, the system has the effect of dramatically reducing the volume of daily trading activity that each fund complex would otherwise be required to process. A hard close rule would, to a large extent, eliminate this efficiency by rendering omnibus and super-omnibus trading activity impossible. As a result, it is foreseeable that daily trading volumes would grow exponentially from current levels. In addition, there is an increased likelihood of "stampedes" of trade entries being placed just prior to close. In combination, these increased trading volumes – suppressed into constrained periods of time – could threaten to overwhelm the processing capabilities of designated parties. These collateral effects on the fund industry would likely exacerbate the very problem that the Proposal seeks to mitigate by spiking trading volumes relative to those currently prevailing. In addition, the funds would incur increased costs and expenses

[4] Consolidated Appropriations Act, 2023, Division T, Pub L. No. 117-238, 136 Stat 4459 (2022).

building out additional administrative capabilities to handle these increases in daily trading volumes, placing upward pressure on fund expense ratios.

A hard close requirement dramatically increases the industry's reliance on the timely processing capabilities of The Depository Trust and Clearing Corporation ("DTCC") -- the nation's sole registered securities clearing agency. Plan trades submitted to DTCC would receive same day pricing only when received by DTCC prior to that day's close. From time to time DTCC experiences systems outages that could impede timely trade submissions.[5] The current regulatory framework's allowance for after-hours processing of trades timely placed with intermediaries prior to close generally affords sufficient time to recover from such events without widespread disruption. This built-in resiliency would be lost under a hard close regime that is intentionally designed to be unforgiving of any delayed trade submissions. We are concerned that the Proposed Rule places too high a degree of reliance on DTCC by assuming DTCC will always function flawlessly notwithstanding recent outage events. The Proposed Rule is unclear as to what outcomes would result from outage events (*e.g.*, whether attempts to transmit orders on a timely basis would satisfy the hard close requirement in situations where systems outages prevent acceptance). In these respects, the Proposed Rule introduces an undue degree of reliance and dependency on a single processing point that tends to undermine the overall resilience of the trade processing system.

4. **Competitive Challenges for Open Architecture Platforms.** For decades, fiduciary considerations related to the selection and monitoring of participant investment line-ups have fostered the development of "open architecture" fund platforms affording Plans access to a broad range of investment options from competing fund families. A hard close requirement would place open architecture platforms at a serious disadvantage relative to "closed platforms" featuring the funds of a single family. It is conceivable that closed platforms could operate with considerably less disruption under a hard close regime relative to open architecture arrangements, since they may be able to develop systems to deliver orders to the internal fund family's designated transfer agent prior to the close of business. To that extent, the hard close proposal could drive Plans to move to closed platforms and to forego the broader array of investment choices available under open architecture platforms. Such a result could sacrifice Plan and participant access to investment choices and could drive up participant costs associated with investment choices. It could also confront Plan fiduciaries with the difficult choice of having to weigh the quality of a recordkeeper's service offering against the quality of the fund family available on the recordkeeper's closed platform. A regulatory incentive for business to migrate to closed platforms would also be anti-competitive and harmful to small businesses, as the

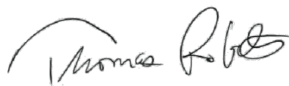
[5] For example, on January 26, 2023 a major hardware outage affecting DTCC resulted in multi-hour delays in trade acceptance and routing.

added costs with systems and process re-designs could drive smaller recordkeeping and third party administration shops out of business altogether. For Plans that choose to remain on an open architecture platform, it is conceivable that participant frustrations with the diminished levels of service available under a hard close regime, will migrate out of the Plan's designated investment options, which are selected and monitored by the Plan's fiduciaries, in favor of self-directed brokerage windows which offer non-designated investment alternatives that are generally not monitored by fiduciaries. If that trend were to emerge, it would tend to leave retirement investors without the benefits and protections of a curated menu of investment options subject to fiduciary oversight – undeniably a step backwards when viewed from a public policy perspective.

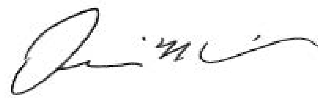
* * *

As our comments indicate, the costs, disruptions and hardships to retirement savers under the Proposed Rule's hard close requirement would be severe and far reaching. In our view, the Proposed Rule has either failed to take those costs into account or has inappropriately discounted their significance. In light of the significance of the issue, we believe the Proposed Rule should be withdrawn at this time in favor of a request for information ("RFI") process. A properly constructed RFI could solicit input on how to address the shareholder dilution and other concerns that gave rise to the Proposed Rule while preserving the well-functioning intermediary networks that are essential to Plan operations. In particular, we believe disclosure-based approaches, including disclosures on the risks and actual costs of investor dilution that may accompany investments with certain types of holdings, merits further consideration in lieu of a hard close approach.

Sincerely,

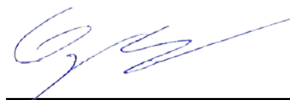


Thomas Roberts



David N. Levine

Kevin L. Walsh



George M. Sepsakos