THE ERISA INDUSTRY COMMITTEE
Shaping benefit policies before they shape you.

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Submitted by email to rule.comments@sec.gov

February 14, 2023

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

Re: Comments on File Number S7-26-22

Dear Ms. Countryman:

On behalf of The ERISA Industry Committee (ERIC), thank you for the opportunity to submit comments on the proposed rule entitled "Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-Port Reporting," Release Nos. 33-11130; IC-37746; File No. S7-26-22, published on December 16, 2022, in the *Federal Register* (Proposed Rule or proposal).[1] As discussed below, ERIC respectfully requests the proposal be withdrawn or amended to exempt transactions involving retirement plans.

ERIC is a national nonprofit organization exclusively representing the largest employers in the United States in their capacity as sponsors of employee benefit plans for their nationwide workforces. With member companies that are leaders in every economic sector, ERIC is the voice of large employer plan sponsors on federal, state, and local public policies impacting their ability to sponsor benefit plans.

Americans engage with an ERIC member company many times a day, such as when they drive a car or fill it with gas, use a cell phone or a computer, watch TV, dine out or at home, enjoy a beverage or snack, use cosmetics, fly on an airplane, visit a bank or hotel, benefit from our national defense, receive or send a package, or go shopping.

ERIC member companies sponsor retirement plans, including both defined benefit and defined contribution plans, that are governed by the *Employee Retirement Income Security Act of 1974*, as amended (ERISA). Millions of workers and retirees participate in these plans. While the Securities and Exchange Commission (SEC or Commission) does not have interpretive

[1] 87 Fed. Reg. 77172.

jurisdiction over ERISA, its rulemakings have the potential to significantly disrupt the operations of private-sector retirement plans.

According to the Investment Company Institute's 2022 Investment Company Fact Book, employer-sponsored defined contribution plans, such as 401(k) plans, account for $11 trillion in assets.[2] Nearly 60 percent of this $11 trillion in private sector defined contribution plan assets is held in mutual funds.[3] Notably, 54 percent of all mutual fund assets is held in retirement accounts.[4] Therefore, a regulation affecting mutual funds has the potential to have major consequences for the operation of retirement plans and their service providers. Indeed, the Commission acknowledges that most mutual fund orders are placed through intermediaries, such as retirement plan recordkeepers. [5]

The stated purpose of this complicated Proposed Rule is to require open-end funds[6] (such as most mutual funds) to engage in "swing pricing," a process under which net redemptions of a fund forces the net asset value (NAV) downward. This allocates the transaction costs of redeeming shares to the selling shareholders.[7] Funds have been able to implement such a policy on a voluntary basis since 2016, but *not one U.S. fund* has done so.[8]

In order to operationalize this requirement, there must be an established cut-off time to receive purchase and redemption orders in order to receive that day's price. This "hard close" time is set at 4 p.m. Eastern Time under the proposal. According to the Commission, this hard close would facilitate the information funds need to implement swing pricing, prevent late trading, and reduce operational risk.[9]

The Commission itself seems to understand the unique challenges this proposal creates for retirement plan recordkeepers and asks whether they should receive a general exemption from the hard close requirements.[10] **The answer is yes; in ERIC's view, applying a hard close requirement to transactions involving retirement plans is inappropriate.**

We focus our comments on this aspect of the proposal.

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[2] Investment Company Institute, 2022 Investment Company Fact Book 139, *available at* https://www.ici.org/system/files/2022-05/2022_factbook.pdf.
[3] *Id.* at 158. According to ICI, $6.368 trillion of $10.975 trillion is held in mutual funds.
[4] *Id.*
[5] Proposal, *supra* note 1, at 77178.
[6] Exchange-traded funds (ETFs) and money market funds are exempt from this proposal.
[7] U.S. Securities and Exchange Commission, "Fact Sheet: Open-end Fund Liquidity Risk Management and Swing Pricing," *available at* https://www.sec.gov/files/33-11130-fact-sheet.pdf.
[8] Proposal, *supra* note 1, at 77177.
[9] *Id.* at 77184.
[10] *Id.* at 77214.

The Proposal Would Require Significant Technological and Process Changes by Retirement Plans and Recordkeepers

The Commission admits that in response to the new hard close requirement, "*funds and intermediaries would need to make significant changes to their business practices*."[11] In fact, the Commission acknowledges that retirement plans and their recordkeepers would face serious disruptions in attempting to comply.

First, as the Commission acknowledges, "*most retirement plan recordkeepers currently do not process orders from investors until they receive a fund's NAV and funds typically receive orders from these intermediaries the next morning*."[12] The proposal would flip this procedure on its head.

Under the proposal, intermediaries like retirement plan recordkeepers would be required to set an internal cut-off time for receiving purchase or redemption orders earlier than the time established by the fund. Investors using an intermediary, therefore, would be significantly disadvantaged relative to an investor submitting an order directly to the fund.[13] Further, some intermediaries rely on other intermediaries to submit orders to the fund's transfer agent.

> *We understand that retirement plan recordkeepers may face particular challenges with adhering to the proposed hard close requirement. Retirement plan recordkeepers may employ a method of order processing that relies on receiving the current day's NAV before submitting orders. Funds do not typically receive the order flow information for transactions from retirement plan recordkeepers until well after the day's NAV has been calculated... We understand that the time it currently takes between when some retirement plan recordkeepers begin to process their orders and when the order is finally submitted to the fund can take upward of six hours due to the limitations of their current processing systems and hardware. We believe that retirement plan recordkeepers would need to substantially update or alter their processes and systems to accommodate the proposed hard close requirement to submit orders more quickly.*[14]

And plan recordkeepers perform compliance checks prior to sending the order for execution. This often takes hours. If the recordkeeper itself uses an intermediary, the process will become even more complicated and costly. In sum, in order to comply, not only would there need to be an earlier cutoff time for participant orders, but plan recordkeepers would need new technological processes and systems, including changes to the batching and submission process.

[11] *Id*. at 77212.
[12] *Id.* at 77238.
[13] *Id.* at 77212.
[14] *Id.*

The Proposal Would Harm Participants Taking Retirement Plan Distributions

The Proposed Rule creates operational challenges specific to retirement plans. For instance, plan rules may require a fund's NAV prior to executing participant instructions under the plan.[15] One such example could include retirement plan rules dictating that transactions like plan loans or withdrawals remain incomplete until each fund in a participant's account is valued using that day's prices.[16] The challenge could be particularly acute if there is an "order of operations" for sequential transactions that could involve different funds. Under the "hard close" proposal, instead of these being processed after one day, each of these transactions may need to occur sequentially over the course of several days, further disrupting plan operations and investor expectations.[17] Asset allocation rebalancing requests could suffer the same problems.

The Commission relegates these concerns by saying that same-day pricing is usually not important because "*[m]ost fund shareholders are long-term investors, and thus we believe that most fund orders are not time sensitive*."[18] Even if true (and it may not be true in the case of plan loans, for instance), retirement investors will be in a second-class position with respect to market events that affect share price later in the day. The relative disadvantage placed on retirement plan participants using intermediaries is unacceptable. For this reason alone, the proposal should be withdrawn or made inapplicable to retirement plans.

The Commission Has Not Estimated the Costs of the Proposal on Retirement Savers and Plan Sponsors

Ultimately, plan sponsors and participants will bear the costs of these new requirements. The Commission itself recognizes that the proposal would "*impose significant switching costs*" related to business practices and technologies that would be passed on to investors.[19] And, these costs would be particularly burdensome for savers that do not have a choice in financial intermediary, such as retirement plan participants. To justify imposing these disruptions on the retirement system, the Commission must produce a credible estimate of the financial burdens these new requirements will impose on savers (regardless of whether they are short- or long-term investors) both directly and through new costs to their recordkeepers. Unfortunately, the Commission freely admits that it cannot quantify the costs of this requirement.[20] The proposal should be withdrawn until such a time as the Commission can submit cost estimates for public comment.

[15] *Id.* at 77238.
[16] *Id.* at 77213
[17] *Id.*
[18] *Id.* at 77213.
[19] *Id.* at 77260.
[20] *Id.* at 77261.

Conclusion

For all of these reasons, the proposed rule should be withdrawn. If the Commission does not withdraw the rule, the hard close requirement should be made inapplicable to transactions involving retirement plans. The Commission could do this by permitting retirement plans to submit orders after the hard close deadline.

Sincerely,

Andy Banducci