Northern Trust Investments, Inc.
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312-630-6000

February 14, 2023

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

Re: Response of Northern Trust Investments, Inc. to Proposed Rule on Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting (File No. S7-26-22)

Dear Ms. Countryman:

Northern Trust Investments Inc. ("NTI" or the "Investment Adviser")[1] is pleased to submit these comments to the Securities and Exchange Commission (the "SEC") on proposed amendments to open-end fund liquidity risk management programs and swing pricing under the Investment Company Act of 1940 ("Act") and the rules and forms thereunder ("Proposed Amendments").[2]

NTI serves as investment adviser to the Funds, which are registered open-end funds, the substantial majority of which would be impacted by the proposed rule and form amendments.[3] As of December 31, 2022, the Funds had approximately $42 billion in net assets (excluding the money market funds). Along with the Funds, NTI and its affiliated entities offer a range of solutions to investors, including institutional money market funds, collective investment trusts, exchange-traded funds, UCITs and separately managed accounts. Because of the importance of

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1 NTI is an indirect subsidiary of Northern Trust Corporation ("Northern Trust") and serves as the investment adviser of the Northern Funds (the "Funds") and is responsible for their overall administration. Northern Trust is a leading provider of wealth management, asset servicing, asset management and banking to corporations, institutions, affluent families and individuals. As of December 31, 2022, Northern Trust had assets under custody/administration of approximately US $13.6 trillion and assets under management of approximately US $1.3 trillion.

2 Proposed Rule on Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting, Fed. Reg. 77,172 (Dec. 16, 2022) ("proposing release").

3 39 of 41 series of the Funds would be impacted by the Proposed Rules (two are money market funds).

the mutual funds that NTI offers to our clients, NTI welcomes this opportunity to engage constructively with the SEC regarding regulatory reform measures for mutual funds.

NTI's views on the Proposed Amendments are summarized below:

- While NTI supports a risk-targeted liquidity risk management framework, the specific and prescriptive proposed amendments to the existing liquidity risk management program are unnecessary and inconsistent with efficient risk management practices.
- Making the current optional swing pricing framework mandatory would fundamentally change how open-end funds are priced, would require operational changes that may not be practicable and would likely impose substantial costs that would harm the Funds' shareholders.
- The proposed hard close, which is designed to support the proposed swing pricing requirement, would materially and adversely change the nature of open-end funds and disadvantage the Funds' shareholders in general, and retirement shareholders in particular.
- The proposed amendments are not calibrated to reflect consideration of costs in relation to potential benefits; the costs of the proposed amendments, which are understated, far outweigh any incremental benefits.
- The proposed amendments risk reducing the utility of open-end funds for important segments of the individual investor market.

We understand that others in the industry, including the Investment Company Institute, the Mutual Fund Directors Forum and the Independent Directors Council, are submitting comments highlighting similar concerns, and we urge the SEC to seriously consider these comments and reassess and balance the need for such fundamental changes in light of the lack of clear evidence of significant dilution and the negative impact the Proposed Amendments would have on fund shareholders.

I. The existing liquidity risk management framework already adequately protects shareholders from dilution.

In 2016, the SEC adopted Rule 22e-4 under the Investment Company Act (the "Liquidity Rule"), which requires open-end funds to adopt and implement liquidity risk management programs and establishes a robust liquidity framework.[4] In 2018, the SEC adopted amendments that were designed to improve the reporting and disclosure of liquidity information by open-end funds.[5]

Consistent with the Liquidity Rule, the Funds have adopted and implemented a comprehensive liquidity risk management program and liquidity framework, which includes, among other things, regular reporting to the board of trustees of the Funds. The liquidity risk management program has functioned as intended, and the Funds have in the past and continue to

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[4] *See* Investment Company Liquidity Risk Management Programs, 81 Fed. Reg. 82142 (Nov. 18, 2016).

[5] *See* Investment Company Liquidity Disclosure, SEC Release No. IC-33142 (June 28, 2018).

be able to meet requests for redemption without significant dilution of remaining investors' interests in the Funds.

As further discussed in Section IV, the SEC has not demonstrated that the Proposed Amendments are necessary to protect shareholders from dilution. The proposing release appears to base its justification for the changes on the fact that, since the adoption of the Liquidity Rule, open-end fund assets have increased. In addition, the proposing release points to the experience of some open-end funds in March 2020 and claims that the SEC's examination of funds' liquidity risk management programs has:

> identified weaknesses in funds' liquidity risk management programs that can cause delays in identifying liquidity issues in stressed periods and cause funds to over-estimate the liquidity of their investments, as well as limited use of tools such as redemption fees or swing pricing that are designed to limit dilution resulting from a fund's trading of portfolio investments in response to shareholder redemptions or purchases."[6]

However, the SEC does not provide evidence that any such "weaknesses" resulted in significant dilution. Thus, the proposing release fails to explain or provide adequate support for why amendments to Rule 22e-4 are necessary.

Moreover, the proposed amendments to the Liquidity Rule are overly prescriptive and not appropriately calibrated. As just one example, the Liquidity Rule currently requires a fund to determine a highly liquid investment minimum if it does not primarily hold assets that are highly liquid investments. The Proposed Amendments would require all open-end funds to determine and maintain a highly liquid investment minimum of at least 10% of the fund's net assets. In addition, a fund would be subject to prescriptive adjustments to the highly liquid investment minimum that would be difficult to calculate on a daily basis. These changes would result in many very liquid funds adopting unnecessary and unnecessarily high liquid investment minimums.

More specifically, under normal market conditions (5% pro rata redemption) and stressed market conditions (10% pro rata redemption), the Funds (excluding the money market funds) have in excess of 95% of assets classified as highly liquid as of September 30, 2022. Requiring the Funds to develop and maintain highly liquid investment minimum shortfall policies and procedures is unnecessary. Moreover, the Proposed Amendments could force the Funds' portfolio managers to hold liquid assets outside of what the portfolio managers believe appropriate for the Funds' publicly disclosed strategies, which would be inconsistent with efficient risk management practices, confusing to shareholders and could negatively impact the Funds' returns.

II. Mandating swing pricing is an inappropriate one-size-fits-all solution.

[6] 87 Fed. Reg. at 77,175.

The Proposed Amendment would mandate swing pricing for all mutual funds (other than excluded funds and feeder funds). As further discussed in Section IV and given the SEC's rejection of mandatory swing pricing in 2016, the SEC has not explained or justified why swing pricing now should be mandatory for all mutual funds.

The Proposed Amendments would impose a one-size-fits-all solution. Even in Europe, where swing pricing is a much more commonly used tool, managers have discretion to impose swing pricing and recognize that swing pricing is not appropriate for all kinds of open-end funds in all conditions.[7]

III. A hard close is fundamentally unfair to intermediated shareholders.

Under the proposed rule, mutual funds also would be required to implement a hard close. Currently, if an investor submits an order to an intermediary to purchase or redeem fund shares, that order will be executed at the current day's price as long as the intermediary receives the order before the time the fund has established for determining the value of its holdings and calculating its NAV, which is typically 4 p.m. ET. The fund, however, may not receive information about that order until after it calculates its NAV.

To implement swing pricing, however, the fund or one of its service providers, such as a transfer agent or a registered clearing agency, must receive order flow information prior to the establishment of that day's share price to allow the fund to determine whether to implement the swing factor and the size of any swing factor. The Proposed Amendments attempts to address this information gap with a blunt tool - an investor would only be eligible to receive the current day's price for a sale or redemption of a fund's shares if the fund, its designated transfer agent or registered securities clearing agency (collectively, "designated parties") receives an eligible order prior to the time a fund calculates its NAV. An investor whose order is received by the designated parties after such time would receive the next day's price and would be subject to market risk during this time.

A hard close is fundamentally unfair to shareholders as it would create inconsistent treatment of shareholders within funds, as shareholders may receive different prices based on which intermediary they invest through. [8] Retirement investors would be particularly negatively impacted as retirement plan recordkeepers' systems generally do not initiate batch processing until a fund's final NAV is received or until final NAVs are received for all funds offered on their platforms, and their investors likely would be unable to access same-day pricing.

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[7] *See*, *e.g*., The Investment Association, "Enhancing Fund Pricing" (Oct. 2022), available at: www.theia.org/sites/default/files/2022-10/Enhancing%20Fund%20Pricing%20October%202022_0.pdf. Moreover, this study indicates that swing pricing may not operate effectively during periods of stress.

[8] Moreover, a hard close would result in some shareholders being subject to a short-term suspension of the right of redemption. While the Proposed Amendments purport to be based on concerns about dilution, particularly for longer-term shareholders, the proposing release does not indicate that the current system has resulted in backward pricing, which was the policy concern underlying the Act. As we discuss more broadly in Section IV, it is not clear how longer-term shareholders will receive benefits from the Proposed Amendments that outweigh the costs to them.

Moreover, investors expect a mutual fund to provide same-day pricing, and the Proposed Amendments confound these expectations. The Proposed Amendments also would subject such investors to risk of loss, particularly during periods of market volatility.

To comply with the proposed hard close requirement, funds, fund service providers and intermediaries would need to make significant changes to their business practices, including updating their computer systems, altering their batch processes, or integrating new technologies that facilitate faster order submission (*i.e.*, before 4 p.m. ET). Some intermediaries may be unwilling to make the necessary changes, and even those that are willing are likely to pass on the costs of such changes, which ultimately will be borne by investors.

IV. The proposing release does not adequately identify or analyze costs and benefits.

The economic analysis in the proposing release is deficient. Before any fundamental changes are adopted to a framework that has served investors well for over 80 years, the SEC should do a much more thorough analysis of whether any changes to the current framework would actually produce meaningful improvement.

In adopting the Liquidity Rule and associated rulemaking, the SEC considered and rejected making swing pricing mandatory. The adopting release acknowledged that the benefits of swing pricing may not justify the costs: "We appreciate the commenters' concerns that swing pricing may have costs that, for some funds, may not be justified by the benefits."[9] The proposing release does not indicate that anything has materially changed, and making swing pricing mandatory still is not justified. The proposing release does not provide evidence that funds have had difficulty meeting redemptions, or that funds' management of redemptions has diluted non-redeeming shareholders. Indeed, it fails to quantify or even give a qualitative assessment of actual levels of dilution. The proposing release appears to justify the determination to make swing pricing mandatory, in part, on the fact that no mutual funds have voluntarily adopted swing pricing since the Liquidity Rule was adopted. The failure to adopt a tool that has been criticized for years as being operationally impracticable and upsetting historically understood and accepted features of mutual funds cannot be a reason to justify mandating that tool.

Moreover, only very minor costs are actually quantified in the proposing release, *e.g.* implementation costs.[10] The cost-benefit analysis generally acknowledges that the SEC is unable to quantify the much more significant costs the Proposed Amendments would impose:

- We are not able to quantify many of the costs associated with the proposed swing pricing framework for several reasons. First, we do not have granular data on the current practices and operating costs for all funds, which might allow us to estimate how their systems would change as a result of the proposed swing pricing

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[9] Investment Company Swing Pricing, 81 Fed. Reg. at 82,092 (Nov. 18, 2016).

[10] For example, the economic analysis estimates that, with regard to the liquidity risk management program, the "modification of existing collection of information requirements would result in an annual cost increase of $7,101 per fund." 87 Fed. Reg at 77,250.

requirement. Second, we cannot predict the number of investors that would choose to keep their investments in the mutual fund sector nor the number of investors that would exit mutual funds and instead invest in other fund structures such as ETFs, closed-end funds, or CITs. We also cannot estimate how many funds would choose to upgrade their systems and processes in order to comply with the proposed swing pricing requirement versus how many funds would instead convert to an ETF or a closed-end structure.[11]

The cost-benefit analysis also acknowledges that the SEC is unable to quantify the much more significant costs related to various aspects of the Proposed Amendments:

- With regard to the liquidity risk management program: "funds may experience other costs related to changing business practices, computer systems, integrating new technologies, etc. We are not able to quantify many of these costs."[12]
- With regard to swing pricing: "Funds would also incur additional operational costs associated with establishing and implementing swing pricing policies and procedures, including the periodic calculation of swing factors associated with the swing pricing framework's thresholds. In addition, the economic benefits of swing pricing would be offset by the costs associated with the proposed hard close requirement. Finally, to the extent that the proposed swing pricing framework would make mutual funds less attractive to investors, mutual funds may experience investor outflows and/or reduced inflows." (citations omitted).[13]
- With regard to a hard close, the economic analysis acknowledges that the Proposed Amendments may have an impact on transfer agents, and intermediaries who "may have to update systems" and particularly retirement-related service providers: "For example, retirement plan recordkeepers and any affiliated brokers and trust companies, as well as DCS&S, would have to modify their processes and systems substantially, as these processes currently require daily price information for all investments prior to processing of any investment instructions from the plan participants. In addition, retirement plans may have to modify their provisions, and employers sponsoring these plans may need to modify payroll systems, as well as change the information (*e.g.*, websites, manuals, and training materials) they provide to employees regarding how to submit orders, as a result of the hard close requirement."[14] Moreover, while the SEC acknowledges that it proposed a hard close requirement in 2003[15] but did not adopt such a requirement, it does not adequately explain what has changed to now justify mandating a hard close.

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[11] 87 Fed. Reg. at 77,250.

[12] *Id*.

[13] 87 Fed. Reg. at 77,256.

[14] 87 Fed. Reg. at 77,260.

[15] *See* Amendments to Rules Governing Pricing of Mutual Fund Shares, 68 FR 70388 (Dec. 17, 2003).

- The economic analysis also acknowledges that "not all intermediaries may be able to comply with the hard close requirement" and therefore mutual funds and their shareholders may have less choice.[16]

We understand that the Investment Company Institute is providing additional information on the cost, resources and efforts that would be required across service providers in the industry, and we strongly encourage the SEC to undertake a meaningful analysis of such costs as well as the costs to shareholders, including limited choice.

V. If adopted as proposed, mutual funds will become less competitive.

As discussed above, the Proposed Amendments would entail significant costs that would be passed to mutual fund shareholders. Intermediaries may not be willing to work with mutual funds. Retirement platforms will be particularly impacted. Shareholders may be subject to increased market risk vis-à-vis other investment products. As a result, the mutual fund product will no longer serve many of its intended functions that investors seek and value, and mutual funds may no longer be viewed by investors as an attractive investment vehicle to help manage their investing needs. Alternative products may not serve investors as well as mutual funds.

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NTI appreciates the opportunity to submit the foregoing comments. Should you have any questions, please contact the undersigned.

Very truly yours,

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Peter Ewing
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cc: The Honorable Gary Gensler
The Honorable Jaime Lizarraga

[16] 87 Fed. Reg. at 77,260.

The Honorable Caroline A. Crenshaw
The Honorable Hester M. Peirce
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