American Bankers Association
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Submitted via email to rule-comments@ sec.gov

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

Re: Proposed Rule, Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting, File Number S7-26-22, 87 Federal Register 77172 (Dec. 16, 2022).

Dear Ms. Countryman:

The American Bankers Association[1] (ABA) appreciates the opportunity to comment on the Securities and Exchange Commission's (SEC or Commission) proposed amendments to open-end fund rules that address liquidity risk management programs and swing pricing.[2] According to the release, the amendments are designed to help mitigate dilution of shareholder interests in an open-end fund by mandating the use of swing pricing in certain circumstances. In order to help operationalize the swing pricing, however, the rules would impose a "hard close" requirement whereby an investor seeking to purchase or redeem shares of a fund would only receive the current day's net asset value per share (NAV) if the fund, its designated transfer agent, or a registered securities clearing agency receives the investor's purchase or redemption order before the fund calculates its NAV, typically as of 4:00 p.m. Eastern Time (ET). The proposal would also amend liquidity classification and disclosure rules.

ABA member banks, savings associations, and trust companies (collectively, banks) have great concerns about the proposal's negative effect on bank fiduciary, custody, and other client

[1] The American Bankers Association is the voice of the nation's $23.6 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $19.4 trillion in deposits and extend $12 trillion in loans.
[2] Proposed rule *available at* https://www.federalregister.gov/documents/2022/12/16/2022-24376/open-end-fund-liquidity-risk-management-programs-and-swing-pricing-form-n-port-reporting.

accounts that are invested in open-end funds as well as retirement accounts that are invested in both mutual funds and bank-maintained collective trust funds (sometimes referred to a collective investment trusts). Of particular concern is the proposed hard close requirement for receipt of purchase and redemption orders. As ABA noted twenty years ago in response to the SEC's 2003 Hard Close Proposing Release[3] and as we reiterate herein, such a requirement would have a discriminatory impact on, distinctly disadvantage, and potentially result in reduced investment returns for, individuals investing for retirement. Specifically, the proposal would adversely impact the (i) availability, timing, and execution of these investors' investment decisions, (ii) the price obtained for purchased and redeemed fund shares because of potential delays in the transaction, and (iii) the availability of certain distribution channels.

The SEC has not made the case for unnecessarily upsetting an efficient and cost-effective intermediated system, one that has worked well for investors and other participants in our complex financial markets - particularly small investors who invest through intermediaries or through their retirement plans. Rather, the proposed amendments would needlessly: (i) disrupt settlement transactions, (ii) interfere with the investor decision-making process, (iii) disadvantage individual investors, especially retirement plan investors, transacting through an intermediary, and (iv) drive up costs for investors. If the amendments are finalized as proposed, the SEC, in the name of market reform, would ironically strip protections from certain retail and retirement plan investors, thus violating its statutory mandate to protect the investing public. Further, the SEC seems to have issued this significant proposal without soliciting the perspectives of either the Department of Labor or the Office of the Comptroller of the Currency (OCC) and other bank regulators, who have substantial responsibilities for protecting retirement plan and other investors. We, therefore, on behalf of our members and their investor clients, strongly urge the Commission not to proceed with any new rule that would result in a hard close requirement for mutual funds.

Retirement Plan Investors Would Be Significantly Harmed By Hard Close Requirement

As demonstrated with the enactment of the SECURE Act of 2019 and more recently the SECURE Act 2.0 in December 2022, Congress and the last few Presidential Administrations

[3] ABA Letter to SEC (Feb. 13, 2004), available at https://www.sec.gov/rules/proposed/s72703/abankera021304.htm. ABA Letter to SEC (Nov. 12, 2003), available at https://www.sec.gov/rules/proposed/s72703/s72703-13.pdf.

have devoted considerable political and policy efforts to protecting retirement savings and increasing investment options for retirement plan participants. The hard close requirement would undermine these recent positive efforts by imposing unreasonable burdens the Commission admits are not fully quantified. Ultimately, the hard close would make a retirement investor's portfolio allocation less efficient and the use of intermediaries by all investors less competitive, and diminish their ability to contribute to capital formation. These three effects are at odds with the statutory edict for the SEC to consider exactly these types of costs:

> Whenever pursuant to this subchapter the Commission is engaged in rulemaking and is required to consider or determine whether an action is consistent with the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[4]

Due to complex processing of retirement plan participant investments by plan recordkeepers and other first and second line intermediaries, the hard close requirement will particularly harm retirement investors. The steps involved in processing a retirement plan participant's investment transaction include: (1) the participant initiating the purchase or redemption order; (2) the recordkeeping system reconciling the order with the participant's account; (3) the recordkeeper netting the order with other orders placed by other participants in the plan; and (4) the recordkeeper sending the net order to the second line intermediary to place with the fund, transfer agent, or clearing agency. This processing ultimately can take 6 hours or more.

One of the presumed benefits to the first line intermediaries is that they can offer a robust selection of investment options to their clients without having to enter into order transmission agreements with the possibly hundreds of fund companies Rather, the first line intermediaries need only enter into order transmission agreements with the second line intermediaries. The second line intermediaries can leverage their size and infrastructure to enter into order transmission agreements with the fund companies and efficiently transmit investor purchase and redemption orders without directly servicing the end investors.

The hard close requirement would disrupt this ecosystem and force intermediaries to set order placement cut off times as early as 10:00 a.m. ET to provide sufficient time for processing at that day's NAV. For those in the western states, this would require participant orders to be

[4] 15 USC 80a-2(c). *See also*, Chamber of Commerce v. SEC, 412 F.3d 133 (DC Cir. 2005) and Business Roundtable v. SEC, 647 F.3d 1144 (DC Cir. 2011), articulating the duty of the SEC to consider the burdens of proposals on "efficiency, competition, and capital formation."

placed by 7:00 a.m. Pacific Time, or earlier. Retirement plan investors therefore would have their orders processed using the fund's next day NAV in most circumstances. Investors with accounts held directly with the fund, on the other hand, would have the ability to place their order to purchase or redeem fund shares up until 3:59 pm ET, with that order processed at the NAV calculated as of 4:00 pm ET that same day. Thus, most retirement plan participant investments would be subject to more market risk from having to place trades earlier in the day with less information and from being out of the market for at least one additional business day as compared to investors who transact directly with the fund. Investing more directly with the mutual fund through an individual retirement account may allow for later order placement, but those investments would not have the benefit of employer matches or higher contribution limits of defined contribution plans, such as 401(k) plans.

In addition to the burdens imposed with simple purchase and sale orders noted above, a plan participant seeking to make a transfer from one fund to another in their plan investment menu, especially if the funds are not within the same fund family, would be more significantly affected. Because the intermediary will not know either fund's NAV until after the order cut-off time, the transfer could not be processed until the business day following the day that the participant placed their transfer order, resulting in the investor's loss of an entire day of market performance. A plan participant would also be unable to rebalance their investment account simultaneously among holdings of mutual funds that are not in the same fund family. In the case of an investment account with two mutual fund holdings, because the redemption order of the one mutual fund would not be confirmed until after the cut-off time, the purchase order for the other mutual fund would have to be processed on the following day. Again, the retirement plan investor would be exposed to market risk with no ability to limit that risk between the first processed order and the second processed order.

Lastly, the hard close will inhibit the ability of funds of funds to rebalance investments (e.g., asset class exposures) consistent with their investment mandates. Target date and other asset allocation products are a popular investment option for the less sophisticated investor who wishes to have their asset allocations professionally managed over time. Defined contribution plan sponsors commonly use these products as default investment options. Target date and asset allocation products may be organized as registered investment companies, bank-maintained collective trust funds or managed accounts, and many invest in mutual funds that would in turn

be affected by the hard close. The earlier order cut-off time would harm long-term investors by requiring rebalance orders to be placed earlier in the day (with less market information) and/or potentially over two or more business days (with more time out of the market). These effects would put retirement savers at a particular disadvantage because they typically lack the desire, time and/or sophistication to themselves research and implement rebalancing and reallocation of their retirement portfolios over the course of their working lives.

Hard Close Could Impose Burdens on Investors in Bank-Maintained Collective Trust Funds

As noted in the release, bank-maintained collective trust funds are created and regulated under banking and tax laws and generally exempt from most SEC regulation. Due to their unique attributes, these funds provide a beneficial and cost-effective investment option for retirement plan sponsors and their participants. In the case of a collective trust fund in which assets of a plan that is subject to the Employee Retirement Income Security Act of 1974 (ERISA) are invested, the fund is not only subject to banking regulation and examination, but also to ERISA and regulations thereunder, including those pertaining to fiduciary duty. Importantly, under applicable law, the banks that maintain collective trust funds have several ways to mitigate or avoid investor dilution that could result from large purchases and redemptions. These include the externalization of transaction costs that result from purchase and redemption transactions in the case of index or model-driven funds (as those terms are defined under bank regulatory guidance), as well as the ability to require in-kind purchases and redemptions in order to mitigate transaction cost impact on the fund in the case of large transactions. However, while collective trust funds are an alternative to registered mutual funds for retirement plan investors, they would not be subject to the SEC proposed rule.

We are, therefore, very concerned with the expected indirect burden that the proposed rule will place on collective trust funds. Retirement plan recordkeepers and other intermediaries often make available both mutual funds and collective trust funds as investment options for their retirement plan clients on their platforms. If required to impose an earlier order cut off time for purchases and redemptions of mutual fund shares, the recordkeepers and intermediaries, in order to ensure consistency, efficiencies, and parity, would likely implement system changes that uniformly apply to *all* available investment options including collective trust funds, whether or

not directly subject to the SEC's rule. Thus, retirement plan participants would suffer the same disadvantages in placing orders to purchase and redeem interests in the collective trust funds to which they would be subject in placing orders to purchase and redeem mutual fund shares - most notably, the earlier order cut off time and related risks. The SEC's proposing release does not contemplate this adverse effect on investors in bank-maintained collective trust funds, but it should be considered in the SEC's cost benefit analysis.[5]

Additional Costs Imposed on the General Investing Public that Uses Intermediaries

The hard close requirement will create additional costs and inefficiencies for the intermediaries that service retail, retirement plan and institutional investors. Every level in the intermediary system, from the community bank's trust department to the largest money center institutions, will necessarily incur costs to adjust to the new requirements, which may be reflected in increased expenses for their customers including:

- Changes to information technology, recordkeeping, accounting systems, and other critical operations to allow for an earlier order cut off time. The earlier order cut off time, which may vary from institution to institution, would likely lead to more frequent batch processing throughout the day and impose more computing burdens on IT infrastructure during the daytime. Most institutions take advantage of after-hours periods to conduct these processes, because of the expense and risk of doing so during the day when many other systems are also taking up precious computing power.
- Changes to order transmission agreements with mutual funds, as well as customer agreements and disclosure materials to reflect the new requirements and order cut off times. Some of these agreements may require individual negotiation.
- The earlier order cut off time could limit and/or complicate the ability of intermediaries to cancel and correct orders promptly.
- New communication programs to educate and answer questions from retirement plan and retail investors about how the changes affect their ability to make transactions. Additional training of staff to answer those questions would be required.
- The hard close requirement ironically would convert the advantages of the intermediary system – such as providing investors with a single access point for a wide variety of investments, and the use of first line intermediaries to provide local service while leveraging second-line intermediaries' infrastructure and size – into liabilities. Ultimately, each successive level in the intermediary system would require an earlier

[5] To the extent ETFs are also offered through a retirement plan, this same disadvantage will likely affect the ability of investors to purchase and sell ETFs even those these funds are not directly impacted by the SEC proposed rule.

order cut-off time, and no two intermediaries are likely to experience the same challenges.

The SEC economic analysis notes that the proposal "may impose significant switching costs…on funds, their intermediaries, and service providers that could ultimately be passed on to investors," including through "less diversified portfolios," and "market risk for investors that trade via intermediaries with earlier cut-off times." Further, the release acknowledges the likely harm to retirement investors reliant on the timing of employer payroll contributions, particularly those in the western states.[6] The Commission further concedes that it is not "able to quantify many of the costs of the hard close," because it does not have information "related to the current practices and operating costs for each intermediary type."[7] Notwithstanding this admission, the Commission has proposed to move its proposal forward, apparently on an accelerated timeline.

Without a full understanding or accounting of the potential financial costs and other disadvantages noted above, the Commission would be remiss to conclude that the hard close burdens on investors, particularly retirement investors and their service providers, demonstrably outweigh its purported benefits. The requirement is not warranted or reasonable and should be dropped.

[6] The Commission in the release suggests several possible alternatives to both the complex swing pricing methodology and the hard close requirement. However, in practice, all of these alternatives would impose substantial burdens on market intermediaries such as our member banks that process mutual fund purchase and redemption orders for fiduciary clients including retirement plans. The alternatives would all also likely require earlier order cut off times for investors.

[7] As one of the justifications for the proposed rule, the release points to the adoption of swing pricing by certain European funds in March 2020. We do not believe that example is relevant in the United States, where retail investors are the predominant investors in pooled funds, most often using intermediaries to facilitate those investments. *See* EFAMA, Asset Management in Europe (December 2022), available at https://www.efama.org/sites/default/files/files/Asset%20Management%20Report%202022.pdf. The report notes in Exhibit 4.2 that retail (household and high net worth) investors account for 48% percent of investment fund clients. Further, unlike European retirement systems, which do not incorporate significant participant choice, U.S. defined contribution plans using first and second line intermediaries facilitate the ability of individuals to manage directly their retirement savings. The ICI Fact Book reflects that 81% of U.S. households owning mutual funds do so inside employer-sponsored retirement plans. Furthermore, among U.S. households that own mutual funds outside employer-sponsored retirement plans, the majority of such households hold them through an investment professional, such as a bank or broker dealer. *See* 2022 Investment Company Institute Fact Book, available at https://www.icifactbook.org/, at Figure 7.8 (indicating that only approximately 18% of U.S. households owning mutual funds purchased them directly from the mutual fund company).

Conclusion

ABA appreciates the opportunity to comment on the SEC's proposed Open-End Fund Liquidity Risk Management Programs and Swing Pricing rulemaking. We are greatly concerned that the proposal would disadvantage retail investors, especially retirement plan investors, transacting through an intermediary, as well as indirectly harm investors in bank-maintained collective trust funds. On behalf of our bank members and their investor clients, we strongly urge the Commission not to proceed with any new rule that would result in a hard close requirement for mutual funds.

Sincerely,

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