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VIA ELECTRONIC SUBMISSION

February 14, 2023

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

Re: *Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting (File No. S7-26-22)*

Dear Ms. Countryman:

We appreciate the opportunity to comment on the Securities and Exchange Commission's (the "Commission's") proposed amendments[1] (the "Proposal") to current rules regarding liquidity risk management programs and swing pricing under the Investment Company Act of 1940 (the "Act") and the Securities Act of 1933.

The Capital Group Companies is one of the oldest and largest privately held investment management organizations in the United States with over 90 years of investment experience. Through our investment management subsidiaries, we actively manage assets in various collective investment vehicles and institutional client separate accounts globally. The majority of these assets consist of the American Funds family of mutual funds, which are U.S. regulated investment companies managed by Capital Research and Management Company, distributed through financial intermediaries and held by individuals and institutions across different types of accounts.

[1] *Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting*, Release Nos. 33-11130; IC-34746; File No. S7-26-22 (November 2, 2022) ("Proposed Rule"), available at https://www.sec.gov/rules/proposed/2022/33-11130.pdf.

We appreciate the Commission's ongoing efforts to improve liquidity risk management, mitigate dilution and enhance reporting of investment companies. However, the regulatory concerns that underlie the Proposal appear to be overstated or nonexistent. In addition, the Proposal would require sweeping and costly changes that will ultimately harm funds and their shareholders. In our view, the Commission minimizes the significant operational burdens and switching costs required to comply with the Proposal. The assumption that financial markets participants, including funds, intermediaries and service providers, can update substantially all of "their business practices, including updating their computer systems, altering their batch processes, [and] integrating new technologies,"[2] in the span of twelve to twenty-four months strikes us as unrealistic. Also, the Proposal places the burdens exclusively on open-end funds.

We generally agree with the comments submitted by the Investment Company Institute (the "ICI"), the Asset Management Group of the Securities Industry and Financial Markets Association and the Society of Professional Asset Managers and Recordkeepers (collectively, the "Industry Letters"), and we write to share our views on the key issues discussed below.

A. Proposed Amendments to Liquidity Risk Management

1. **The stressed conditions identified in the Proposal are infrequent and extreme and open-end funds have been successful in managing liquidity risk to meet shareholder redemptions for decades.**

Open-end funds offer redeemable shares, which entitle a shareholder to a proportionate share of a fund's net assets upon redemption. Such funds are required by the Act to pay redemptions within seven days.[3] As a practical matter, most investors expect to receive redemption proceeds in a matter of days.

We continue to believe that open-end funds have been successful in appropriately managing liquidity risk for decades, including before the adoption of rule 22e-4 under the

[2] Proposed Rule at 140.
[3] See Section 22(e) of the Act.

Act (the "Liquidity Rule").[4] The requirement that all open-end funds (except money market funds) establish a liquidity risk management program, and the specified elements required by each program, underscore that liquidity risk management at the fund level is multi-faceted and specific to each fund. Managing a fund's liquidity requires the consideration of several factors, including the fund's investment strategy, the liquidity of its portfolio investments, investor flows and dilution, characteristics of its shareholder base, fund liabilities, and available liquidity tools, including the ability to raise cash in anticipation of future outflows, short-term borrowing options, access to interfund lending, and the ability to redeem securities in kind.

In our over 90 years of investment experience, we have consistently been able to meet shareholder redemptions in a timely manner. This aligns with the broader industry. In fact, the ICI could only identify twelve instances of funds failing to meet such redemptions over an eighty-year period.[5] The Commission states in the Proposal that due to "the economic shock from the onset of the COVID-19 pandemic, U.S. open-end funds faced a significant volume of investor redemptions. As investors sought to redeem fund investments to free up cash during a time of market uncertainty, open-end funds faced significant redemptions and liquidity concerns."[6] However, it is telling that the Proposal does not include any specific examples of funds failing to meet shareholder redemptions during this period of volatility.[7] We believe funds should not be managed as if infrequent, extreme market conditions like the last quarter of 2008 or March 2020 are the norm. Even when such conditions exist, funds of varying

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[4] See *Investment Company Liquidity Risk Management Programs,* Release Nos. 33- 10233; IC- 32315; File No. S7-16-15 (October 13, 2016) ("Liquidity Rule"), available at https://www.sec.gov/rules/final/2016/33-10233.pdf. As required by the Commission under the Liquidity Rule, each registered open-end management investment company must establish a written liquidity risk management program designed to assess and manage the fund's liquidity risk. The Liquidity Rule requires a fund's liquidity risk management program to incorporate a number of specified elements, including, among other things, (1) assessment, management, and periodic review of the fund's liquidity risk, (2) classification of the liquidity of each of the fund's portfolio investments, as well as at-least-monthly reviews of the fund's liquidity classifications, (3) determining and periodically reviewing a highly liquid investment minimum, and (4) limiting the fund's investment in illiquid investments to no more than 15% of the fund's net assets.
[5] Comment Letter of the Investment Company Institute (February 14, 2023) ("ICI Letter").
[6] Proposed Rule at 12.
[7] See also Proposed Rule at 26 n.44 (noting that "[o]pen-end funds also experienced heightened outflows in other stressed periods, such as the last quarter of 2008, but outflows in March 2020 surpassed those witnessed in these other periods." However, the Proposal does not include any specific examples of funds failing to meet shareholder redemptions during this earlier period of volatility either).

strategies and sizes have demonstrated their ability over time to successfully respond to challenging market conditions and sudden spikes in redemptions—whatever the nature of the shock—with comprehensive risk management programs.

We believe the procedures adopted by our funds under the Liquidity Rule are reasonably designed to assess and manage liquidity risk and meet shareholder redemptions in a timely manner. As discussed in more detail below, many aspects of the Proposal will cause funds to alter their investment strategies to comply with the proposed requirements. This may have the effect of limiting investor returns, thereby making mutual funds less competitive than other investment vehicles like private funds or separate accounts. This could result in more assets being held by products that are not subject to the protections of the Act.

Accordingly, we recommend that the Commission retain the Liquidity Rule. Any amendment to that framework should recognize the vital role that reasoned judgment and discretion play in evaluating market conditions and managing liquidity risk in a fund's portfolio. If adopted, the Proposal would place unnecessary burdens on mutual funds and the retail investors who invest in them.

2. The proposed amendments do not account for the vast diversity of open-end funds and are overly prescriptive with a one-size-fits-all framework.

The Proposal introduces overly prescriptive, one-size-fits-all requirements relating to the manner and frequency in which funds must classify each of their portfolio holdings, as well as the definition of the liquidity buckets. This one-size-fits-all framework is inconsistent with the practical realities of liquidity risk management, which (i) utilizes a variety of tools to assess and manage liquidity and (ii) recognizes these tools are not appropriate in all cases and are dependent on a multitude of factors and criteria, including, but not limited to, market conditions, shareholder activity and the fund's level of cash and other highly liquid assets.

Unlike the Liquidity Rule, where funds have an appropriate level of discretion to classify fund investments and determine a highly liquid investment minimum ("HLIM"), the Proposal forces an overly prescriptive framework on all open-end funds. This framework not only overlooks the vast diversity of such funds, but also (as acknowledged by the

Commission) will reduce fund discretion and impact portfolio construction.[8] The Commission even admits that under its proposed framework, "[A]lthough funds would follow a more standardized methodology for liquidity classifications, the same investment could be classified differently by different funds, depending on how much of this investment a fund holds, thereby reducing comparability of liquidity classifications between different funds."[9] This result is inconsistent with the Commission's objective of promoting comparable liquidity classifications across open-end funds. The proposed framework also disproportionately affects larger funds solely due to the size of their holdings and ignores other risk mitigants the funds may have in place.

a. The assumption of a sale of a stressed trade size of 10% is excessive compared to actual fund outflows, disproportionately impacts larger funds and would result in many funds having to rebalance their portfolio holdings, despite long track records of successfully managing liquidity risk.

The Commission states that "[r]equiring funds to apply the 10% stressed trade size to each investment would better prepare funds to manage their liquidity in stressed conditions, when a fund may be required to sell positions that are larger than the assumed sale sizes some funds are using currently."[10] However, the analysis relating to this statement is flawed because actual outflows funds face—even in stressed conditions—vary widely and are typically well below 10%. Based on the Commission's own analysis of historical data from 2009 and 2021, outflows greater than 6.6% occurred *only 1%* of the time in a pooled sample across weeks and funds.[11] Although 10% is noted in the Proposal as "moderately higher"[12] than 6.6%, in reality, the Commission increases this figure by almost 50%. Requiring such a high percentage for a stressed trade size is inconsistent with actual or even anticipated market conditions and forces funds to classify and manage investments as if they were under constantly extreme stress. While perhaps suitable for banking products (e.g., certificates of deposit or bank loans), where investors sacrifice returns in exchange for protection against

[8] Proposed Rule at 268-269.
[9] Proposed Rule at 270.
[10] Proposed Rule at 48.
[11] Proposed Rule at 47.
[12] Id.

loss, this approach is inappropriate for capital markets, where investors make informed investment decisions under the Commission's disclosure-based regime for potentially higher returns but also increased risk of loss. This requirement disproportionately impacts larger funds because they typically have less volatile flows, as a percentage of total net assets. Based on an analysis of historical data from 2014 to 2022 for all American Funds, *less than 0.50%* of days experienced outflows greater than 1% of total net assets and *less than 0.10%* of days experienced outflows greater than 5% of total net assets.

The proposed 10% stressed trade size would result in many funds, including funds with long track records of successful liquidity risk management under normal and stressed market conditions, being required to divest from high conviction liquid assets, irrespective of market conditions, in order to comply with the 15% limit on illiquid investments. Accordingly, funds would need to rebalance their portfolio holdings and incur transaction costs, which would be borne by fund shareholders. Importantly, this loss of investment discretion could negatively affect the results of these funds. Some funds would struggle to survive and would be forced to reexamine their portfolio construction, particularly funds focused on small cap and emerging market strategies. This outcome is despite their long track records of successfully managing liquidity risk. If these funds determine they are no longer viable after examining their portfolios and must liquidate, a decrease in the number of funds offering such strategies would harm investors seeking these strategies. This would particularly harm retail investors because these funds may be their only means of accessing such strategies. The Commission knows there are significant costs to comply with the 10% test[13], but justifies them by pointing to a fund's potential lack of preparation for higher-than-normal redemptions, which also can negatively affect fund results[14]. However, this argument presumes that funds generally are unable to generate sufficient liquidity to meet redemptions in a timely manner. This presumption contradicts current and past practices, and the Commission provides no evidence of widespread failure of open-end funds meeting redemptions. Additionally, this 10% test is framed as an "objective" standard, but it would have disparate effects on larger funds, particularly those that invest in securities without high daily average trading volumes or that are subject to extensive market holidays (e.g., small cap

[13] See Proposed Rule at 272-273.
[14] Proposed Rule at 46.

or emerging markets funds). Such funds hold a larger number of securities that may require a sale under the 10% test than smaller funds holding the same securities.

Finally, we do not oppose further efforts to prepare for stressed conditions in liquidity risk management programs. In fact, the Commission provides this guidance in the Liquidity Rule.[15] We believe a more efficient option could be to encourage more robust and discretionary determinations of a "reasonably anticipated trade size" (the "RATS"), but not prescribe a specific methodology since liquidity risk management depends on a particular fund's facts and circumstances. The RATS framework is a more representative and realistic depiction of how funds should react and adjust their portfolio holdings to address liquidity needs. Liquidity tools at funds' disposal include, among other things, trading in smaller lot sizes, divesting from illiquid securities and adjusting the concentration of certain holdings. Instead, the Commission proposes to eliminate the RATS framework and apply one stressed trade size on all open-end funds, regardless of their size and actual market conditions. The Proposal would force funds and their shareholders to incur significant costs to guard against the historically remote risk of a fund not being able to meet redemptions in a timely manner.

b. The minimum value impact standard is overly rigid, does not account for differences in trading characteristics among investments and would lead to anomalous results.

Under the Liquidity Rule, funds are required to use their reasonable judgment to determine what constitutes a significant change in the market value of an investment, considering a variety of factors (e.g., the type and nature of investment, market conditions and the availability of vendors and methodologies) to assess and determine the investment's liquidity.[16] The Proposal, however, intends to apply one method for all open-end funds based on trading volume for listed securities and a decline in price for fixed-income and other

[15] Liquidity Rule at 62 (noting the Commission has "provided guidance [in the rule] regarding each liquidity risk factor and the need to consider normal and reasonably foreseeable stressed market conditions").
[16] Liquidity Rule at 108 (noting the Commission's belief that "a fund's classification policies and procedures should address what [the fund] would consider to be a significant change in market value").

unlisted securities.[17] In each case, the rigidity of the proposed requirements would produce unintended consequences as detailed below.

With respect to measuring average daily trading volume, the preceding 20 business days include those days where U.S. markets are open but where one or more international markets are closed. This contrasts with the current FAQ relating to holidays, which reflects the Commission staff's view that an anticipated extended holiday closure presents liquidity risk that differs from, and in our view is less than, the liquidity risk the reporting regime under Form N-RN is designed to cover.[18] This difference in risk is because, to the extent that investments become illiquid due solely to an extended holiday closure, they are illiquid for a known, temporary duration. As a result, funds can appropriately manage liquidity risk relating to the market closure in advance. We believe that eliminating this FAQ and requiring funds to include holidays in the lookback period results in a distorted picture of liquidity.

In addition, we believe liquidity risk is also different with respect to market-wide technical issues that cause short-term, delayed settlements (e.g., a typhoon which might delay settlement for one to two days should not impact the liquidity classification of the underlying securities that settle in that market), including for foreign exchange of U.S. dollar settlements. We believe the market's historical distinction between securities that are truly illiquid, such as private placements, compared to securities with protracted settlement periods, is a more fair and accurate view of liquidity. Moreover, under the Proposal, a security subject to U.S. sanctions that cannot be legally traded nor converted into U.S. dollars indefinitely would be treated identically to an actively-traded security with a known, albeit protracted settlement period (e.g., due to the proposed day count changes further discussed below, any investment being classified on a Monday which takes more than five days to trade and settle would be classified as illiquid).

With respect to both fixed-income and unlisted securities, although applying a market impact threshold based on a 1% decline in sale price may reduce subjectivity in making liquidity classifications, it would not provide a representative picture of a security's liquidity characteristics. The proposed value impact standard would result in many liquid high-yield

[17] Proposed Rule at 44.
[18] Investment Company Liquidity Risk Management Programs Frequently Asked Questions, available at https://www.sec.gov/investment/investment-company-liquidity-risk-management-programs-faq.

bonds and emerging market securities being classified as illiquid due to their price fluctuations commonly exceeding 1% during normal market conditions. The proposed standard will also lead to inconsistent treatment for similar securities. For example, in normal market conditions, a longer duration bond has higher trading costs than a shorter duration bond. Because trading costs are factored into the 1% decline in sale price, longer duration bonds may be classified as illiquid, although they have similar liquidity characteristics to shorter duration bonds. Such a rigid definition of liquidity would therefore be inconsistent with fixed-income market practices.

A 10% stressed trade size test coupled with the proposed value impact standard for listed or unlisted securities would harm funds and their shareholders due to the certainty of portfolio rebalancings required to comply with the 15% limit on illiquid investments. The 20% average daily trading volume with a 20-day lookback would particularly affect funds with small cap and emerging market strategies, making them appear artificially more illiquid and making it more difficult and costly to meet their investment strategies and comply with other requirements such as rule 35d1-4 under the Act. A forced sale of these "illiquid" securities could lead to increased volatility, price declines, and in volatile markets, create procyclical sales of such securities. We therefore believe that a less prescriptive, risk-based approach is beneficial to funds and shareholders alike and recommend that the Commission retain the existing aspects of the Liquidity Rule's value impact analysis.

3. We oppose mandating a 10% minimum HLIM for funds and changing the 15% illiquid calculation.

The Proposal would amend the HLIM provisions in the Liquidity Rule to require all funds have at least 10% of net assets invested in highly liquid assets. This aspect of the Proposal is designed to ensure that funds have sufficient liquid investments for managing heightened levels of shareholder redemptions. We also oppose this requirement because it is arbitrary and has almost no reasonable relation to a fund's specific liquidity risk factors, even in stressed conditions. The Commission argues that "[g]iven the level of weekly outflows some funds have experienced and the difficulty in predicting future stress events, [it] believe[s] that a regulatory minimum of 10% for the highly liquid investment minimum would benefit investors by improving the ability of funds to meet shareholder redemptions in stressed scenarios."[19] However, once more, this regulatory concern is overstated and the Commission does not include a single example of shareholder redemptions failing to be met in March 2020—the main period of stressed conditions cited throughout the Proposal.[20]

We would not object to removing the "primarily highly liquid" exception and requiring funds (except in-kind exchange-traded funds) to set an HLIM. But we believe funds should be able to do so based on an assessment of their specific liquidity risks. Indeed, this is what the Liquidity Rule already requires for affected funds.[21] In most cases, an HLIM set primarily by flow history—even in stressed conditions—would result in a level well below 10%.

We also object to the Proposal's prescriptive adjustments to the HLIM calculation, including requiring adjustments for (i) highly liquid assets posted as margin or collateral for non-highly liquid derivatives and (ii) fund liabilities. These adjustments would be difficult to calculate on a daily basis (e.g., fund liabilities are not static, and the derivatives-related adjustment would require complicated daily "mapping" of specific margin or collateral assets to specific derivatives). Again, setting an HLIM already requires an assessment of a broad range of liquidity-related factors[22], and the Commission should instead reiterate the importance of considering other claims on fund assets (other than redemptions) in setting an HLIM. For example, if a fund believes that an HLIM of 5% would be appropriate to meet redemptions and conservatively estimates that highly liquid investments committed to non-highly liquid derivatives positions and liabilities together would generally be less than 1%, the fund could then set its HLIM at 6%, avoiding the need for complicated daily adjustments.

Finally, we oppose similar changes to the 15% illiquid calculation because the adjustment would be even smaller than the proposed HLIM adjustment. The reality is a fund's

[19] Proposed Rule at 78.
[20] See Proposed Rule at 30 n.57 (As it relates to some fund managers requesting emergency relief in March 2020 that would provide additional flexibility for interfund lending and other short-term funding to help meet redemptions, the Commission provided this relief for a period of time, but noted that it understood that no fund needed to use it). See also ICI Letter ("The SEC did not grant any exemptive orders permitting one or more funds to suspend redemptions in 2008 or 2020").
[21] Liquidity Rule at 76-77.
[22] See Liquidity Rule at 195 ("In determining its highly liquid investment minimum, a fund will be required to consider the factors the fund also has to consider, as applicable, in assessing its liquidity risk under rule 22e-4").

exposure to illiquid derivatives is usually exceedingly small.[23] This too would be a complex calculation that generally would have a negligible impact on a fund's illiquidity classification. Again, we believe that a comprehensive multi-factor assessment of liquidity specific to each fund's risk and management of that risk suffices and is far superior to the Proposal.

4. The Proposal has additional areas of impact to liquidity risk management which increase costs without commensurate benefits.

Currently, the Liquidity Rule requires funds to classify their investments into four categories: highly liquid, moderately liquid, less liquid, and illiquid. A fund may classify as less liquid those investments reasonably expected to be sold or disposed of in seven calendar days or less without significantly changing the market value of the investment, but where settlement is reasonably expected to occur beyond seven calendar days. The Proposal would eliminate the less liquid category, merging assets currently classified as less liquid with those assets classified as illiquid, leading to an automatic increase in a fund's illiquidity profile and increasing the risks of breaching the 15% illiquidity ceiling. The Proposal would thus result in a distorted depiction of a fund's liquidity profile by mixing investments with protracted settlement periods with those that are truly illiquid. For example, certain newly issued fixed-income securities with longer settlement cycles would be classified as illiquid despite the presence of a readily available market for such securities. Abandoning the less liquid category would have at least the following negative consequences: restrict investment allocation decisions, impede the effective execution of investment strategies sought by shareholders, negatively impact shareholders seeking broad investment exposure to certain asset classes, restrict the ability of funds to operate within established investment guidelines, and likely lead to lower results for funds.[24]

In addition, the Proposal amends the Liquidity Rule to specify that funds must count the day of classification when determining the period in which an investment is reasonably expected to be convertible to U.S. dollars. Currently, the Liquidity Rule does not specify when to begin counting the number of days, which the Commission alleges has led to inconsistent

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[23] Since the adoption of the Liquidity Rule, no illiquid derivatives have been held in any American Funds.
[24] See Comment Letter of the Asset Management Group of the Securities Industry and Financial Markets Association (February 14, 2023) ("SIFMA Letter").

practices and risks of overestimating liquidity classifications. However, requiring funds to count the day of classification as day one is inconsistent with the industry standard for counting trade and settlement dates for mutual fund and individual security transactions. We recommend that the day counting convention for liquidity classifications be consistent with the industry standard to avoid confusion. So, if, on a Monday, a fund determines that it can convert the requisite size of an investment to cash by Thursday, then that should be considered the third business day, and the investment should count as highly liquid.

We also recommend that the Commission preserve the option for funds to use asset class classifications for liquidity determinations. The Commission suggests that asset class classifications are not widely used by many funds, but we believe asset-based classification can be an appropriate and efficient way to classify certain securities. For example, asset class classifications were used broadly and effectively during the recent Ukraine crisis to promptly reclassify sanctioned Russian securities as illiquid. Requiring funds to individually classify every asset they hold, or might hold, will result in significant implementation costs and few benefits for those managers that have built asset-based classification into their comprehensive risk management programs. These costs are even greater given that the Proposal contemplates daily, instead of monthly, classification. We believe moving to daily classification would not bring much benefit as there are no or minimal changes on a day-to-day basis during normal market conditions. Conversely, this would require funds to incur additional operational costs (in our estimate, at least double) and risks to perform this analysis on a daily basis. This increase in costs would be primarily due to (i) the increased amount of data and analysis that vendors would need to process and would seek compensation for and (ii) updates and enhancements to internal systems to daily classify investments not covered by such vendors. In addition, although daily classification theoretically provides a sense of precision, practically it would lead to funds having less time to vet and challenge liquidity results, potentially lowering the quality of their liquidity classifications. If the Commission determines to proceed with requiring funds to classify their portfolio investments each business day, the Commission should allow the daily classifications to be considered provisional and not the basis for a reportable breach until the classifications can be confirmed.

B. Proposed Amendments to Hard Close and Swing Pricing

1. **The proposed amendments to hard close would upend the mutual fund industry ecosystem and impose significant costs on and ultimately disadvantage investors, particularly retail investors.**

For more than 50 years, investors have relied on a 4:00 p.m. cut-off time to place orders through intermediaries, including retirement plan recordkeepers and broker-dealers. This is the same cut-off time for investors placing orders directly with the fund's transfer agent. A 4:00 p.m. cut-off time has become a universal expectation of investors, and the U.S. pricing system has developed a well-established process to accommodate investment vehicles that require the use of intermediaries. Under this process, investor orders are submitted to intermediaries that then collect them into subscriptions and redemptions before submitting them in one or more batches to mutual fund families. Given the significant influx of orders and the involvement of a multitude of intermediaries, the meticulous collation and processing of orders into net subscription or redemption amounts demands a copious amount of work within an extremely tight deadline. Knowing these challenges and to ensure that smaller investors could place orders and receive same-day pricing, the Commission adopted a process whereby orders placed through intermediaries would receive a given day's NAV as long as the order is received by such intermediaries before 4:00 p.m.[25]

A mandatory hard close will require sweeping and costly changes that will harm funds and their shareholders. If adopted as proposed, investors who purchase or sell fund shares through intermediaries will likely have to place orders many hours before 4:00 p.m. or have their orders processed the next day at the following day's price. The Proposal would undermine the long-held expectation of U.S. investors that when they place an order before 4:00 p.m.—whether directly to the fund or through an intermediary—they will receive that day's price. The Proposal disadvantages investors using intermediaries—most of the investing public—because they would have less time and information upon which they could base their investment decision.

[25] See SIFMA Letter (discussing the history and development of the current U.S. pricing system).

Approximately 80% of mutual fund investors invest through an intermediary relationship (either via broker or advisory accounts or through their retirement plan).[26] A hard close of 4:00 p.m. would cause a vast majority of investors, most of whom are retail or retirement plan investors, to have less time to place orders due to earlier cut-off times. This outcome is because intermediaries would be compelled to establish earlier cut-off times for their retail customer trades so that the intermediaries could batch and submit their trades to mutual fund families by 4:00 p.m. The reality of the Proposal is, due to earlier cut-off times exacerbated by time zone differences, some retail investors in the U.S. would have to make purchase and sale decisions before eating breakfast.

In addition, these affected investors would receive less information to make an informed investment decision in contrast to other investors due to their inability to consider material information that becomes available before 4:00 p.m. but after their earlier cut-off times. Conversely, direct investors would have the advantage of being able to place orders up to 4:00 p.m., providing them with access to a broader and more comprehensive range of information. This information disparity is particularly concerning for those affected investors who may not have the option to invest in funds directly, leaving them permanently disadvantaged. Employees investing through their retirement plan can only hold shares through an intermediary chosen by their employer. Similarly, investors in funds sold only through intermediaries would have to choose between (i) an earlier cut-off time or one-day delay or (ii) divesting from these funds. Even if they could invest directly, investors would be forced to choose between direct investing to avoid earlier cut-off times or using intermediaries for their financial advice and for facilitating rebalancings, exchanges, or allocations across multiple fund complexes. Although one of the Commission's stated goals is to "mitigate the first-mover advantage,"[27] it is in danger of creating a "last-mover advantage." Consequently, investors who can invest in funds directly are able to benefit from the information disparity provided by their longer trading window, compared to those who are penalized with an earlier cut-off time or one-day delay.

Retirement plans and their participants have benefited from the cost-effective, open architecture environment through which a complex network of intermediaries interconnect

[26] SIFMA Letter.
[27] Proposed Rule at 233.

and communicate using well-established order flow management systems that utilize omnibus accounting and batch processing. Material changes to this environment and its systems require careful deliberation and analysis given the monumental near and long-term costs for investors and their intermediaries. The changes will likely lead to increased fees and charges borne by retirement plan savers to the ultimate detriment of their retirement savings. Costs of implementation would also include amending service agreements among intermediaries, funds, platforms and plan sponsors, and creating new or substantially revising communication and education materials for plan sponsors and participants.

From a practical perspective, it is likely that different intermediaries would impose different cut-off times on investors based on their own ability to process and transmit data to mutual fund families by 4:00 p.m. This would result in investors having to keep track of different cut-off times if investing through multiple intermediaries (for example, through an advisory account or a retirement plan), leading to investor confusion and increasing their risks of inadvertently placing orders after the cut-off time.

A hard close would also cause disparate treatment of investors with respect to the trading and settlement of mutual fund orders, resulting in lower returns for many retail investors. Order processing systems typically make the determination of a fund's NAV a condition precedent to the submission of orders. Thus, rebalances and exchanges on intermediaries' platforms would be delayed and subject to increased operational risks because the price of the first leg of the transaction could not be established in time to process the second leg in the same day. Consequently, the second leg would be uninvested and exposed to market movements for an additional day, unlike the current process, whereby rebalances and exchanges are processed and invested on the same day. A fund of funds would face similar issues and delays: the hard close would require the fund of funds to submit subscription or redemption orders to its underlying funds before the fund of funds knows the underlying funds' NAVs or its own final net subscription or redemption amounts for that day. In addition, a hard close would create complications for life insurance and variable annuity products because providers of such products rely on the dissemination of the underlying funds' NAVs to begin processing orders. Our research shows that missing a few days of market activity over long periods can significantly impact investor returns. For example, an investor who hypothetically invests $1,000 in the MSCI All Country World Index on January 1, 2012 and misses the market's ten best days from 2012 to 2021 would have missed 50% of total gain.

The Commission observes that "[t]he extent to which the hard close proposal would affect investors largely depends on the value investors place on their ability to obtain same-day pricing."[28] We believe, based on our experience, that investors, including long-term investors, value same-day pricing and would view being locked out of the market as an unreasonable compromise to facilitate a hard close. This could compel investors and intermediaries to gravitate towards investment vehicles or other products that are not subject to a hard close. The potential loss of mutual fund assets and economies of scale coupled with the costs to comply with the Proposal would increase mutual funds' expense ratios, making these funds less attractive to existing investors, and could lead to further procyclical redemptions.

Mutual funds provide retail investors with professionally managed, diversified portfolios at a relatively low cost. The Commission's disclosure-based regime is designed to allow these investors to make their own informed investment decisions, balancing risks against potential returns, and is not designed to limit investor choice. As former Commissioner Kara M. Stein said at an event for the 75th anniversary of the Act, "[mutual] funds play an absolutely vital role in the ability of many Americans to retire … Whether it is for retirement, college, a future home purchase, or anything in between, Americans rely on investment companies now more than ever."[29] The American mutual fund industry is the largest in the world with $27 trillion in total net assets as of December 31, 2021.[30] The diversity and scale of mutual fund vehicles give retail investors the ability to obtain exposure to specific sectors or investments. Among other benefits, mutual funds provide investors with diversification, variety, liquidity, affordability, convenience, and ease of recordkeeping—as well as the protections of strict government regulation and fulsome disclosure.[31] Many of the benefits of mutual funds would be lost if investors migrated assets to other products. The

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[28] Proposed Rule at 144.
[29] Commissioner Kara M. Stein, "Mutual Funds - The Next 75 Years", at the Brookings Institution (June 15, 2015), available at https://www.sec.gov/news/speech/mutual-funds-next-75-years-stein.
[30] <u>See</u> 2022 Investment Company Fact Book, available at https://www.icifactbook.org/pdf/2022_factbook_ch3.pdf.
[31] A Guide to Understanding Mutual Funds, Investment Company Institute (2007), available at https://www.ici.org/doc-server/pdf%3Abro_understanding_mfs_p.pdf.

Proposal leads to a strange outcome in which (i) mutual funds would be uniquely disadvantaged compared to other products and (ii) retirement plans and other retail shareholders who invest through intermediaries—a vast majority of the shareholder base—would be placed at a disadvantage to direct fund investors. Accordingly, we strongly oppose the hard close requirement, given the significant adverse effects it would have on mutual fund investors and the mutual fund industry ecosystem.

2. We strongly oppose the swing pricing amendments that apply to all mutual funds.

The swing pricing proposal is unnecessary and will harm mutual fund investors. Because the industry does not have the infrastructure in place to support swing pricing, investors could lose access to mutual funds as an investment option along with the advice and guidance of financial professionals who rely on fees paid by mutual funds to provide their services. The Commission should withdraw the swing pricing proposal and engage with the public to develop a realistic alternative that does not massively disrupt the mutual fund industry or favor one investment vehicle over another.

The swing pricing proposal is too prescriptive and complex, and the Commission underestimates its impacts and costs. For swing pricing to be workable, funds must have complete (or close to complete) daily flow information when they begin calculating their NAV per share (typically 4:00 p.m.). We understand that the hard close requirement is intended to allow funds to receive sufficient information to apply swing pricing accurately. However, as discussed above, the costs and collateral damage to investors resulting from the hard close requirement would more than grossly outweigh the benefits that swing pricing might bring.

a. The Commission does not fully consider the critical differences between Europe and the U.S.

Although the Commission relies on the use of swing pricing in Europe to support the Proposal, it overlooks the fundamental differences in markets, operations and investor types between European and U.S. open-end funds. In addition, the Proposal's framework is materially different from Europe's swing pricing regime. European regulations do not reflect the prescriptive elements of the Proposal, and the flexibility and optionality of swing pricing in Europe is required to make it viable. Funds retain discretion in how they address dilution concerns, and they can set their own swing factors with or without market cost impact adjustments.

i. Different systems, expectations and investors.

In the U.S., the cut-off time for investors to receive that day's NAV is 4:00 p.m. EST, which is generally when NAVs are calculated. Whereas in Europe, the cut-off time is generally between 11:00 a.m. and 12:00 p.m. GMT, with the fund pricing process starting around 3:00 p.m. GMT. Critically, trading platforms in Europe regularly collect and submit orders throughout the day to the fund's transfer agent, which then applies an estimated NAV against such orders to determine that day's net subscription or redemption amounts. The earlier cut-off time and the transfer agent's ability to use an estimated NAV against actual (but not complete) flow information allow firms to make swing price determinations that are reasonable but which are not expected to be perfect. It is understood and accepted in Europe that swing pricing is based on imperfect information and there is less risk of second-guessing or litigating swing price determinations.

Swing pricing is also viable in Europe because there are significantly fewer pension fund investors in European open-end funds than U.S. open-end funds. In 2022, pension funds were approximately 10% of European Union fund assets, compared with 54% of U.S. fund assets.[32] In addition, only a small amount of European Union pension funds are defined contribution retirement plans, compared to the U.S. where defined contribution plans are almost one-third of retirement plan assets.[33] With the prevalent role of retirement plan recordkeepers and other intermediaries, U.S. funds thus have substantially less access to real-time shareholder activity and flow information than European funds. Additionally, the National Securities Clearing Corporation of the Depository Trust & Clearing Corporation (the "DTCC") processes the majority of trades from these intermediaries, adding more layers of processing and further delaying the submission of final orders to the fund's transfer agent.

[32] Proposed Rule at 242-243.
[33] Release: Quarterly Retirement Market Data, Investment Company Institute (December 15, 2022), available at https://www.ici.org/statistical-report/ret_22_q3.

ii. The Commission should mirror Europe's more flexible and discretionary swing pricing regime.

Swing pricing is inherently complicated and demands a level of judgment and subjectivity that is incompatible with the Proposal's precise, one-size-fits-all requirements. Swing pricing is operational in Europe because it is not prescriptive. Swing factors in Europe are reviewed and adjusted periodically, oftentimes quarterly or monthly but rarely daily, based on market and fund-specific facts and circumstances, including the fund's liquidity risks and cash levels, the level of volatility and stress in financial markets, and current and historical transaction costs. The Proposal, however, would require funds to design a process to calculate transaction costs with precision each and every day since any net redemption would require swing pricing to apply.

Applying market impact cost adjustments to the swing price if net redemptions exceed 1% or net subscriptions exceed 2% of a fund's net assets would be especially problematic since such costs are not clearly defined by the Commission. It is also unclear what assumptions and inputs would be used to make the calculation or whether such data would be available, particularly with respect to unlisted securities. In addition, the calculation of swing factors during periods of market volatility is more challenging and will result in more subjective and less precise adjustments and greater risks of error, which is understood and accepted in Europe. These reasons are likely why most funds in Europe do not consider market impact costs when swing pricing.

If the Commission does adopt a version of swing pricing, it should give funds greater latitude in the setting of swing factors. We support the Industry Letters in urging the Commission (i) follow the European regime of implementing swing pricing based on market and fund-specific factors and (ii) remove the prescriptive elements, including (a) the unspecified, periodic calculation of swing factors; (b) mandatory swing pricing upon a net redemption or if a net subscription exceeds 2% of net assets; and (c) the incorporation of market impact costs in swing factors.[34]

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[34] See SIFMA Letter.

C. Proposed Amendments to Public Reporting

The Proposal would require funds to file reports on Form N-PORT within 30 days of month-end, and such reports would be made public 60 days after month-end. We believe filing monthly would be overly burdensome and costly. We believe the Commission should retain the requirement to file reports on Form N-PORT within 60 days after quarter-end; however, if the Commission concludes that accelerated timing of public disclosure is critical, we recommend that funds file such reports within 45 days after quarter-end. This timing supports funds' ability to adequately prepare and report accurate information.

We oppose the requirement that funds file their complete portfolio holdings on Form N-PORT on a substantially more frequent basis—ten times per year instead of twice per year. We believe the current requirement rightly balances providing investors with access to information in a centralized location against protecting funds' sensitive information about portfolio holdings and strategies. In addition, it takes substantial time and resources to reconcile the Form N-PORT information into a Reg. S-X/GAAP-compliant presentation. If an adopted rule requires the information to be Reg. S-X/GAAP-compliant, funds with a T+1 settlement cycle would have to complete a full "accounting close" process monthly instead of quarterly. We estimate it will cost an additional $15,000 per fund annually to comply. With the size of our fund complex, we estimate a total cost of $1.7 million annually to comply, which will ultimately be borne by fund shareholders.

The Proposal would require funds to disclose information on Form N-PORT about the number of times a swing factor was applied during the month and the amount of each swing factor applied (positive or negative). We believe these disclosures would have little value to retail investors and could prove harmful if they enable sophisticated traders and other parties to strategically time their subscriptions and redemptions based on expected swings. Accordingly, many European funds have chosen to not disclose such information and only disclose, as required, their maximum swing factors. In addition, public disclosure could invite investors to second-guess the swing factors that were applied, spurring meritless shareholder litigation and undermining confidence in capital markets. Therefore, we recommend the requirement to disclose swing factors on Form N-PORT be removed.

Lastly, Form N-PORT would be amended to require a fund to report the aggregate percentage of its portfolio represented in each of the three proposed liquidity classification categories, with such percentages adjusted to give effect to other aspects of the Proposal. We are not opposed to disclosure of this type of information. However, public disclosure of such information using the Proposal's extremely stressed parameters would create an unclear, unfair and inaccurate picture of a fund's liquidity profile, and would be confusing and misleading to investors. As such, we oppose the proposed requirements, but would support more disclosure of current information, based on the reasonable level of discretion funds have today under the Liquidity Rule.

D. The Commission's Approach to Rulemaking

Given its scope and potentially substantial impacts, we believe the Commission should take additional time to consider the Proposal. We believe the Proposal introduces extremely challenging operational burdens and complexities, conflicts with longstanding principles and practices, and raises significant questions about whether its negative effects are commensurate with its alleged benefits.

One of the Commission's primary bases for the Proposal are a selected but not comprehensive set of academic papers and studies. Some of this literature purports to provide evidence of a potential "liquidity mismatch" between the immediate liquidity that open-end funds provide to their shareholders and the illiquidity of portfolio investments and the associated risks. The theoretical effects of this "mismatch" in stressed conditions include (i) shareholder redemptions not being met within the statutorily required seven days without funds incurring significant trading costs; (ii) fund investors being subject to dilution risk; (iii) fund investors being incentivized to act first and avoid dilution by redeeming their shares before other investors; and (iv) such redemptions ultimately leading to a fund's fire sale of assets, thereby further disrupting stressed markets.[35]

These articles, based generally on models and assumptions and not on actual events, are not dispositive: other sources provide alternative or contradictory findings and conclusions. For example, one study found that swing pricing in Europe has a limited effect

[35] See Proposed Rule at 230.

on outflows in stressed conditions.[36] The study also found that funds that used swing pricing experienced greater volatility of their published prices during a stressed period.[37] Another paper, cited by the Commission, concluded that the behavior of open-end fund investors is similar to that of investors in separate accounts and that redemptions in open-end funds may occur for reasons unrelated to their mutual fund structure.[38] This conclusion undermines a premise of the Proposal, that the purported "liquidity mismatch" in mutual funds causes fund shareholders to redeem before others in stressed conditions. A recent study from the ICI also shows separate accounts with fixed-income mandates exhibit the same sensitivity to negative results and corresponding selling of fixed-income assets as fixed-income mutual funds.[39]

The Commission also is unable to point to recent examples for some of its concerns. To support the proposed hard close requirements, the Commission argues a hard close "would help prevent late trading."[40] As part of its rationale, it points to "several instances of late trading in the early 2000s."[41] If late trading was a pressing concern, one would reasonably expect the regulatory agency with appropriate oversight to be able to point to more recent examples than almost twenty years ago. We generally believe if regulatory action is to be taken now, it should be based on legitimate and real concerns today.

Given the massive costs and impacts across the mutual fund industry, we believe the Proposal cannot be based on assumptions and qualitative analysis, let alone the incomplete record that the Proposal cites. Rather, the consideration of these proposed changes requires significantly more collection and analysis of historical and current data as well as industry input. In fact, the Commission acknowledges that it failed to quantify many of the Proposal's costs and benefits, including (i) how funds would adjust the liquidity of their portfolios in response to the proposed Liquidity Rule amendments; (ii) the extent to which investors would reduce their mutual fund investments due to the proposed swing pricing rule; (iii) the

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[36] Ulf Lewick & Jochen Schanz, *Is the Price Right? Swing Pricing and Investor Redemptions* (Monetary and Economic Department of the Bank for International Settlements, October 2017), available at https://www.bis.org/publ/work664.pdf.
[37] Id.
[38] Christof W. Stahel, *Strategic Complementarity Among Investors with Overlapping Portfolios* (Investment Company Institute, September 1, 2022), available at https://ssrn.com/abstract=3952125.
[39] Report of the COVID-19 Market Impact Working Group: Experiences of European Markets, UCITS, and European ETFs During the COVID-19 Crisis, Investment Company Institute (2020), available at https://www.ici.org/doc-server/pdf%3A20_rpt_covid4.pdf.
[40] Proposed Rule at 130.
[41] Id.

antidilutive impact of the proposed changes; and (iv) the extent to which investors would exit mutual funds to invest in other investment vehicles, such as closed-end funds, exchange-traded funds or collective investment trusts.[42]

Without a comprehensive, holistic breakdown of quantitative costs and benefits, the Commission minimizes the extent of the operational burdens and switching costs that intermediaries, custodians, fund administrators, transfer agents, DTCC, and other market participants (e.g., financial data aggregators) would have to undergo. Similarly, without any definitive evidence showing open-end funds were materially responsible for worsening market volatility or were facing significant difficulties meeting shareholder redemptions during March 2020, we believe the Commission significantly overstates any potential benefits of adopting the Proposal. Despite these uncertainties, it is clear that the costs and impacts to investors will be enormous and include, among others, loss of same-day pricing, loss of choice of investment vehicles and loss of the benefits of mutualization. Given the ramifications of the Proposal, we are concerned about the potential risks of serious misallocation of scarce resources and time to reengineer entire systems, infrastructures and workflows that may not yield the desired results for mutual fund investors.

We believe that the lack of an assessment of the overall impact of a proposal of such breadth and magnitude is a fundamental flaw and should be remedied with an industry-wide reevaluation by the Commission. The implications, impacted parties, and potential costs and benefits warrant a more comprehensive analysis and assessment than a single notice and 60-day comment period. As Commissioner Hester M. Pierce said in remarks on the Commission's rulemaking agenda in 2022, "Essential to facilitating substantive input from a wide variety of interested parties is *giving people enough time to comment*."[43] For this reason, the Commission has historically provided the industry with longer periods to comment on major initiatives, including nearly 120 days for the proposal relating to

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[42] Proposed Rule at 234.

[43] Commissioner Hester M. Pierce, "Rat Farms and Rule Comments - Statement on Comment Period Lengths" (December 10, 2021) (emphasis added), available at https://www.sec.gov/news/statement/peirce-rat-farms-and-rule-comments-121021. <u>See also</u> Joint Association Letter to the Commission regarding the Importance of Appropriate Length of Comment Periods (April 5, 2022), available at https://www.sifma.org/wp-content/uploads/2022/02/SEC_Joint-Trades_Comment-Period-Letter_4-5-2022.pdf (describing the multitude of harms from insufficient time for meaningful public input).

Regulation Best Interest[44] and nearly 140 days for the proposal relating to fund of funds.[45] We appreciate that the Commission has requested comment on a wide range of questions in the Proposal, but such a short time to respond shortchanges any meaningful analysis. Therefore, we urge the Commission to engage in more public dialogue and fully analyze the costs and benefits before proceeding with the Proposal.

Additional time to gather data and provide a quantitative costs and benefits analysis will allow (i) the Commission to propose a workable solution to address the actual risks of a fund's potential "liquidity mismatch"; (ii) the public to provide meaningful input on the Proposal; and (iii) millions of open-end investors to invest without having to bear the significant costs, challenges and complications resulting from the proposed changes, which could well exceed the problems noted in the Proposal that again are more theoretical than proven.

E. Compliance Period

Due to the reasons noted herein and set forth in the Industry Letters, the proposed twenty-four-month compliance period for the proposed amendments to hard close and swing pricing and the proposed twelve-month compliance period for all other aspects of the Proposal are grossly inadequate to implement the required changes.

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[44] *Regulation Best Interest*, Release No. 34-83062; File No. S7-07-18 (April 18, 2018), available at https://www.sec.gov/rules/proposed/2018/34-83062.pdf.
[45] *Fund of Funds Arrangements*, Release Nos. 33-10590; IC-33329; File No. S7-27-18 (December 19, 2018), available at https://www.sec.gov/rules/proposed/2018/33-10590.pdf.

We appreciate the opportunity to comment on the Proposal and are grateful for your consideration of our views and recommendations. If you have any questions regarding our comments, please feel free to contact [redacted].

Sincerely,

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cc. The Hon. Gary Gensler, Chairman
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