February 14, 2023

Ms. Vanessa 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; File Number S7-26-22; Release Nos. 33-11130; IC-34746; RIN 3235-AM98

Dear Ms. Countryman:

Please accept the following comments of the Securities Industry and Financial Markets Association ("SIFMA")[1] on the above referenced rule proposal (the "Proposal"). In addition to this letter, the SIFMA Asset Management Group ("AMG")[2] is submitting two separate letters discussing the overall Proposal. SIFMA agrees with and supports the comments set forth in the AMG letters and writes separately and specifically on behalf of our mutual fund intermediary members with respect to the proposed swing pricing and "hard close" requirements.

I. Executive Summary

We are concerned that the swing pricing requirement and the attendant "hard close" elements of the Proposal will have significant adverse consequences for the millions of investors who invest in mutual funds through intermediaries or retirement plans. As discussed in more detail below, we believe the Proposal will have the following significant negative consequences:

- the swing pricing requirement will create investor confusion and introduce new delays into the mutual fund order management infrastructure;

[1] SIFMA is the leading trade association for broker-dealers, investment banks, and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate for legislation, regulation, and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] SIFMA AMG brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG's members represent U.S. and global asset management firms whose combined assets under management exceed $45 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds. For more information, visit http://www.sifma.org/amg.

- the "hard close" element of the Proposal would require the mutual fund industry to re-engineer the entire process though which mutual fund orders are collected, submitted, and processed by intermediaries and retirement plans, at great cost; and
- the "hard close" requirement would also negatively impact or entirely eliminate the ability of investors who transact in mutual funds through intermediaries or retirement plans to purchase or sell shares at the net asset value ("**NAV**") of a fund on the same day they submit their orders.

We are also concerned that the benefits the Commission is seeking to provide are speculative and unbalanced in relation to the costs that the Proposal would force on funds and investors and that the Proposal would, overall, make mutual funds less attractive investment options versus alternative structures.

For the reasons discussed in detail below, we strongly urge the Commission to withdraw or formally stay this Proposal, pending more thorough and thoughtful engagement with the industry to assess the costs, benefits, and potential downstream consequences to other industry participants.

II. Introduction

We believe the swing pricing requirement and the attendant "hard close" elements of the Proposal will have significant adverse consequences for the mutual fund industry generally and specifically for the millions of investors who invest in mutual funds through intermediaries or retirement plans. As discussed in more detail below, we believe the "hard close" requirement associated with the swing pricing requirement would result in massive costs to almost entirely reengineer the mutual fund order processing systems and also negatively impact or entirely eliminate the ability of investors who transact in mutual funds through intermediaries or retirement plans to purchase or sell shares at the NAV of a fund on the same day they submit their orders. In addition, swing pricing itself would make mutual funds more complicated for investors to navigate, as investors will be transacting at prices that could be disconnected from the market values of their investments.

As a result, the Proposal could cause mutual funds, as an investment option, to become less attractive than other alternative options. Additionally, investors who continue to invest in mutual funds would be discouraged from engaging intermediaries in connection with those investments. Finally, the operational hurdles imposed on retirement plans could result in these plans abandoning mutual funds as investment options or, as the Commission noted in the Proposal, such plans could "cease to exist."[3]

[3] *See* Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting, Securities Act Release No. 33-11130, Investment Company Act Release No. 34746, 87 Fed. Reg. 77,172, 77,209 to be codified at 17 C.F.R. pts. 270, 274; *See also* the Proposal at 307, https://www.sec.gov/rules/proposed/2022/33-11130.pdf.

We recognize that one of the goals of the Commission in issuing the Proposal was to address potential concerns relating to the allocation of transaction costs associated with shareholder purchases and redemptions. However, as it stands, it is unclear to SIFMA and our members that any projected benefits of the Proposal to mutual fund shareholders, which would be evident only in extreme market conditions, would be outweighed by the significant and generational costs associated with the radical changes that would be imposed on funds, intermediaries, their service providers and, ultimately, the shareholders themselves, which will apply in all market conditions.

Based on the above, we strongly oppose the adoption of the Proposal and recommend that the Commission pursue addressing its concerns regarding mutual fund transaction cost allocation and potential dilution through a responsible and comprehensive evaluation, including a detailed assessment of the potential costs and benefits of swing pricing. The Commission could also undertake more substantive industry engagement through roundtable discussions and concept releases in order to validate its assumptions and identify potential unintended consequences. Given that mutual funds have not only operated, but flourished, without the intended benefits of the Proposal for the 83 years since the adoption of the Investment Company Act of 1940, we submit that the Commission has the time to conduct a thorough analysis of these issues. In that vein, SIFMA respectfully requests that the Commission formally withdraw or alternatively, formally stay the Proposal—at least with respect to swing pricing and the attendant "hard close" requirement—subject to further review and engagement with the industry and the public at large. SIFMA stands ready to assist the Commission in these efforts.

III. Background

A. Background on Mutual Fund Market Infrastructure

Investors generally invest in mutual funds through three channels: (1) indirectly through intermediaries; (2) indirectly through an employer-sponsored retirement plan (e.g., a 401(k) plan); or (3) directly with the fund. Regardless of the channel used, investors in mutual funds expect to be able to purchase or redeem shares at the NAV of the funds calculated on the day they place their orders, provided their orders are submitted to their funds or the intermediary by 4:00 p.m. ET.[4] Currently, the vast majority of mutual fund investors invest indirectly through either intermediaries or employer-sponsored retirement plans,[5] and the Proposal could have an adverse impact on these investors and their ability to transact with mutual funds.

1. The Role of Intermediaries and Retirement Plans

The fund intermediary serves several important roles for investors. While an individual investor's relationship with a fund intermediary may vary, our members perform critical services

[4] All references to specific times in this letter are references to Eastern Time.
[5] In 2021, 81% of mutual fund–owning households held funds inside employer-sponsored retirement plans. For households owning mutual funds outside employer-sponsored retirement plans, 79% owned funds purchased with the help of an intermediary. *See* Inv. Co. Inst., *2022 Investment Company Fact Book* 123 (2022), https://www.icifactbook.org/.

for their clients, including (without limitation): offering financial planning assistance and guidance; providing investment recommendations; facilitating the delivery of regulatory disclosures; completing paperwork associated with investing in a fund; monitoring their overall portfolio performance; and efficiently processing purchase, sale, and exchange orders. Intermediaries also serve as the investor's point of contact with respect to their fund investments and provide investors with important documentation and confirmations, such as periodic account statements, tax forms, and reporting of account balances on websites, and stand ready to answer investor questions about funds and the investment process generally. In short, intermediaries make investing in funds easier for millions of retail investors while also helping create more efficient mutual fund markets and lowering the costs of investing for investors.

In addition, intermediaries offer additional products and services for their clients. Intermediaries facilitate the offering of hundreds of investment funds (as well as other products) from a variety of fund families in order to meet investor demand for more investment options. Intermediaries are also increasingly offering advisory programs to millions of clients. Advisory programs offer fund rebalancing to clients and provide opportunities to use an array of investment types in one account. To make investing easier for their clients, intermediaries are able to provide consolidated statements of client holdings across all of these products and services, rather than forcing investors to deal with multiple fund families and receive multiple account statements.

Importantly, intermediaries also perform a valuable service for funds in connection with the fund order process. Specifically, intermediaries can "net" their clients' orders, so that instead of thousands or tens of thousands of individual orders, a fund will receive a single net order from a fund intermediary that the fund intermediary will allocate among its clients. In this way, funds benefit from the scale systems that intermediaries can provide. In order words, because a fund intermediary operates at a large scale, it can provide these services more efficiently than funds would be able to do for investors on an individual basis. The fund intermediary also provides funds with support with respect to certain regulatory or contractual responsibilities. For example, intermediaries ensure that clients receive breakpoints and repurchase credits and monitor rights of accumulation of clients. In fact, the industry has been generally moving away from direct shareholder accounts toward fund intermediary accounts in recognition of the efficiencies of their operations.

Retirement plans perform similar functions as intermediaries with respect to netting of individual investor orders, answering retirement plan investor questions and facilitating retirement plan investor transactions (e.g., retirement plan loans and exchanges). Retirement plans also generally offer their plan participants the ability to effect exchanges among funds in different fund families on the same day. Unlike investors who choose to invest in mutual funds through intermediaries, investors who invest in mutual funds through employer-sponsored retirement plans generally do not have an option to invest their retirement assets except through the retirement plan.

2. Mutual Fund Order Flow Processes

In concept, the order flow process for both intermediaries and retirement plans are similar.

First, intermediaries and retirement plans collect fund trading instructions from individual investors. These instructions can be orders to purchase, sell, or exchange shares of funds in connection with new investment decisions or in connection with portfolio rebalancing. A given account can have multiple transactions during the course of a trading day, especially in the case of rebalance instructions, which may result in several different purchase and sell orders. This activity is iterated across thousands, even millions, of accounts at a given intermediary and represents many millions of individual transaction instructions each day. Intermediaries also process intra-day order changes and corrections, and rigorously adhere to a 4:00 p.m. market close for order submissions and corrections.

This order flow process takes time, and current rules allow intermediaries to submit orders to funds for processing at the NAV price on that day so long as the fund intermediary has received the order prior to when that NAV is calculated. Indeed, intermediaries routinely submit orders to purchase or sell fund shares to funds on behalf of their clients after the fund has calculated its NAV. These orders may be submitted up to – and potentially after – 5:30 p.m., depending on the specific funds and intermediaries involved, as well as overall market activity.

Second, after the market close of 4:00 p.m., funds will determine their NAV per share and disseminate that value to intermediaries and retirement plans. This process also takes time, and intermediaries do not currently receive NAVs until around 6:00 p.m., but depending on the funds, market activity and the complexity of the calculations involved, NAVs may not be delivered until 8:00 p.m. or later.

Third, once they have received order confirmations from funds and the applicable NAVs, intermediaries execute their "overnight batch" order processing. The "overnight batch" is a critical element of the client service intermediaries provide to investors. It allows for executed fund orders to be appropriately credited to investor accounts, provides updated information to websites, and ensures that investor reporting is accurate and complete. These "overnight batch" processes are designed to be completed by the following morning, allowing investors to view their updated account balances and fund investments and to receive visual confirmation of the execution of their orders.

With respect to retirement plans, the process is similar to the above, but with three critical distinctions. First, retirement plans operations are generally run through legacy systems that process plan participant orders as percentages or in dollars. As such, these processes are "NAV-dependent" in that they require a fund NAV to execute. Second, retirement plans also offer the ability for plan participants to exchange shares across funds within the same fund family or among funds across different fund families. Finally, retirement plan order processing is more complex in that it also includes an additional step of transferring order information to and from a plan recordkeeper.

The above systems have been developed over time with an emphasis on efficiency and accuracy and allow for millions of transactions to be effected on behalf of mutual fund investors every day.

B. Summary of the Proposal

For the purposes of our comments, we focus narrowly on the impacts of the swing pricing and "hard close" requirements described in the Proposal.[6]

The Proposal would, among other things, require all open-end mutual funds (other than exchange traded funds ("**ETFs**") and money market funds)[7] to incorporate swing pricing. Swing pricing is a method of pricing that incorporates anticipated transaction costs arising from shareholder purchase and redemption activities into the NAV on which the fund will base its transactions with its shareholders.[8] Swing pricing is designed to ensure that (i) the investors who are transacting in a fund are paying the costs associated with their transactions, (ii) such transaction costs will not be borne by non-transacting investors, and (iii) funds are able to, as described in the Proposal, "more fairly allocate costs, reduce the potential for dilution of investors who are not currently transacting in the fund's shares, and reduce any potential first-mover advantages."[9]

In order to implement swing pricing as contemplated in the Proposal, a fund must have complete information about the purchase and redemption orders that the fund would reflect in its NAV.[10] To ensure that funds have this information, the Proposal would impose a "hard close" on funds, requiring any orders to purchase or sell shares of a fund to be received by the fund and its transfer agent or clearing agency ("**Eligible Order Parties**") by the time it strikes its NAV to be processed at that NAV.[11] The Proposal frames these revisions as instituting a "hard close"; however, we submit that a "hard close" already exists, as individual investor orders are due prior to the market close. The Proposal is better understood as eliminating the ability for intermediaries and retirement plans to serve as agents of the funds in accepting orders. As discussed in detail below, our members are concerned that these requirements, taken together, will have significant adverse impacts on mutual funds and their investors.

IV. Swing Pricing Concerns

A. Swing Pricing Would Create Investor Confusion and Result in Mutual Funds Becoming Less Attractive Than Other Investment Options

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[6] The AMG comment letter discussing swing pricing and "hard close" includes a detailed history and summary of the specific terms included in the Proposal.
[7] The hard close proposal applies only to those funds that would be required to implement swing pricing (i.e., all registered open-end investment companies other than money market funds and ETFs). *See* Proposal at n.222.
[8] *Id*. at 92.
[9] *Id*. at 93.
[10] As noted in the Proposal, swing pricing requires mutual funds to receive "sufficient net order flow information to determine whether to apply a swing factor, and the size of that swing factor, before they finalize that day's price."
[11] *See* Investment Company Act of 1940 Proposed Rule 22c-1(a)(3)(i); *See also* 17 CFR § 270.22c-1(a)(3)(i).

As proposed, swing pricing would generally require a fund to incorporate anticipated transaction costs into its NAV calculation. In general, shareholders transacting on days with significant net cash flows into or out of a fund would expect the NAV adjusted (up or down) to reflect the transaction costs associated with the net flows.

The implementation of swing pricing would require funds to incur costs in developing and maintaining a swing pricing framework, and these costs would be passed on to investors. More importantly, swing pricing introduces confusion for investors. Since the swing factor would be based on information that will be unknown to investors (i.e., the total net orders for the day), investors would be unable to predict the price at which they will ultimately transact. Indeed, the swing pricing adjustments will be unrelated to overall market activity and could be imposed on investors who simply choose to transact at the wrong time.

For example, an individual investor could choose to redeem his or her investments at the end of the month in connection with purchasing a new car. If, at the same time, a large pension plan chose to rebalance its investments and effected a large redemption from the fund on the same day, the individual investor could receive significantly less than he or she expected (or would have received had the fund not been required to implement swing pricing).[12] Critically, there would be no way for the individual investor, in this example, to anticipate such large net flows and delay his or her redemption by one day, which, in this example, would save the investor the potentially significant costs associated with the swing price.

In fact, this uncertainty could lead fund investors to alter their redemption practices in order to avoid transacting on days where other investors may also be transacting. For example, investors may seek to avoid fund transactions on month- or quarter-ends, as those would be times where significant rebalancing could be expected to occur. This could create an "order roulette" wherein large fund investors seek to transact on random days, creating further uncertainty for retail investors as to whether a swing factor was likely to be applied on a given day – and also for funds that may anticipate routine institutional investor flows.

This element of unpredictability could increase the complexity of mutual funds as an investment option, creating confusion for mutual fund investors and reducing the attractiveness of mutual funds as an investment option versus other structures.

B. Swing Pricing Would Introduce New Operational Delays and Create Confusion for Fund Investors

A swing pricing requirement will also necessarily introduce operational delays in the process for funds to calculate and disseminate their NAVs to fund investors. To implement swing pricing, funds would be unable to calculate a NAV until they have received and processed all order information. The hard close requirement discussed below is intended to address some potential

[12] The Proposal would remove the current 2% limit on the swing factor that currently exists in the optional swing pricing provisions under Rule 22c-1. *See* the Proposal.

delays in connection with this step by requiring all orders to be submitted to the fund by the time the fund calculates its NAV, but even with that delay addressed, the operational processes associated with administering a swing pricing calculation will take additional time.

In order to properly apply a swing factor, funds will first need to assess the order direction (i.e., inflow or outflow) and magnitude and determine whether to apply a swing factor. Then, the fund will need to determine the size of the swing factor, which, in certain instances, may require an assessment of the market impact of the inflows/outflows. Finally, the fund will apply the swing factor as the final step in the NAV calculation, update the fund's systems and communicate the NAV to the fund service providers for their NAV-dependent processes.

Our members estimate that this additional process will take an additional 60-90 minutes to perform. This delay could have adverse results on the "overnight batch" process described above, resulting in these processes being based on a "stale" NAV or not run at all. In either case, fund investors would no longer have reliable information about their investments (including whether orders had been executed and at what price) on the day after execution. This uncertainty will increase shareholder questions and complaints to intermediaries and make the fund investment process less accessible and more cumbersome to investors.

V. Hard Close Concerns

A. General

Under current rules, orders to purchase or sell fund shares are processed at the NAV calculated after the order is received by an Eligible Order Party or a fund intermediary. Thus, so long as investors have provided their orders to their intermediaries by the time the fund's NAV is calculated (typically 4:00 p.m.), investor orders are processed at the NAV calculated on the same day the orders were submitted. Under the Proposal, only orders received by Eligible Order Parties prior to the fund's calculation of its NAV would be processed at that NAV. All orders submitted after would receive the NAV calculated on the next day.

This change would fundamentally disrupt the entire operational infrastructure in use today for the purchase and sale of mutual funds, causing significant investor confusion, discouraging investors from engaging intermediaries altogether, and ultimately making mutual funds less competitive with other investment products.

B. The Proposed Hard Close Would Adversely Impact Fund Intermediary and Retirement Plan Processing Times

As noted above, intermediaries perform certain order processing tasks to validate and net investor orders. These processes take time, and under the Proposal many intermediaries would not have time to perform these functions and send the resulting order information to funds by 4:00 p.m. in order to allow these orders to be processed at the NAV calculated that day. As a result, intermediaries who wish to continue to offer their clients the ability to transact in mutual funds at the NAV calculated on the same day they issue the order will be required to impose an early cut-off time. Our members are currently estimating that early cut-off times could be as soon as 2:00 p.m., but these cut-off times will certainly vary among intermediaries.

Critically, the early cut-off time established by intermediaries will be based on the fund intermediary's systems and capabilities. Given that investors value the ability to transact at the price calculated on the same day they issue their order, intermediaries will be forced to compete with respect to their ability to provide the latest cut-off time. This competition would place an emphasis on the speed of order transactions, which could result in less reliable order transmission processes and/or order transmission processes that are not as durable or failsafe as the processes currently in place.

With respect to retirement plans whose systems require NAVs in connection with processing orders, compliance with the hard close requirement would be impossible. The fund would be unable to calculate its NAV without the investor orders, and the retirement plan would not be able to submit the orders without the NAV. The retirement plan systems would stand ready to net orders and process exchanges but would be unable to proceed without the data point of the fund NAVs, thus creating a catch-22 of mutually dependent processes. Our members report that the retirement plans that may be able to offer same-day processing of plan participant orders are considering establishing cut-off times as early as 10:00 a.m.

Intermediaries are also subject to this same catch-22 with respect to certain transactions. Specifically, some transactions are processed through the "overnight batch" and are NAV-dependent. Specifically, dividend reinvestment, corporate action processing, class conversions (whether because a shareholder has newly qualified for a lower-fee class or due to a large-scale conversion), and account rebalancing transactions all depend on the fund NAV for processing. Under the Proposal, all of these transactions will become two-day processes.

Theoretically, intermediaries and retirement plans could utilize a proxy or estimated NAV to allow their NAV-dependent systems to process orders, but this would ultimately result in incorrect order instructions and suboptimal results. Funds could nonetheless rely on these estimated orders to determine whether their NAV would be adjusted by a swing factor, and then provide a NAV to intermediaries and retirement plans. Intermediaries and retirement plans could then re-run their batch processing and assess the differences between the results of the estimated batch and the final batch (i.e., "breakage"). The costs of this breakage would likely be borne by fund investors, as their orders would need to be modified or adjusted to reflect the correct prices.

To the extent intermediaries that are registered broker-dealers are unable to execute orders on the same day as they are submitted, these intermediaries may be subject to new regulatory concerns under the rules of the Financial Industry Regulatory Authority ("**FINRA**"). For example, FINRA rules require that, absent written authorization, a broker cannot exercise time and price discretion beyond a single day.[13] Even with such written authorization, brokers would be

[13] FINRA Rule 408T(d).

required to exercise execution discretion to remain in compliance with SEC staff guidance regarding whether such discretion constitutes investment advisory activity.[14]

C. The Proposal Would Potentially Negatively Impact Business Continuity and Disaster Recovery Plans

The Proposal would create significant implications for business continuity and disaster recovery plans. Notably, the timing of a systems disruption could create substantial data integrity issues related to the recovery of systems, as there would be increased delay between order submission and the execution of the "overnight batch". This delay creates the risk that a business disruption would have additional downstream consequences, requiring additional validations and increased restoration time.

Currently, in the event of a system disruption, the restoration of core trading and holdings systems is prioritized, with systems relating to costs, commissions and pricing being a secondary priority. This is possible because intermediaries have some flexibility to submit orders later in the day while still being processed at the same day's NAV. Under the Proposal, the interdependencies of order processing systems with NAV calculations would require the cost and commission-related systems to be prioritized in order to perform the NAV calculations. This realignment would require a complete reengineering of fund business continuity and disaster recovery plans and could extend recovery timelines with respect to the core trading and holdings systems.

D. Investors' Ability to Receive Same-Day Pricing of Mutual Fund Orders Would Be Limited or Eliminated

As noted above, investors transacting through intermediaries will lose flexibility in when they could submit orders through an intermediary to receive that day's price, as intermediaries may institute earlier cut-off times or require next-day processing. The Commission notes that the "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 for orders initiated in the period."[15]

We submit that investors value the ability to receive same-day pricing. Investors will often consider market events in determining whether and when to execute a fund order. For example, on a day where the Federal Reserve is expected to announce a rate change, investors will often delay their order submission until the announcement is made (or investors who have submitted orders earlier in the day may cancel these orders depending on the expected market impact of the announcement). Our members report that financial advisers tend to submit mutual fund orders between 1:00 p.m. and 3:00 p.m., as the ultimate transaction price for the order comes more into focus and the likelihood of extreme market events that would impact the transaction price decreases.

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[14] *See, e.g.*, Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser, SEC Rel. No. IA-5249 (June 5, 2019).
[15] Proposal at 144.

As noted above, our members are contemplating cut-off times as early as 2:00 p.m., which would clearly impact existing order submission processes. Investors and intermediaries would be required to issue their orders much earlier in the day and would no longer be able to react to afternoon market events. Particularly troubling is the fact that investors and investment advisers located on the West Coast of the United States or in Alaska or Hawaii could be disparately impacted. Such transacting individuals would have an exceedingly narrow window to submit mutual fund orders and have a much shorter time to evaluate market developments and prepare to make and execute decisions before the effective cut-off time imposed to meet the hard close deadline.

Also, as noted above, some retirement plans may be unable to offer same-day order processing because their systems are NAV-dependent. This additional extra day of processing could be a detrimental delay for retirement savers who are seeking an emergency loan from their retirement plan.

In addition, the overall quality of an investor experience would decline, should the Proposal be adopted. Some transactions currently effected by investors through intermediaries would no longer be possible under the Proposal. Certain transactions, such as mutual fund exchanges and share class conversions, require a fund NAV in order to correctly process; however, if intermediaries are not permitted to submit orders to funds after the funds have calculated the NAV at which the orders would be processed, these types of transactions are effectively prohibited, without significant structural changes to order processing systems. In addition, advisory account valuations, in an environment where one type of investment may lag in pricing, are unlikely to be viable. Further, investors would be subject to more frequent delays in the reporting of their investments because the "overnight batch" processes that feed these reports would be disrupted under the adjusted time schedule.

In addition to a degraded investor experience, the Proposal would create new confusion for investors. Different intermediaries will likely impose different cut-off times for investors based on their own ability to process and transmit data to the mutual funds by 4:00 p.m. This could result in investor confusion, especially among investors who have engaged multiple intermediaries (e.g., a financial adviser and a retirement plan). An investor may have different order deadlines among these intermediaries, potentially even for the same funds. Even where investors do not seek to time their orders around anticipated inflows/outflows, investors (especially retail investors) will likely incur unnecessary confusion tracking these varying cut-off times. These differing order deadlines could result in the same investor receiving different prices and execution times for the same orders, depending on whether the investor was executing with an intermediary who was able to accommodate a same-day NAV.

The variation in cut-off times may also have an adverse impact on intermediaries who serve as investment advisers. Clients of investment advisers that execute through multiple broker-dealers could receive disparate pricing depending on the intermediary through which the adviser executes. This is especially true for independent registered investment advisers whose client's custody their assets through a non-affiliated custodian and broker-dealer.

Such confusion would serve as a headwind toward investors investing in mutual funds (versus other structures, such as ETFs).

E. Investors Would Be Discouraged from Investing Through Intermediaries

These earlier cut-off times would not be required with respect to investors who directly invest in mutual funds.[16] As a result, intermediaries, and the mutual funds that are primarily sold through intermediaries, would be at an unnecessary competitive disadvantage versus direct fund investing because intermediaries would generally require earlier cut-off times or would only accept orders for processing on a T+1 basis. In other words, the Proposal would, in effect, force investors to choose between direct investing into funds to avoid earlier cut-off times (and still receive that day's price) or using intermediaries to provide financial advice (but run into earlier cut-off times or, potentially, receive the next day's price). This is an unnecessary dichotomy that forces investors who value the financial advice and support of intermediaries to expose themselves to greater market risk.

Investors may choose to move to direct investing in mutual funds (if they are able to do so). The migration of fund investors from intermediaries to direct accounts would create certain disadvantages for fund investors. Critically, investors who invest directly with funds would not benefit from the advice and support from intermediaries. FINRA supervisory rules effectively discourage broker-dealers from providing recommendations on assets held away from the broker-dealer.[17] As noted above, such a move would be contrary to the industry trend away from direct shareholder accounts. We strongly encourage the Commission to avoid creating a system that functionally discriminates against investors based solely upon their choice of distribution channel.[18]

Further, a migration of investors en masse to accounts held directly at funds could overwhelm existing fund operational systems and shareholder support functions. Fund systems have generally been designed to benefit from the scale that fund intermediary systems can provide. In response to more investors moving to direct holdings, funds would be required to make significant changes to their operations, such as increasing investor-facing call center staff and re-building the systems intermediaries currently have, but without the benefit of the scale provided by servicing investors across fund families. As a result, investor experience in mutual funds could qualitatively decline.

We also note that retirement plan investors do not have the option of investing directly with mutual funds, so those investors will be forced to accept any conditions imposed by the retirement plans with respect to early cut-off times or limitations on same-day order processing.

[16] Proposal at 308.
[17] *See, e.g.*, FINRA Rule 3100, 3110.
[18] American Bankers Association Letter to Paul Roye, Director of Investment Management RE: Late Trading and Market Timing Issues (Nov. 12, 2003).

F. The Proposal Would Adversely Impact the Competitiveness of Mutual Funds as Investment Options

Taken together, these changes result in an investment product that is potentially less competitive with other investment options, such as ETFs or collective investment trusts ("**CITs**"). For example, under the Proposal, a mutual fund shareholder will be subject to a compressed period in which to execute an order if the shareholder wishes to avoid an additional day of market risk. Further, when that order is processed, which may be after an additional business day, the transacting shareholder's price could be adversely impacted by the decision of other investors to transact on the same day.

When compared to an ETF or a CIT, both of which would continue to allow for same-day (and in the case of an ETF, practically immediate) liquidity, mutual funds do not appear as a competitive investment option. As a result, many intermediaries and retirement plans may be less willing to undertake the significant expenses to adapt systems to the Proposal's new requirements and could, instead, determine to eliminate mutual funds from their offerings altogether or, with respect to the smaller retirement plans, as the Commission notes, opt to cease to exist.[19]

While SIFMA members also support ETFs on the platforms they offer, ETFs have different features and may not completely substitute for mutual funds for all investors and all investment strategies. Additionally, CITs are not available outside retirement plans and, even within retirement plans, are not available for state and local government plans. A detailed assessment of the costs and benefits of these structures is outside the scope of our comments, the critical point is that mutual funds continue to serve important roles in investor portfolios, but this Proposal could steer investors to other structures that are sub-optimal for their investment goals.

Distressingly, the Commission appears to understand the potential to make mutual funds a less attractive investment option and drive investors to other products. For example, the Commission makes the following observations in the Proposal:

- open-end funds may become relatively more costly compared to other collective investment vehicles, such as ETFs or CITs, which may result in investors choosing to divest from the mutual fund sector;[20]
- some investors may be averse to the potential effects of the proposed swing pricing requirements, including uncertainty regarding the price at which the investor's transactions will ultimately execute;[21]
- to the extent that not all intermediaries may be able to comply with the hard close requirement, investors that use such intermediaries may face a decreased ability to invest in mutual funds through those intermediaries;[22] and

[19] Proposal at 306-07.
[20] Proposal at 296, 319-20.
[21] Proposal at 320.
[22] Proposal at 307.

- the hard close requirement may disadvantage investors that do not have a choice in their intermediary by precluding them from responding to market events after an early cut-off time.[23]

Indeed, the Commission notes specifically that the Proposal would have adverse impacts on the competitiveness of mutual funds:

> The mandatory swing pricing requirement would impose costs on mutual funds, investors, their intermediaries, and other market participants…. To the extent that investors expect an increase in the costs of investing in mutual funds as a result of the proposed mandatory swing pricing, they may choose to divest from the mutual fund sector.[24]

The Commission also notes several times that one impediment to its analysis of the costs of the Proposal is the inability to predict the number of investors who would "divest from the mutual fund sector."[25] Given the significance of its own predictions of potential consequences, we again urge the Commission to withdraw or stay this Proposal, pending further engagement with the industry and investors.

G. The Proposal Would Adversely Impact the Competitiveness of Mutual Funds as Investment Options

The changes to operational systems that would be required under the Proposal are enormous in scope. The Commission acknowledges some of these impacts in the Proposal, noting that:

- retirement plan recordkeepers would need to substantially update or alter their processes and systems to accommodate the proposed hard close requirement to submit orders more quickly;[26]
- intermediaries would need to submit orders for fund shares earlier than they currently do in order to receive that day's price;[27]
- funds and intermediaries would need to change business practices, computer systems, and integrate new technologies in order to remain in compliance;[28]
- intermediaries would need to impose an earlier cut-off time for orders and investors would not be able to reflect the entire day's market information into their allocation decisions;[29]

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[23] *Id*.
[24] Proposal at 295-96.
[25] Proposal at 303; *See also* Proposal at 292, 296, 307, 309, 319, 321.
[26] Proposal at 140-41.
[27] Proposal at 263.
[28] Proposal at 269.
[29] Proposal at 316.

- certain types of orders could not be executed at current prices and would be sent to funds the next day, which may expose investors to additional market risks and decreased portfolio returns;[30]
- to the extent that intermediaries require NAVs for purposes of updating and publishing account statements, they would incur costs updating their operations and systems to adapt to later NAV publication times;[31]
- because mutual fund flows from different intermediaries and investors are received by funds at different times, fund transfer agents may have to process orders in multiple batches that may span until the next day;[32]
- other market participants, such as financial data aggregators, would have to update their operations systems to adapt to later NAV publication times;[33] and
- processing orders in a short amount of time requires more manpower and/or more processing capabilities, which may increase the operational burden of open-end fund transfer agents.[34]

We agree with the Commission's assessments above, and we further note that this list is merely the beginning of the potential operational challenges that intermediaries and funds would face under the Proposal. The changes required to comply with the framework set forth in the Proposal would touch every point in the mutual fund transaction process, including order entry systems; omnibus order aggregation; sub-accounting systems/processes; trade restriction systems; creation and delivery of pricing and confirmation files; trade postings, registration records/updates; fund share settlement processes; and trade correction systems. These operational changes would also impact wrap account trade processing, as these systems require confirmation records in order to successfully calculate rebalance trade instructions.

As one example of the revisions that would be required, we note that under current operational flows, many of the files used are "trigger files", which are dependent on the timely receipt of certain information. As the Proposal would disrupt the timing of the entire order process, each "trigger file" would need to be individually re-evaluated and potentially revised. This requires review of operational systems with billions of lines of code and an assessment of many interdependencies. This example is merely one grain of sand in a sandbox of fundamental changes the Proposal would require.

In addition to the significant costs of revising systems, the Proposal would also require costs with respect to repapering thousands of documents, contracts, disclosures and agreements that currently govern the processing of mutual fund transactions. By way of example, our members have indicated that the following documents would need significant revisions:

- recordkeeper contracts;
- retirement plan constituent documents and transaction rules;

[30] *Id*.
[31] Proposal at 296.
[32] Proposal at 305.
[33] Proposal at 296.
[34] Proposal at 305.

- every broker-dealer contract regarding fund transactions for every fund;
- all fund intermediary account opening documents, which would require every fund intermediary client to accept new amendments to their existing documentation;
- website disclosure;
- every fund prospectus; and
- every service-level agreement concerning fund orders.

Thus, the Proposal would effectively require the repapering of not only the entire mutual fund industry, but also the documents underpinning most retirement plans. This repapering process is expensive and time-consuming and would likely take many months or even years to complete.

While the Commission recognized the potential for these costs, it does not provide an estimate. Given the far-reaching implications of these structural revisions, our members are also unable to provide specific estimates within the comment period window. However, extrapolating from other recent infrastructure investments, our members estimate that the costs to implement these changes would run well into the billions of dollars.

We contend that the Proposal does not sufficiently capture these proposed costs; as such, we believe the cost-benefit analysis discussion in the Proposal with respect to swing pricing is inadequate, arbitrary, and capricious in violation of the Administrative Procedure Act ("**APA**").[35] Further, we also note that while the potential costs and systemic revisions are estimated, they are real and significant costs, and stand in stark contrast to the speculative and *de minimis* benefits the Proposal seeks to provide.

VI. The Benefits of the Proposal Are Questionable

A. General

In poor or volatile market conditions, swing pricing may reduce instability, but at increased cost. While funds with swing pricing tend to mitigate redemption risk during stress periods, they also tend to receive less inflows outside periods of market stress.[36] This may be a result of higher tracking errors, as funds with swing pricing may have higher tracking errors as a result of moving prices in response to flows that may not correspond to changes in underlying asset valuations.[37] Additionally, funds with swing pricing are able to attract significantly fewer new investors outside periods of high market stress,[38] which highlights that investors may value price certainty over the benefits of swing pricing, outside of extremely poor market conditions.

[35] *See, e.g., Chamber of Commerce v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005) (holding that the statutory language of the APA imposes an obligation on the SEC to weigh the cost and benefits of proposed regulation, and to quantify those costs and benefits where possible); *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011) (holding that an SEC rule violated the APA because the SEC "inconsistently and opportunistically framed the costs and benefits of the rule" and "failed adequately to quantify certain costs of its proposed rule or to explain why those costs could not be quantified").
[36] *See Dunhong Jin, et al.*, IMF Working Paper, *Swing Pricing and Fragility in Open-end Mutual Funds* 20.
[37] *Id*.
[38] *Id*.

The Commission also notes that a hard close could benefit investors by preventing late trading of fund shares. In theory, an unscrupulous intermediary could misrepresent the time at which it received an order, allowing a shareholder to effectively transact in a fund after the fund has struck its NAV (contrary to the requirements of Rule 22c-1). While, under the Proposal, this behavior would not be possible (as orders would have to be submitted to the fund by the calculation of the NAV), the Commission does not cite any evidence that such late trading has occurred in the period since the adoption of Rule 22c-1. Our members have adopted policies and procedures to ensure that such late trading does not occur, and none of our members have identified circumstances where orders were being fraudulently submitted, as suggested by the Commission. As a result, we do not believe that the Proposal would provide fund shareholders with any benefits in this regard.

The Commission also posits that the Proposal would "provid[e] certainty to intermediaries and investors about whether orders are accepted or rejected at an earlier point in the process."[39] This is not a material concern for our members, who are the very intermediaries the Commission supposes would benefit from this certainty. In general, our members report that trade rejection rates are very low (e.g., less than 0.05% of orders), so this additional certainty would not materially improve our members' operational process, and certainly would not be worth the significant investment required to support a hard close. On the other hand, our members are very concerned about the increased likelihood of error corrections that intermediaries would no longer be able to address with the accelerated order process that would be required under the Proposal.

Finally, even assuming the Proposal accomplishes its goal of shifting transacting costs entirely to transacting investors, these costs on an individual basis are likely small. Even at its most extreme, a swing factor is unlikely to exceed the current cap of 2%,[40] and this would be applied only during the days with the most extreme shareholder flows. In other words, the days on which a meaningful swing factor would be applied are likely to be rare and applied only to a very small portion of investors – and only with respect to few transactions. This suggests that the benefits to remaining shareholders would be limited. In contrast, the significant and generational costs the Proposal would impose on funds would become part of the economics of investing in funds, increasing the costs of investing in mutual funds every single day.

B. The European Swing Pricing Model Cannot Be Directly Compared with the Current U.S. Model

In support of the benefits of the Proposal, the Commission cites a study based on the swing pricing experience in the European markets.[41] In the Proposal, the Commission acknowledges that the transaction cost components may be different between the United States and Europe,[42]

[39] Proposal at 138.
[40] We note that the Proposal would eliminate the current upper limit, but we believe it remains a relevant data point to assess the magnitude of potential swing factors (*see* Proposal at 215).
[41] *See* Proposal at n.478.
[42] *Id*. at 305.

but we submit that the Commission has not appreciated significant and material differences between the markets for mutual funds in Europe and the United States.

Operating models and distribution infrastructure in certain European countries enable some European funds to obtain accurate estimates of capital flows before calculating their NAV. The timing of orders, types of orders, and time of fund valuation all contribute to the successful use of swing pricing in Europe.[43] However, European conditions and practices differ greatly from those in the United States. For example:

- In the United States, mutual funds are held primarily by retail investors,[44] whereas in Europe, mutual funds are primarily held by institutional investors;
- Europe does not have the same defined contribution retirement model present in the United States or the associated NAV-dependent legacy systems;
- Most shareholder trades in Europe are denominated in cash amounts or percentages, which can be readily processed by funds and intermediaries without estimation, with a lesser portion in share or unit amounts or a percentage of assets held; this stands in contrast to the United States, where there are a wide mix of orders denominated in shares, percentages of holdings, and currencies.

Based on the above, we believe the European experience with swing pricing is based on different market dynamics and its implementation there is not indicative that swing pricing could be similarly implemented in the United States. It would also create more confusion in the United States, as swing pricing and hard close provisions are less likely to confuse and/or adversely impact institutional investors. We also note that the European implementation of swing pricing is optional, which is a significant difference from the mandatory implementation described in the Proposal. Given the Commission's reliance on the European fund model to substantiate that the Proposal would be feasible, we again reiterate that the Commission should withdraw or stay implementation of the Proposal pending a more thorough examination of the costs and benefits of the Proposal and alternative solutions.

VII. Other Comments

A. Reporting on N-PORT

The Proposal would require funds to file reports on Form N-PORT on a monthly basis, rather than filing monthly reports with the Commission 60 days after the end of each fiscal quarter.[45] This would mean that funds must separately file reports for each month of a fiscal quarter, increasing the number of filings under Form N-PORT from four to twelve. Our members have provided feedback that this is an unnecessary administrative burden. We defer to the AMG letter

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[43] Investment Company Institute, *Evaluating Swing Pricing: Operational Considerations* (2016).
[44] According to the European Fund and Asset Management Association (EFAMA), about 24% of European investment fund assets are held by retail shareholders in Europe, versus 94% held by retail shareholders in the United States.
[45] Proposal at 196.

for a more robust discussion of this portion of the Proposal, and we join in their recommendations.

B. Transition Period

The Proposal, if adopted, would allow for a 24-month implementation period.[46] Should the Commission determine to proceed with this Proposal, we submit that this period is woefully insufficient to allow for the entire reinvention of the mutual fund order processing infrastructure that has developed over many decades.

The efforts required to comply with the terms of the Proposal would be enormous, and such efforts are effectively impossible at the current time. With the other initiatives the industry is facing, such as the conversion to T+1 settlement, the industry simply lacks the resources to address changes of such a magnitude as the ones proposed.[47] As noted above, entire systems would need to be redesigned and rewritten; the contractual underpinnings of the industry would need to be renegotiated all at once; and the disclosures made to investors would need to be revised and resubmitted. We do not believe there are enough programmers, system developers, or operational and legal professionals to implement these changes in the proposed timeframe, and certainly not while the industry is focused on other significant changes.

To that end, we expect that the changes required by the Proposal would take at least forty-eight (48) months. We also request that any implementation period not start until after the industry has completed the anticipated transition from T+2 to T+1.[48]

VIII. Other Options / Recommendation

As discussed above, we request that the Commission withdraw or at least stay this Proposal pending further engagement with the industry and fund investors. The Commission itself cites several alternative approaches to address the Commission's concerns with respect to the allocation of transaction costs, such as liquidity fees. We also note that liquidity fees could, in theory, address the Commission's policy concerns regarding investor dilution without requiring the structural revisions to the market for mutual funds that would be created by the swing pricing requirement. Further, the infrastructure for the assessment of such fees is already in place, and the Commission notes the effectiveness of such fees in providing an exemption for ETFs from the swing pricing requirement.[49] While we are not prepared to recommend or endorse liquidity fees, we raise these points to underscore our contention that these matters warrant more careful consideration.[50]

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[46] Proposal at 234.
[47] Shortening the Securities Transaction Settlement Cycle, SEC Rel. No. 34-94196 (Feb. 9, 2022) ("T+1 Proposal").
[48] We note that consideration of this T+1 Proposal for adoption has been included on the SEC Open Meeting Agenda for February 15, 2023. https://www.sec.gov/os/agenda-open-021523.
[49] *See* Investment Company Swing Pricing, SEC Rel No. IC-32316 (Nov. 19, 2018), at 22.
[50] Liquidity fees would impose their own costs and have their own disadvantages that we are not discussing in this submission.

We also note that such deliberate and responsible rulemaking is not without precedent, and the regulation of ETFs offers one example. ETFs were originally created through a slow and deliberately evolving process of exemptive orders.[51] ETFs were originally only passive products, but in 2001 the Commission issued a Concept Release seeking public comment on how active ETFs could be structured.[52] In 2008, the Commission proposed an ETF rule and sought further comment on active ETFs.[53] It was not until 2018, just over 10 years later and after significant deliberation with the industry, that the Commission proposed a rule that would standardize ETF conditions and allow for active ETFs outside the exemptive order process.[54]

In contrast to that almost 20-year rule making process, here the Commission is seeking to fundamentally alter critical components of an investment product that millions of investors use for their primary savings vehicle and impose incalculable costs on the funds and their investors with a 60-day comment period. We respectfully request that the Commission withdraw or at least stay this Proposal pending further engagement with the industry and fund investors.

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SIFMA stands ready to provide any additional information or assistance that the Commission might find useful and welcomes the opportunity for collaboration. Please feel free to contact Thomas Price at [redacted] or our counsel, Lance C. Dial at Morgan Lewis & Bockius LLP at [redacted], should you have any questions.

Sincerely,

Kenneth E. Bentsen, Jr.
President and CEO
Securities Industry and Financial Markets Association

cc: The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
The Honorable Mark T. Uyeda, Commissioner
The Honorable Jaime Lizárraga, Commissioner

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[51] *See, e.g.*, SPDR Trust, Series 1, SEC Rel. Nos. IC-18595 (Sept. 17, 1992) (notice) and IC-19055 (Oct. 26, 1992) (first ETF order), and Country Baskets Index Fund, Inc., SEC Rel Nos. IC-21736 (Feb. 6, 1996) (notice) and IC-21802 (Mar. 5, 1996) (first open-end ETF order). Between 1993 and the adoption of Rule 6c-11 in 2019, the SEC issued more than 300 exemptive orders for ETFs.

[52] SEC Concept Release: Actively Managed Exchange-Traded Funds, SEC Rel. No. IC-25258 (Nov. 8, 2001).

[53] Proposed Rule: Exchange-Traded Funds, SEC Rel. No. IC-28193 (May 19, 2008).

[54] Proposed Rule: Exchange-Traded Funds, SEC Rel. No. IC-33140 (June 28, 2018). This proposal was adopted in 2019, with several modifications based on comments received. Final Rule: Exchange Traded Funds, SEC Rel. No. IC-33646 (Sept. 25, 2019).

William A. Birdthistle, Director, Division of Investment Management