sifma

sifma asset management group

November 30, 2023

Via Electronic Submission
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. Release Nos. 33–11130; IC–34746

Dear Ms. Countryman:

A year has passed since the Securities and Exchange Commission ("Commission" or "SEC") voted to propose rules that would overhaul liquidity risk management rules for open-end mutual funds (the "Proposal").[1] The Securities Industry and Financial Markets Association ("SIFMA")[2] and the Asset Management Group of the Securities Industry and Financial Markets Association ("SIFMA AMG")[3] continue to recommend that the SEC reconsider how best to proceed.

I. Executive Summary

In light of the magnitude and breadth of apprehension expressed in response to the swing pricing/hard close elements of the Proposal, the SEC should affirmatively reset and regroup before it decides on a path forward. The Commission should re-consider whether the Proposal's measures are warranted. If such measures are warranted, the Commission should define and describe its new path and formally release a revised proposal for public comment before formally adopting any rules

[1] "SEC Proposes Enhancements to Open-End Fund Liquidity Framework," SEC Press Release, November 2, 2022. Published in the Federal Register on December 16, 2022 (87 FR 77172).

[2] 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 one million employees, we advocate on legislation, regulation, and business policy affecting retail and institutional investors, equity and fixed income markets, and related products and services. SIFMA serves as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. SIFMA also provides 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 (the "GFMA").

[3] 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.

related to the Proposal so that any alternatives receive the benefit of a comprehensive review from all interested parties.

SIFMA and SIFMA AMG and its members remain willing to work with the Commission and SEC Staff to discuss public policy objectives, potential avenues, implementation logistics, and specific alternatives.

II. Responses to the Commission's Proposal Have Raised Serious Concerns

The Proposal has attracted critical attention from a wide range of commenters. The public comment file is filled with concerns from investors, fund managers, dozens of independent fund directors/trustees, intermediaries, and industry trade associations, including SIFMA and SIFMA AMG.[4] The SEC also received bi-partisan letters from both chambers of Congress[5] and the issue has been raised during Congressional hearings. The Chair and Commissioners as well as SEC Staff have also heard directly from interested parties in bilateral meetings.

The Proposal is far-reaching and has potential disruptive implications for many market participants, including fund shareholders. In addition to well-founded concerns raised about the Proposal's adverse impact on shareholders and funds regarding the revisions to the requirements for liquidity risk management programs, commenters have expressed strong reservations about the swing pricing and hard close elements of the Proposal.

Commenters have questioned the premises of material dilution, the cause/effect relationship between anti-dilution measures and the "first mover advantage," and the artificial precision in estimating transaction costs and imposing those costs on shareholders. Funds, intermediaries, and retirement platforms have illustrated the severe implementation challenges of swing pricing and the hard close, including the detrimental effects on shareholders. They collectively highlighted the implementation costs that investors will ultimately bear from restructuring internal systems, record-keeping platforms, and technology. Members of Congress – particularly those with west coast constituents – are troubled by early cut-off times for intermediaries that would disadvantage those who do not invest directly but rather invest through intermediaries and retirement platforms. Others have questioned why the SEC would discourage use of mutual funds by investors and savers and noted the likelihood that assets will migrate elsewhere. Material concerns about the tangible costs to shareholders and potential benefits have also been highlighted.[6]

Put simply, the Proposal's swing pricing/hard close framework is not viable.

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[4] See e.g., comment letters submitted by SIFMA AMG (February 14, 2023) and SIFMA (February 15, 2023).

[5] See, e.g., letter to SEC Chair Gary Gensler from 38 Members of the House of Representatives requesting that the SEC withdraw the Proposal based on both anti-dilution and liquidity risk program grounds (September 5, 2023).

[6] See e.g., Recommendations of the SEC Investor Advisory Committee (discussed at the September 21, 2023 meeting) noting areas of investor impact highlighted in comments that had not been fully studied in the proposal and suggesting that the SEC needed to expand and revisit its economic analysis before making any conclusion for supporting a final adoption of swing pricing and hard close.

III. The Path Forward Requires Re-Consideration. The Commission Must Publish Alternatives for Comment Prior to Adoption.

With the benefit of the significant feedback received, the SEC should re-validate the premises and public policy objectives of the Proposal before proceeding further with any mandated anti-dilution measures.[7] The lack of agreement on benefits compared to the very real costs of the SEC's stated policy objectives of mitigating dilution and first-mover advantage alone is cause for pause.[8]

As this swing pricing/hard close framework is not viable, the SEC may consider other options. Interested parties should have the opportunity to opine on any proposed alternative framework prior to adoption. Soliciting comment would enable the SEC and commenters to assess implications, costs, and benefits that were not fully described or developed in the Proposal.[9]

Anti-dilution alternatives have many variations, and none offer a perfect solution. Every alternative has trade-offs and the potential for unintended consequences. Even seemingly small differences could have material implications and pose serious implementation challenges. Many variations also have downstream effects beyond fund operations for shareholders, intermediaries, retirement platforms, recordkeepers, insurance providers and others.

The SEC should want full and thoughtful feedback to accomplish its public policy objectives and minimize damage to an investment vehicle that plays such a vital role in our capital markets. Any alternative anti-dilution concept requires the opportunity for assessment and formal public feedback before adoption. Commission Staff benefit from the diverse perspectives provided via the comment process in considering what final recommendation to make to the Commission. Any alternative deserves its own robust quantitative assessment of costs and benefits. Commissioners should know that any recommendation has been sufficiently pressure tested such that it will accomplish the intended public policy goals and the benefits are compelling enough to clearly outweigh the costs.

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[7] While this letter primarily focuses on anti-dilution measures, substantial critical comment was also provided to the Commission in response to the liquidity risk management elements of the Proposal. We continue to recommend caution before proceeding with the Proposal's liquidity risk framework provisions in light of the potential adverse impacts to investors and funds. The Commission should re-evaluate whether such provisions are warranted and, if so, determine whether a re-proposal is appropriate to ensure sufficient consideration of alternatives from the Proposal's framework.

[8] Since the Proposal, the SEC also adopted rules to shorten settlement cycle to T+1. That process is underway and will help address the Commission's concerns about differences between mutual fund share settlement and underlying asset liquidity.

[9] For example, liquidity fees could impact insurance providers in terms of contractual obligations, state insurance regulatory requirements and logistics infrastructure. If they are unable to adapt and comply with SEC requirements, there are meaningful implications for policy holders, insurance providers, and funds. This aspect is not identified in the Proposal, comments were not sought, and the SEC did not assess the related costs.

IV. The Logical Outgrowth Principle Limits the Commission's Ability to Adopt Alternatives without Further Notice and Comment.

Under long-standing principles of administrative law, the substance of an agency's final rule must be a "logical outgrowth" of its proposal and notice for public comment.[10] This logical outgrowth standard limits the Commission's ability to adopt a different anti-dilution measure than what it proposed.[11] While the Proposal generally asked about alternatives to swing pricing, it did not provide sufficient specifics to allow a substantive assessment of the implications, costs, and benefits of any alternative path forward.

Before adoption, proposed alternatives must be well developed enough to enable substantive comment. In this case, for example, the Proposal declined to propose liquidity fees, but mentioned liquidity fees and acknowledged that there are a wide range of variations that could exist within a liquidity fee framework. Bid pricing is another alternative that could take a multitude of forms. In both cases, the Proposal includes no detail and specific design decisions would have significant implications for a final rule.

Acknowledging that alternatives exist is not the same as fully developing and describing alternatives in proposed rule text. There is no focused quantitative assessment of costs and impacts for a particular alternate framework. While the SEC sought comment, it is unrealistic to expect commenters to address the benefits, costs, and operational impacts of every possible variation of each alternative mentioned.[12] No alternatives were identified and described in sufficient detail to allow thoughtful public comment. As a result, the SEC did not lay sufficient groundwork in the Proposal to adopt these types of alternatives without additional opportunity to comment.[13] A final rule with features that are substantially different than those in the Proposal cannot be a "logical outgrowth" of the Proposal.

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[10] "Where the change between proposed and final rule is important, the question for the court is whether the final rule is a 'logical outgrowth' of the rulemaking proceeding." (United Steelworkers of America, *AFL-CIO-CLC v. Marshall*, 647 F.2d 1189 (D.C. Cir. 1980)).

[11] The logical outgrowth test is applied to consider whether a new round of notice and comment would provide the first opportunity for interested parties to offer comments that could persuade the agency to modify its rule. See *National Exchange Carrier Association, Inc. v. FCC*, 253 F.3d 1 (D.C. Cir. 2001).

[12] Parties are not required to divine the agency's unspoken thoughts about specific alternatives. Anticipating modest changes from a proposal and commenting accordingly is different than identifying and commenting on every potential variation with different terms and parameters. The burden is on the agency to provide adequate notice of what actions it proposes to take. See *CSX Transportation, Inc. v. Surface Transportation Board*, 584 F.3d 1076 (D.C. Cir. 2009).

[13] See also Recommendations of the SEC Investor Advisory Committee (discussed at the September 21, 2023 meeting) suggesting the SEC further examine anti-dilution alternatives, conduct a robust cost-benefit analysis, and consider issuing a concept release and establishing working groups to obtain additional input.

V. Recent Money Market Amendments Are Relevant to Considering Liquidity Fee Alternatives.

Only four months ago, the SEC voted to adopt amendments for money market funds.[14] In those final amendments, the SEC replaced the proposed swing pricing concept with a new framework of liquidity fees (mandatory and discretionary). Compliance dates for these amendments are staggered throughout 2023 and 2024.

In adopting liquidity fees for money market funds, the Commission attempted to make a variety of cost and benefit assessments. The adopting release contains ample commentary about what "might" happen or the costs or benefits that "may" result or noting that the implications "depend" on different approaches taken by funds and shareholders.

Actual data and experience should be the preferred foundation for economic analysis rather than speculation for any rule. The money market fund rule adoption and implementation provide an opportunity for review and reflection before proceeding with further measures for open-end funds more broadly.[15]

Before moving forward with anti-dilution measures for open-end funds more broadly, the Commission and SEC Staff should know how money market funds and intermediaries implemented liquidity fee changes in practice, what costs were incurred, what impacts resulted for strategies and fund products, the impact to fund shareholders, and whether those changes achieved the desired public policy objectives.[16] While there are differences between the money market and open-end fund ecosystems, learning from implementation of liquidity fees would help inform the thinking of the Commission and the SEC Staff.

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SIFMA and SIFMA AMG remain willing to work with the Commission and SEC Staff on the public policy questions of open-end fund liquidity. Engagement can happen through direct discussion in the absence of a specific proposal or more formally in response to a request for input.

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[14] "SEC Adopts Money Market Fund Reforms and Amendments to Form PF Reporting Requirements for Large Liquidity Fund Advisers," SEC Press Release, July 12, 2023. Published in the Federal Register August 3, 2023 (88 FR 51404).

[15] Lessons from the money market fund implementation experience (especially with respect to elements such as market impact) would be necessary but not sufficient alone. The open-end fund market is broader and more complex. Applying a similar fee regime to open-end funds would have far-reaching impacts to NAV-dependent products, retirement platforms, and the wide variety of intermediaries. This further demonstrates the need for a comprehensive assessment of the specifics of any anti-dilution measures prior to adoption.

[16] The recent money market reform amendments were built on lessons learned from impacts stemming from prior money market fund rulemaking. Given the potential implications for market liquidity, volatility and flow behavior, open-end fund regulation should move cautiously and avoid causing or exacerbating risks.

If you have any questions or would like to discuss anything in this letter further, we welcome the opportunity to engage with you. Please feel free to contact Lindsey Keljo (lkeljo@sifma.org), Kevin Ehrlich (kehrlich@sifma.org), or Thomas Price (tprice@sifma.org).

Sincerely,

Ken Bentsen, Jr.
President and CEO

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
Mr. William A. Birdthistle, Director, Division of Investment Management