sifma
asset management group

February 14, 2023

Submitted electronically via SEC.gov
Ms. Vanessa A. Countryman
Secretary
U.S. 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—Comments on Proposal to Mandate Swing Pricing and a Hard Close (File No. S7-26-22)**

Dear Ms. Countryman:

The Asset Management Group of the Securities Industry and Financial Markets Association ("SIFMA AMG")[1] appreciates the opportunity to provide comments to the United States Securities and Exchange Commission (the "Commission" or "SEC") on the Commission's proposals to make certain revisions to liquidity risk management programs for open-end funds and to require swing pricing by open-end funds (the "Proposal").

This letter addresses SIFMA AMG's comments on the swing pricing and hard close aspects of the Proposal from the perspective of the asset management industry and, except when the context otherwise requires, "Proposal" refers only to those aspects of the Proposal. SIFMA AMG comments on liquidity risk management programs and related disclosures are provided in a separate letter.[2] In addition to this letter, SIFMA[3] is submitting a separate comment letter on behalf of mutual fund intermediary members with respect to the proposed swing pricing

[1] 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. SIFMA AMG appreciates the assistance of George B. Raine, Jennifer Choi, Jimena Smith, Elizabeth Madsen and Alina Cathcart of Ropes & Gray LLP in the preparation of this response.

[2] SIFMA AMG, Comment Letter on Proposal to Amend Liquidity Risk Management and Reporting Rules (Feb. 14, 2023).

[3] 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).

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and hard close requirements. SIFMA AMG agrees with and supports the comments set forth in the SIFMA letter.[4]

SIFMA AMG recognizes the Commission's goals of addressing concerns of dilution associated with investor purchases and redemptions of fund shares and eliminating a potential first-mover advantage that might incentivize early redemptions to avoid anticipated fund trading costs. To address these perceived concerns, the Commission has determined to mandate swing pricing for most open-end funds and to require a hard close to operationalize swing pricing. While there are various views on the need for, and efficacy of, swing pricing, SIFMA AMG strongly opposes the proposed requirements for a hard close and mandatory swing pricing, which would fundamentally change the U.S. mutual fund ecosystem and disadvantage mutual fund investors, particularly retail investors, who purchase and redeem fund shares through intermediaries and retirement savings plans. Even members receptive to swing pricing as a concept are opposed to a hard close, believing that the adverse impact on investors and the costs and disruption that would be caused by requiring a hard close far outweigh the potential benefits of the Proposal.

We also suggest that proposals of such breadth and potential import be evaluated on an industry-wide basis. The implications, impacted parties, and potential costs and benefits warrant a more comprehensive analysis and assessment than a single notice and comment period for investment company rulemaking allows. We appreciate that the Commission has requested comment on a wide range of questions, but such a short time to respond precludes any comprehensive analyses or academic studies.

Finally, SIFMA AMG notes that the Commission has included a 60-day comment period for the Proposal.[5] The complexity of this potentially transformative rulemaking and the Commission's already crowded regulatory agenda call for a longer comment period to allow adequate time to provide thoughtful commentary on the Proposal and its interactions with other proposed changes to the federal securities laws.[6]

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[4] SIFMA, Comment Letter on Swing Pricing (February 14, 2023).

[5] Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting, Securities Act Release No. 11,130, Investment Company Act Release No. 34,746, 87 Fed. Reg. 77,172 (proposed Dec. 16, 2022) (to be codified at 17 C.F.R. pts. 270, 274) (the "Proposing Release").

[6] *See* SIFMA AMG et al., Letter on Proposed Rules, File Nos. S7–26–22, RIN 3325-AM98, RIN 3235-AN18 (Nov. 16, 2022), https://www.sifma.org/wp-content/uploads/2022/11/Open-End-Fund-Liquidity-Risk-Management-Programs-and-Swing-Pricing-Form-N-PORT-Outsourcing-by-Investment-Advisers-Joint-Trades.pdf; *see also* Investment Company Names, Securities Act Release No. 11,067, Exchange Act Release No. 94,981, Investment Company Act Release No. 34,593, 87 Fed. Reg. 36,594 (proposed June 17, 2022) (to be codified at 17 C.F.R. pts. 230, 232, 239, 270, 274); Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, Securities Act Release No. 11,068, Exchange Act Release No. 94,985, Investment Advisers Act Release No. 6034, Investment Company Act Release No. 34,594, 87 Fed. Reg. 36,654 (proposed June 17, 2022) (to be codified at 17 C.F.R. pts. 200, 230, 239, 249, 279); The Enhancement and Standardization of Climate-Related Disclosures for Investors, Securities Act Release No. 11,042, Exchange Act Release No. 94,478, 87 Fed. Reg. 21,334 (proposed Apr. 11, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 232, 239, 249).

I. Executive Summary

SIFMA AMG strongly recommends that the Commission take a more holistic approach to the swing pricing Proposal. The Proposal would impact many entities, beginning with shareholders and extending through investment companies, fund intermediaries, recordkeepers, and others. This impact warrants a collective and cooperative approach to evaluating the feasibility of swing pricing in the U.S. By way of illustration, we have found that our members have differing perspectives and views on each aspect of the Proposal, in many cases directly informed by their experience with European swing pricing, which the Proposal frequently references. Impacts of this magnitude warrant treatment through avenues such as a concept release or roundtables, and we stand ready to participate if the Commission agrees to take that course.

In addition, we have the following primary concerns with the Proposal, which are discussed in further detail herein:

- SIFMA AMG strongly opposes a hard close requirement to facilitate swing pricing. A hard close, which some of our members believe is necessary to facilitate swing pricing, is incompatible with the current mutual fund infrastructure, would upend the entire mutual fund ecosystem, and would have a direct detrimental impact on retail investors and retirement plan participants, the very investors the Proposal is seeking to protect. If a hard close is a prerequisite to swing pricing, we believe the potential costs of implementation and market-wide disruption from requiring a hard close would be too great.

- SIFMA AMG opposes mandatory swing pricing in its proposed form, specifically its prescriptive elements. This prescriptiveness stands in stark contrast to the European model, which is characterized by its flexibility and is often cited by the Commission in the Proposal. If the Commission decides to move forward with the Proposal, SIFMA AMG recommends the Commission adopt a more flexible, voluntary swing pricing framework.

For the reasons articulated more fully herein, we also believe that the Proposal's assessment of the costs and benefits falls short of the consideration we believe is due for a Proposal of this magnitude and warrants reconsideration.[7]

II. Summary of the Proposal

In 2016, the Commission amended Rule 22c-1 under the Investment Company Act of 1940, as amended ("<u>Rule 22c-1</u>"), to permit, but not require, certain open-end funds to implement swing

[7] The Proposal's cost-benefit analysis is inadequate and arbitrary and capricious in violation of the Administrative Procedure Act ("APA"). *See 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 the certain costs [of its proposed rule] or to explain why those costs could not be quantified").

pricing as a liquidity risk management tool.[8] In the time since the adoption of amended Rule 22c-1, no U.S. funds have implemented swing pricing. [9]

In November 2022, the Commission proposed amendments to Rule 22c-1 to *require* all open-end funds, except for money market funds [10] and exchange-traded funds ("ETFs") [11] (together, "excluded funds"), to engage in swing pricing under certain conditions. Specifically, the Proposal would require an open-end fund, other than an excluded fund, to establish and implement swing pricing policies and procedures that adjust the fund's current net asset value per share ("NAV") by a "swing factor" if the fund has either (i) net redemptions (no threshold) or (ii) net purchases that exceed 2% of the fund's net assets. Although not required, open-end funds, other than the excluded funds, would be permitted to apply swing pricing at other times (*i.e.*, when daily net purchases of shares do not exceed 2% of fund net assets). The Proposal states that by imposing the costs associated with net purchases or net redemptions on the shareholders who are purchasing or redeeming from the fund at that time, "swing pricing can 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."[12]

The Proposal includes additional amendments to Rule 22c-1 to require a "hard close" for funds that are required to implement swing pricing. The proposed hard close requirement would provide that a direction to purchase or redeem a fund's shares is eligible to receive the price established as the current day's NAV, provided that the fund, its designated transfer agent, or a registered securities clearing agency (collectively, "designated parties") receive an eligible order before the time the fund has established for calculating its NAV. Purchase and redemption orders received after the time the fund has established for determining the day's NAV would receive the next day's NAV.

The Proposal states that, to implement the proposed swing pricing requirement, "mutual funds need 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."[13] Among other things, the Proposal argues that the proposed hard close requirement "would facilitate the more timely receipt of order flow information by requiring that the fund, its transfer agent, or a clearing agency receive all orders that are eligible to receive that day's price before the fund computes its NAV."[14] Currently,

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[8] Investment Company Swing Pricing, Securities Act Release No. 10,234, Investment Company Act Release No. 32,316, 81 Fed. Reg. 82,084 (Nov. 18, 2016) (the "2016 Adopting Release").
[9] Proposing Release, *supra* note 5, at 77,200 n.162.
[10] SIFMA AMG strongly opposes swing pricing requirements for any type of money market fund. Implementing swing pricing requirements for money market funds would unnecessarily restrict investors' ability to use money market funds for their intended cash management purposes and would be ineffective in achieving the Commission's goals for reform. Swing pricing also would present significant operational impediments in implementation that would impact an investor's ability to use money market funds as an effective cash management vehicle. For more information, see SIFMA AMG, Comment Letter on Money Market Fund Reforms (Apr. 11, 2022), https://www.sifma.org/resources/submissions/sec-money-market-fund-proposal/.
[11] Consistent with current Rule 22c-1, the Proposal would exclude ETFs from the swing pricing requirement because, among other reasons, (i) in connection with creation unit transactions, ETFs often impose fees that are intended to defray operational processing and brokerage costs to prevent possible shareholder dilution and (ii) swing pricing could impede the effective functioning of an ETF's arbitrage mechanism.
[12] Proposing Release, *supra* note 5, at 77,199.
[13] *Id.* at 77,209.
[14] *Id.*

however, the Commission permits certain intermediaries, including insurance companies and managers of 401(k) plans, to forward orders to the fund, its transfer agent or clearing agency, as applicable, a few hours after the fund has struck its NAV and still receive that day's NAV, as long as investors submit orders to these intermediaries before a fund strikes its NAV.[15]

In 2003, the SEC proposed a similar hard close requirement but did not adopt the proposed amendments, in no small part due to the potential adverse impact on fund shareholders.[16] The feedback in the comment file from the 2003 proposal remains valid and should be incorporated into the Commission's consideration of this Proposal, now almost two decades later.

III. Letter Roadmap

SIFMA AMG acknowledges that the concept of mandatory swing pricing and the hard close requirement, as envisioned by the Proposal, are inherently intertwined. While some funds may want the option to use a more flexible, non-mandatory form of swing pricing in the U.S., depending on their particular facts and circumstances, we oppose a mandatory hard close for all open-end mutual funds as the means to operationalize swing pricing. This letter first describes why a hard close requirement would be unworkable in the U.S. and why, because of that incompatibility, we are opposed to mandatory swing pricing with a hard close. Even members that acknowledge swing pricing to be an effective anti-dilution tool believe the costs and disruption that would be caused by requiring a hard close outweigh the potential benefits. For this reason, we will address the proposed hard close requirement separately from the swing pricing framework.

IV. The Commission Should Not Adopt a Hard Close Requirement

SIFMA AMG opposes the hard close requirement because it would upend the mutual fund ecosystem with which investors are familiar and upon which they rely. In this section, we review the development of the pricing regime in the U.S., discuss the negative consequences that would result from implementation of the Proposal, and urge the Commission to invest in a discussion of alternative anti-dilution measures.

A. The U.S. Pricing System Was Uniquely Structured to Serve the U.S. Investor Base

The U.S. pricing model is governed by Rule 22c-1. Under Rule 22c-1, investors' orders to buy or redeem mutual fund shares must be placed before the fund's NAV is determined each day. The cut-off time, *i.e.*, the time when the NAV is determined, is generally set at 4:00 p.m. ET (the "<u>Market Close</u>"), the close of a regular trading session of the New York Stock Exchange. This time was chosen under the assumption that the value of a fund's portfolio would not change much between the time the orders to buy and redeem are submitted and the Market Close.[17] Orders received after the Market Close, with certain exceptions the development of which are discussed below, are executed at the price determined at the Market Close on the following business day.

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[15] Tamar Frankel & Lawrence A. Cunningham, *The Mysterious Ways of Mutual Funds: Market Timing*, 25 ANN. REV. BANKING & FIN. L. 235, 244-45 (2006).
[16] Amendments to Rules Governing Pricing of Mutual Fund Shares, Investment Company Act Release No. 26,288, 68 Fed. Reg. 70,388 (Dec. 11, 2003).
[17] 15 U.S.C. § 80a-22(c); 17 C.F.R. § 270.22c-1; Frankel & Cunningham, *supra* note 15, at 240.

The development of the current U.S. pricing system was structured in large part around the specific needs of investors transacting through intermediaries. In the 1940s, there were no 401(k) plans, variable annuities, or variable life insurance policies.[18] These investment channels only emerged later, and the industry adopted systems to accommodate the needs of these channels that directed the savings of hundreds of thousands of investors into mutual funds. Though the investors in these channels had the right to place purchase and redemption orders up to the Market Close, intermediaries faced operational hurdles in submitting client orders to mutual funds by the Market Close.

In particular, there was a need for a time extension to allow the sorting and collating of investors' orders. Most intermediaries today use "omnibus accounts" to transact in fund shares. When intermediaries receive investors' orders, they have to collate the orders into one group for "buy" and another for "redeem" and then send the information to the mutual fund at the aggregate omnibus account level. Given the volume of orders, this process can be extremely time-consuming. To ensure timely and cost-effective processing, intermediaries often needed to outsource work to organizations that collect and collate investors' orders—small, unregulated organizations not vested with any discretionary powers but expected merely to perform certain ministerial functions.[19]

In 1968, in light of these unique challenges and to allow small investors to place orders through intermediaries up to the same cut-off time afforded to direct investors, the Commission began permitting intermediaries to forward orders to mutual funds after the Market Close, honoring the time the order was placed with the intermediary.[20] Therefore, orders placed with intermediaries would receive that day's price as long as the order was placed with the intermediary by the Market Close cut-off.

Since that time, it has been the universal expectation of U.S. investors that orders placed before the Market Close (whether directly to the fund or through an intermediary) will receive that day's price. The U.S. pricing system has developed uniquely to accommodate these intermediaries, which have become increasingly important to investors, particularly retail investors, who seek advice in purchasing and redeeming fund shares in support of a more personalized investment strategy.

In December 2003, the SEC proposed a rule that would have mandated a hard close at the Market Close for mutual funds in an attempt to prevent late trading.[21] The SEC declined to adopt the proposed rule, however, after receiving over 800 comments, the majority of which were in opposition to the rule for reasons nearly identical to those we put forth today.[22] Since then, NAV-

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[18] Frankel & Cunningham, *supra* note 15, at 244.
[19] *Id.* at 245.
[20] *See* Staff Interpretive Position Relating to Rule 22c-1, Investment Company Act Release No. 5569 (Dec. 27, 1968) (Rule 22c-1 "contemplates that the time of receipt of the order by the retail dealer is controlling" for purposes of determining the price obtained by the dealer).
[21] Amendments to Rules Governing Pricing of Mutual Fund Shares, Investment Company Act Release No. 26,288, 68 Fed. Reg. 70,388 (Dec. 11, 2003).
[22] *See* Eric Hazard, *SEC Rethinking Hard Close Proposal*, PLANSPONSOR (Mar. 10, 2004), https://www.plansponsor.com/sec-rethinking-hard-close-proposal/.

dependent products (*e.g.*, 401(k)s, model portfolios, etc.) have proliferated, all based on the assumption that buy and sell orders submitted by investors before Market Close will receive today's price.

B. The Hard Close Would Have Significant Negative Consequences on the Current U.S. Market Infrastructure

SIFMA AMG believes the adoption of a hard close requirement would have severe consequences on funds and their investors by fundamentally changing the buying and selling experience of retail investors in mutual funds.[23] Not only would the implementation of a hard close negatively impact investors, intermediaries and funds themselves, but also the middle office, back office and third-party service provider transactions and processes responsible for calculating a fund's daily NAV.[24] Given the time necessary to process orders as described above, investors who purchase or sell fund shares through intermediaries or retirement plans would likely have to submit orders by a much earlier deadline than the current Market Close or have their orders processed the next business day at the following business day's price.

The Proposal would completely change the long-held expectation of U.S. fund investors that if they submit an order by the cut-off time—whether directly to the fund or through an intermediary—they will receive that day's price. It would 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 or recommendations (but run into earlier cut-off times or, potentially, receive the next business day's price).[25] For funds that are sold exclusively through intermediaries, investors would have no choice but be subject to an earlier order deadline or receive the next business day's price. Mutual fund investors in retirement savings plans also would be harmed if retirement plans were forced to implement even earlier (likely mid-morning) cut-off times for orders or if their orders took two business days to process, subjecting them to market movements for an extra business day. We believe the Commission is well aware of these consequences, given that it declined to impose an early cut-off time when it adopted swing pricing as a permissive tool in 2016, noting the "significant downsides" of such an approach.[26]

i. The Hard Close Would Have a Significant and Disproportionate Negative Consequence on Retail Investors

Currently, about 80% of mutual fund investors hold mutual fund shares indirectly through intermediaries, including brokerage and advisory accounts, because those intermediaries offer

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[23] In 2021, 81% of mutual fund-owning households held funds inside employer-sponsored retirement plans. *See* Inv. Co. Inst., 2022 Investment Company Fact Book 123 (2022), https://www.icifactbook.org/. For households owning mutual funds outside employer-sponsored retirement plans, 79% owned funds purchased with the help of an intermediary. *Id*. at 124.

[24] Our members noted several other transactions that would be impacted by a hard close, including, but not limited to, processing dividends, plan loans, fund-of-fund rebalances and exchanges, and dollar value redemptions.

[25] See SIFMA's letter focusing on broker-dealers and fund intermediaries for additional discussion about the types of financial advice or recommendations offered to investors by intermediaries. SIFMA, Comment Letter on Swing Pricing (Feb. 14, 2023).

[26] 2016 Adopting Release, *supra* note 8, at 82,103.

additional customer services or support, and retirement plans.[27] Many of these intermediaries allow investors to hold mutual fund shares in multiple fund families and to make exchanges across fund families on a same-day basis through batch and net trades. We believe it would be a great disservice to investors if they were forced to choose between investing through an intermediary to gain the investment advice and other benefits provided, or to invest directly with the fund to have until 4 p.m. to submit their orders, particularly when there may be other alternatives to a hard close to address potential dilution.

Specifically, if a hard close were adopted, investors holding mutual fund shares through intermediaries would be at a competitive disadvantage relative to direct investors for two primary reasons. First, investors who purchase and sell fund shares through intermediaries or through retirement accounts would be at an informational disadvantage. Intermediaries would have to set different cut-off times depending on the client channel. For example, certain intermediaries might be able to manage trades for institutional clients up until a time very close to the Market Close, while a retirement investor might have to submit instructions to its retirement plan intermediary much earlier.[28] An earlier cutoff for investors who transact through intermediaries is problematic because these investors would not be able to benefit from late-breaking market information (arising after the cut-off but before the Market Close) that direct investors would have before transacting up to the Market Close. This would create a "last-mover advantage." That is, investors who can buy directly from the funds and can wait to place their orders until immediately before the Market Close can reap the benefit of whatever information becomes available after intermediary investors have had to place their orders for the day. The Proposal purportedly seeks to address and mitigate the effects of a "first-mover advantage." However, in doing so, the Commission may be trading one timing advantage for another.[29]

Second, orders of investors who purchase and sell fund shares through intermediaries or through retirement accounts could be subject to market movements from a delay in execution of their orders. The Proposal suggests that "[m]ost fund shareholders are long-term investors, and thus we believe that most fund orders are not time sensitive." The Commission, however, would be taking away from the very investors it seeks to protect the ability to control the timing of their trade executions. Particularly for shareholders seeking safety in a time of market volatility, being locked out of the market for another business day limits the freedom and agency of shareholders to control their own destiny. Further, the Proposal states that "[f]or those investors who place a premium on being able to place orders up until 3:59 p.m. ET, they generally could place orders with the fund's transfer agent to retain this option."[30] For the substantial proportion of retail investors who own shares

[27] Inv. Co. Inst., Fact Book, *supra* note 23. Only a small percentage of retail mutual fund investors hold assets directly with fund families, which allows them to place trades up to the Market Close. In contrast, institutional investors are more likely to have direct fund investments. The hard close is not likely to impact the ability of direct investors to place trades up until the close of the market unless fund families establish earlier cut-offs to aggregate direct retail trades.
[28] The Proposal states "because of advances in technology, it seems likely that intermediaries would set cut-off times that are only incrementally earlier than current cut-off times." Proposing Release, *supra* note 5, at 77,213. We believe this prediction is unlikely to materialize. Our members believe that cut-off times for intermediaries will likely be hours before fund cut-off times.
[29] This early cut-off will also create an inability to cancel or correct a trade once the transmission has been sent to the fund, even in the case of legitimate errors.
[30] Proposing Release, *supra* note 5, at 77,213.

through retirement plans or intermediaries, this option is structurally not available. For example, employees have no choice with regard to retirement plans and holding shares through an intermediary is the only way to facilitate exchanges and re-allocations across fund families. Given these questionable predicates, we urge the Commission to re-evaluate its assessment of the public policy trade-offs.

Furthermore, it is likely that different intermediaries would impose different cut-off times for investors based on their own ability to process and transmit data to the mutual funds by the Market Close. This could result in investors having to keep track of several different order cut-off times if investing through multiple intermediaries (for example, through an advisory account or a retirement plan). At a minimum, there is a risk of confusion within the system of different cut-offs that does not presently exist. Second, intermediaries would no longer be able to process exchanges on behalf of their retail customers between different fund families because the NAV of the first leg of the exchange could not be established by the time of the order for the second leg. The consequence for these investors would be that the second part of their exchange would be exposed to market movements for an extra day.

We also note the obvious implications for investors and financial advisors in the Pacific time zone, as well as in Alaska and Hawaii. If cut-offs move to noon Eastern time, those in western-U.S. time zones would have a narrower window each morning to submit mutual fund orders. At present, such investors and those supporting them have more than half a day to conduct business. In a possible future state, for example, such investors would have to evaluate market developments after the prior business day's U.S. market close, monitor news from overseas markets during the night, and be prepared to make and execute decisions before 9 a.m. Pacific time. The impact to investors is obvious but there are also indirect impacts to financial advisors who are under a duty to assess relevant information, make recommendations, communicate with their clients to seek instructions, and implement share transactions. A recommendation not acted upon by 9 a.m. Pacific time could require re-evaluation and re-affirmation given the possibility of changing circumstances after the cut-off. A compressed timeline makes this challenging at best and imposes greater regulatory risk on licensed and registered parties who have no control over the timeline.

ii. The Hard Close Would Impose Unique Negative Consequences on Retirement Investors

As previously discussed, most retirement plan participants currently have access to plan administration services that allow participants to submit investment instructions relating to their plan investment options up until the Market Close and receive the price determined for mutual fund shares as of the Market Close on that day. This allows participants to make their investment decisions based on current market information on a basis similar to that available to retail investors who submit instructions directly to a mutual fund or its transfer agent. This is possible only because plan recordkeepers and administrators receiving investment instructions from participants are permitted to process and transmit participants' investment instructions to funds or their transfer agents after the Market Close.

Implementing a hard close would upend this timeline. To allow plan recordkeepers to complete omnibus accounting in time to submit trades to mutual funds by the Market Close, plan administrators would need to implement earlier cut-off times for plan trades, meaning plan participants would need to finalize their investment decisions much earlier on each trading day. As discussed previously, this would give an advantage to those who can buy or sell directly from the fund. For example, if cut-off times were set at noon Eastern time for plan participants, direct investors would have an advantage if there were developments in the market between a noon Eastern time cut-off and the NAV strike time at the Market Close. Alternatively, orders in retirement savings plans would have to be processed using the following day's NAV. We believe these disadvantages would be unacceptable to retirement plan administrators and would likely drive administrators to move client assets out of mutual funds and into alternative vehicles.[31] Although the Commission has suggested retirement plan administrators could simply "substantially update or alter their processes and systems to accommodate the proposed hard close requirement to submit orders more quickly," we believe this expectation greatly underestimates the cost to retirement plan administrators to rebuild their entire systems.[32]

In addition, under the Proposal, individual investors' rebalancing of retirement assets between mutual funds would have to occur over two days (or even more), resulting in retirement assets being out of the market for a day. As studies have shown, missing out on just a few days of market activity over long periods can significantly impact the performance of a portfolio.[33] In a rebalance (most of which are done automatically), the recordkeeper would have to submit sales on Day 1, wait to receive the NAV and redemption amount on Day 2, and then submit the trade. However, significant variations in the market could cause imprecise rebalancing, and force subsequent trades to rebalance back to the client's requested allocation. One account can have many transactions throughout the course of a trading day. In the case of rebalance instructions, this may result in several different purchase and sell orders. This activity is repeated across thousands, even millions, of accounts at a given intermediary, representing millions of daily individual transaction instructions.

Similarly, the hard close also would result in participants no longer being able to exchange from one fund investment to another without being out of the market for at least one day. Retirement plan recordkeepers would no longer be able to manage trading activity by batching up and processing exchange orders based on a fund's NAV later in the evening. Instead, recordkeepers would have to process the two sides of an exchange transaction over two days, meaning plan participants would be out of the market for an extra day. Unlike other investors who may be able to invest directly in a fund if they want same-day pricing, retirement plans would have no choice but to receive delayed pricing for their mutual fund investments.[34]

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[31] Costs involved with this Proposal borne by mutual funds also would increase expense ratios, increasing costs to investors and making open-end mutual funds less attractive compared to other options. Expenses are particularly a consideration for those with a fiduciary duty when there are similar strategies available in other investment vehicles.
[32] Proposing Release, *supra* note 5, at 77,212.
[33] "Even missing a few trading days can take a toll. Consider an example of a hypothetical $1,000 investment in the MSCI ACWI from January 1, 2012, to December 31, 2021. An investment for the full period would have grown to $3,065. But missing even the 10 best days of the 10-year period would have decreased long-term gains by 50% — and the more missed 'good' days, the more missed opportunities." Pramod Atluri, Caroline Randall & Andrew Suzman, *5 Keys to Investing in 2023*, CAPITAL GRP. (Jan. 5, 2023), https://www.capitalgroup.com/advisor/insights/articles/5-keys-investing.html.
[34] This is particularly relevant in light of the fact that retirement plans comprise a significant proportion of mutual fund investments. *See* Inv. Co. Inst., Fact Book, *supra* note 23.

SIFMA AMG is concerned that the outcomes described above could lead some retirement plans to materially shift to other investment vehicles, including collective investment trusts ("CITs").[35] The risk of spurring significant flows on the basis of a hard close requirement would be massively disruptive. If there are similar regulatory changes being contemplated by regulators for other collective vehicles, such efforts should be coordinated across regulators to minimize disruption.

C. There Is a Need for More Extensive Analysis Given the Potential for Adverse Impacts

SIFMA AMG strongly believes that the Proposal would benefit from further consideration of its effects on investors (both retail and institutional), retirement plans, intermediaries, service providers, and investment companies. In particular, the disadvantages to retail investors investing through intermediaries and retirement plans and the cost and extent of the undertaking to make system changes throughout the entire fund ecosystem to accommodate a hard close—despite the Commission's cursory treatment of these concerns—would be a significant detriment to retail investors in particular, and, at minimum, must be weighed against any proposed benefits. We believe the Commission has failed to analyze adequately these harms and costs.

The requirement for a hard close would fundamentally change the buying and selling experience of retail investors who invest in mutual funds through retirement plans or through intermediaries. Although the Commission assumes that retirement plans and intermediaries would simply change their systems at significant cost to investors and the industry to accommodate the proposed regulatory changes, we believe a more likely scenario would be the replacement in retirement plans and intermediary platforms of mutual funds with other investment vehicles that do not necessitate these system changes. Small retirement plans do not enjoy the economies of scale that other intermediaries might. This could result in these smaller retirement plans being disproportionately affected by the costs involved in implementing the proposed hard close. If these costs are too large compared to the size of their assets under management, they may have no choice but to shut down entirely or offer different investment vehicles like CITs or ETFs. We note that Chair Gensler has mentioned that there may be discussions with banking regulators about analogous changes to products that are similar to mutual funds.[36] It is our view that, if the Commission determines to move forward with this Proposal, it only do so as part of a coordinated consideration of proposed analogous changes to other products to ensure that investors and others potentially impacted have a full picture of the regulatory landscape before choosing the investment vehicle that best fits their needs. At a minimum, there are material operational and technological implications inherent in the Proposal. If other products are going to be subject to change, whether similar or bespoke, it would be an incredible misallocation of scarce resources and time to continually re-engineer the system, infrastructure and workflow. As with other Commission priorities, we urge that consideration be made holistically rather than piecemeal and in separate silos. We recommend that the Commission not move forward with the Proposal for open-end funds until there is a clearer picture of other regulators' intended actions to avoid the risk of incentivizing regulatory arbitrage.

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[35] The impact could be uneven. Some retirement plans may be better positioned to move to other vehicles, particularly private sector plans subject to ERISA. This is because collective investment trust vehicles are not generally available to participants in 403(b) plans, investors with Individual Retirement Accounts or taxable investment accounts.

[36] Gary Gensler, Chair, Fin. Stability Oversight Council, Prepared Remarks Before the Financial Stability Oversight Council: Annual Report (Dec. 16, 2022).

We believe the Commission must undertake a more extensive economic analysis of the impact of implementing a hard close and whether the benefits outweigh the significant harms. In support of the proposed hard close, the Proposal claims that its implementation "would help prevent late trading of fund shares."[37] The only support the Commission provides for this claim is a reference to "several instances of late trading in the early 2000s."[38] We believe that the issue of late trading was addressed by the Commission and the New York Attorney General's Office through both new rules and the prosecution of offenders.[39] If the Commission believes late trading remains an issue, we question the reason why the Commission has not given any recent regulatory focus to this area in advance of the Proposal.

Further, the Commission notes that it does not have "specific data about the dilution fund shareholders experienced in March 2020 because funds do not report information about their trading activity and the prices at which they purchase and sell each instrument."[40] Nor does the Commission have data to quantify, among other things, "the extent to which investors may reduce their holdings in open-end funds as a result of the proposed swing pricing requirement," "the extent to which investors may move capital from mutual funds to other investment vehicles," "costs related to changing business practices, computer systems, integrating new technologies, etc.," and the effects on small entities subject to the rule and forms.[41] If the Commission decides to proceed, it must do so only after conducting further economic analysis that justifies the need for this level of intervention, investor confusion and complexity, and market disruption and also clarifies the costs to those impacted.

The implementation of a hard close requirement is not compatible with the current U.S. market infrastructure without undermining the entire order processing system of the mutual fund industry. A hard close would impose a high cost, resulting in disparate treatment of investors depending on the method by which they invest in mutual funds or mutual funds being disfavored over other investment vehicles. We believe that the direct and indirect costs and adverse impacts of a hard close requirement would far outweigh the potential benefits of swing pricing as proposed.

D. The Commission Should Consider Alternatives to a Hard Close Requirement to Implement Swing Pricing

SIFMA AMG believes additional alternatives are worth exploring in greater detail and therefore recommends that the Commission convene working groups of relevant stakeholders to consider the feasibility and implications of alternatives to the hard close requirement. We emphasize that

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[37] Proposing Release, *supra* note 5, at 77,209.
[38] *Id.*
[39] *See* GAO, MUTUAL FUND TRADING ABUSES: LESSONS CAN BE LEARNED FROM SEC NOT HAVING DETECTED VIOLATIONS AT AN EARLIER STAGE, 29 tbl.2 (2005) (describing each rule adopted by SEC in wake of late trading scandals); *Timeline: 2000s*, SEC HIST. SOC'Y, https://www.sechistorical.org/museum/timeline/2000-timeline.php#:~:text=Late%20Trading%20and,of%20fund%20families ("New York State Attorney General Eliot Spitzer charged a small number of mutual funds with allowing customers to purchase shares at the previous day's net asset value and to trade frequently against a rising and falling market. The U.S. Securities and Exchange Commission and several state securities commissions then brought action against a number of fund families.").
[40] Proposing Release, *supra* note 5, at 77,178 n.40.
[41] *Id.* at 77,236, 77,250, 77,287.

reconsidering such fundamental aspects to the financial services ecosystem warrants an open and methodical process of corresponding weight. Although the Commission and Commission Staff have worked diligently for months within the walls of the Commission, they have done so without market-wide input and participation. Market-wide matters require more thoughtful consideration than a relatively brief notice and comment period allows.

V. The Commission's Swing Pricing Amendments Should Not be Adopted as Proposed

The Commission relies heavily on what it views as the success of the European model in its support of a mandatory and prescriptive swing pricing regime. However, we believe the European experience cannot be replicated in the U.S. because of various structural differences between the U.S. and the European markets and because the U.S. market is primarily comprised of retail investors. Additionally, the critical essence of the European swing pricing framework that allows it to operate—the flexibility and discretion afforded funds in its operation—is absent from the Commission's Proposal. Without flexibility, swing pricing would be extremely difficult, if not impossible, to implement. We describe these differences and the issues with the proposed swing pricing amendments in more detail below.

A. The Proposal Departs Significantly from the European Model

i. The Proposal Glosses Over the Differences in the Current Pricing Model in the U.S. versus Europe, to the Potential Detriment of U.S. Investors

As described in Section 3.A. above, orders to buy and redeem fund shares in the U.S. placed with intermediaries currently receive that day's price so long as the order is placed with the intermediary by the Market Close, the time as of which funds generally calculate their NAV.[42] It is therefore the universal expectation of U.S. investors that orders placed by the Market Close (whether directly with the fund or through an intermediary) will receive that day's price.

By contrast, the European pricing model differs significantly from the U.S. model. In Europe, individual fund dealing cut-offs for redemptions and subscriptions are generally between 11:00 a.m. and 12:00 p.m. GMT, with the fund pricing process starting around 3:00 p.m. GMT. This "early" dealing cut-off provides the time necessary for European funds to obtain final trade flows from internal systems (*i.e.*, for self-administered funds) or from trading platforms of third-party distributors (*e.g.*, dealers, retirement plan record-keepers, and clearing firms) before pricing begins in the late afternoon or early evening.

In Europe, trading platforms collect a fund's subscription and redemption activity throughout the day and supply it to the fund's transfer agent at regular intervals (*e.g.*, tabular information is provided in the morning, midday and early afternoon). The transfer agent then applies an estimated fund price to generate "estimated" trade values for that trading day. Those values are applied to aggregated subscription and redemption data to generate estimated net subscription or redemption amounts for funds. Upon receiving net estimates from the transfer agents, the funds, or their swing pricing committees, calculate whether the aggregate subscription or redemption amount has

[42] Frankel & Cunningham, *supra* note 15, at 244-45.

crossed the set swing threshold, which varies depending on the fund as discussed below, triggering the application of a swing factor for that day.

ii. The Proposal Does Not Account for Structural and Operational Differences Between the U.S. and European Markets

There are several operational and structural issues that distinguish the U.S. market from the European market and would cause implementation of swing pricing–in particular the hard close–in the U.S. to have significant negative consequences for fund investors. Unlike in the U.S., swing pricing *is* feasible operationally in Europe because the system is not structured around the Market Close principle. Instead, trade flows based on estimated prices and actual trades occurring on the trade date ("T") *are* generally available on a timely basis on T, providing the information that is widely understood in Europe to be neither complete nor 100% accurate, but sufficient to make a determination as to whether and by how much to swing the price of a fund. This process is by no means a hard science. Without similar trade flow information at end-of-day on T, U.S. funds could not comply with the rigorous standards required by the Proposal. U.S. fund managers lack the requisite data to determine whether the price of a fund should be swung based on net redemptions or subscriptions that exceed prescribed thresholds. The hard close, which is offered as a remedy to this problem, invites its own set of operational complications and harms to the retail investor, as discussed above, and cannot be the means to operationalize swing pricing for the U.S. mutual fund industry.

Significantly, the U.S. and European markets have different investor bases. Although the U.S. mutual fund market consists primarily of retail investors, Europe's investor base is primarily institutional.[43] Europe also does not have the complex retirement community network of 401(k) investors that rely on intermediaries to offer customer service, support, and financial advice and which represents a key player in the U.S. market. In Europe, full swing pricing is more likely to be used by funds with institutional investors whose transactions are larger in size and more likely to incur transaction costs, while partial swing pricing is more likely to be used by funds with many, smaller retail investors where only larger, aggregate flows are likely to incur transaction costs.[44] However, the Proposal would mandate full swing pricing for a market that consists primarily of retail investors, ignoring this important distinction.

Finally, operational issues also distinguish the U.S. from Europe. Certain third-party distribution platforms (*e.g.*, retirement plan record-keepers, insurance companies, and trust companies) require the receipt of actual fund prices before making trade allocations across accounts. The majority of fund trades flow through the National Securities Clearing Corporation or Defined Contribution Clearance & Settlement, which introduces an additional layer of feeds and flow processing, delaying the receipt of final flow data by fund managers.

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[43] *Compare Asset Market Share of Institutional Clients vs Retail Clients in Europe 2013-2020*, STATISTA (May 23, 2020), https://www.statista.com/statistics/368484/europe-market-share-institutional-retail-clients/ (finding that between 2013 and 2020, 75% of the European market was made up of institutional investors), *with* Inv. Co. Inst., 2022, Fact Book, *supra* note 23, at 48 (finding that in 2021, retail investors held 88% of the $27.0 trillion in U.S. mutual fund net assets).

[44] Inv. Co. Inst., Report of the Covid-19 Market Impact Working Group 49 n.42 (Dec. 2020), https://www.ici.org/system/files/private/2021-04/20_rpt_covid4.pdf.

iii. The Commission Should Incorporate the Flexibility and Optionality of the European Swing Pricing Framework if It Insists on Proceeding with the Proposal

Despite the significant differences in market structure, order processing, and investor base, the Commission relies heavily on what it views as the success of the European swing pricing model in its support of the Proposal. However, the Proposal removes a defining feature of the European model—its flexibility. For example, European fund managers review and adjust swing factor models at intervals they deem appropriate, such as quarterly or monthly, based on fund-specific circumstances. The Proposal, on the other hand, would require funds to design a data-intensive process to calculate swing pricing factors in effect with daily precision, as well as mandating the factors to be considered in those calculations.

Additionally, in Europe, swing pricing remains an optional tool to address dilution concerns at the discretion of fund managers. No regulation requires swing pricing, and no regulation imposes the prescriptive elements of the Proposal. SIFMA AMG believes that the flexibility and optionality of the European model—and reflected in the current Rule 22c-1 framework that allows, but does not mandate, swing pricing—is preferable to the prescriptive swing pricing regime contemplated by the Proposal.

B. The Commission Should Explore Other Anti-Dilution Options

Given the differences between the systems in Europe and the U.S. for processing and pricing fund orders and the significant negative consequences that would result from imposing a hard close, SIFMA AMG believes the Commission should consider other alternatives that may address the Commission's concerns, and we welcome collaboration with the Commission on alternative solutions to shareholder dilution and potential first-mover advantages. We believe, however, that the current comment process for the Proposal falls short of bringing together the relevant stakeholders to fully explore the feasibility and potential pitfalls of alternative anti-dilution measures. Given the short length of the comment period, it is not possible to offer what we view as a well-developed, "best" alternative.

To illustrate, following discussion with our membership, some members believe the use of a liquidity fee should be explored at greater length. These members believe that adoption of a liquidity fee could serve similar anti-dilution goals and could potentially be implemented operationally without the massive and costly disturbance of a hard close. Additionally, some members believe the concept of a liquidity fee could be easier for investors to understand, given that some investors are already familiar with the operation of similar fees (*e.g.*, redemption fees), and for funds to disclose. Some members, however, strongly oppose a liquidity fee as a mandated alternative to swing pricing, suggesting instead a broad principles-based framework, allowing funds discretion to choose from those anti-dilution tools best tailored for their funds and operations. These members would urge the Commission to carefully consider the impact of, and possible negative reception to, the application of additional fees and costs on investors, especially fees that are not well-understood. If the Commission is looking to Europe for inspiration in rulemaking, we note that European regulators allow funds and their managers a wide range of anti-dilution tools and do not mandate swing pricing as a matter of law.[45]

Without further consideration of the benefits, costs, and operational feasibility, SIFMA AMG cannot formally recommend or propose liquidity fees. However, SIFMA AMG believes that alternatives to swing pricing are worth exploring in greater detail and therefore recommends that the Commission convene working groups of relevant stakeholders to consider alternative anti-dilution measures. We also note that funds already have a suite of anti-dilution tools available to them, including, but not limited to, redemption fees, extended settlement times, larger order notification and redemptions in kind.

C. Prescriptive Elements of Swing Pricing Should be Eliminated if the Commission Determines to Adopt Swing Pricing

If the Commission determines to adopt mandatory swing pricing despite our objections to a hard close as a means to operationalize swing pricing, we strongly recommend that it not adopt the prescriptive elements of the Proposal, including (i) the unspecified, periodic calculation of swing factors; (ii) mandated swing pricing for all net redemptions and net purchases above certain thresholds; (iii) exclusive focus on transaction costs in swing factor calculations; (iv) the incorporation of market impact costs in swing factors; and (v) the public disclosure of swing factors. We believe that eliminating the Proposal's prescriptive elements, combined with opportunities for discussion with various stakeholders to flush out the mechanics of swing pricing and quantify the real costs to retail investors, could bridge the gap between swing pricing as a concept and swing pricing as one anti-dilution tool that could potentially be implemented in the U.S. without massive disturbance to the mutual fund industry and with recognition of the potential costs to intermediaries and investors.

In addition, if the Commission adopts the Proposal, and in light of the far-reaching impact such changes would have on the mutual fund industry, we believe that the Commission should allow for an implementation period of at least three years, to be revisited following funds' assessment of, and adjustments to, their operations in response to the Proposal. At a minimum, the amount of technology redesign and rebuilding and renegotiating of agreements between market participants would be significant. We also recommend that the Commission consider the sequential nature of the proposed changes, some of which could not start until other aspects are identified and restructured. For example, intermediaries would only be able to set their cut-off times once funds have determined how much time they will need to process orders.

i. The Proposed Periodic Calculation of Swing Factors Is Unclear and Susceptible to Second Guessing from the Commission and Investors

The proposed requirement that funds calculate their swing factors generally on a "periodic" basis but requiring "quicker" evaluations after significant market developments, over-simplifies what is inherently a complex calculation and portrays the process of setting swing factors as mechanical and precise, rather than demanding judgment and involving a level of subjectivity. The

[45] For example, anti-dilution tools available in Europe include swing pricing, anti-dilution levies, dual pricing, redemption fees, in-kind redemptions, temporary borrowing, suspensions and redemption gates, among others. *See generally id*.

particularity envisioned by the Proposal requires time and a high quantity of data to produce daily. We note that fund managers with experience using swing pricing in the European market reported that it can take approximately a *week or more* to gather the necessary data to calculate swing factors.[46] We believe that requiring swing factors to be calculated promptly could result in swing factors that are less accurate and perhaps even misleadingly so. Furthermore, investors are unlikely to understand these complex mechanics and may be confused by the disclosure attempting to explain them.

By establishing a rule that purports to give precision to a given fund's frequent assessment of its swing pricing adjustments—when those assessments are based on potentially inaccurate data given the adjustment frequency—funds and their sponsors are exposed to increased risk of litigation claims based on second-guessing in hindsight that they inaccurately assessed the swing pricing adjustment to be applied.

Funds also would incur significant costs attempting to perform this complicated, data-intensive calculation on a "periodic" basis.[47] The Proposal does not clarify whether "quicker reevaluations" would mean weekly, monthly or quarterly but, in any case, European funds can take a week or longer for their calculations. Further, different European funds perform these calculations at different intervals such that "quicker reevaluations" could mean "monthly" for some funds and "quarterly" for others. Due to the lack of guidance in the Proposal, a fund's interpretation of the meaning of "quicker reevaluations" makes it susceptible to second guessing from its investors and/or the Commission. The Proposal also makes no attempt at estimating the costs involved with this requirement, but the costs would be substantial and would ultimately be borne by the same investors the Proposal is intending to protect.

As discussed above, the European swing pricing model, which the Commission seeks to emulate, does not require funds calculate swing factors on any specific timeline. European funds instead calculate swing factors when they think appropriate, often on a monthly or even quarterly basis.

ii. Swing Pricing Should be an Option Rather than a Mandate

The Proposal would specify when a fund must use swing pricing to adjust its current NAV, depending on whether the fund has any net redemptions or net purchases above a specified threshold on a given day. In contrast, although swing pricing is used by many European funds, it is just one anti-dilution tool available to those funds.

In the case of net redemptions, the Proposal would require a fund to always apply swing pricing without any swing threshold. Our members with European operations have noted that this would result in swinging a fund's NAV too frequently, up to approximately half of the time in any given calendar year, diminishing its usefulness as a liquidity risk management tool.[48] We believe that mandating swing pricing for any day where a fund experiences a net redemption is a blunt instrument that is out of step with the European model that the Commission seeks to emulate.

[46] Some members report that during periods of market stress, it can take significantly longer to gather and analyze necessary data.
[47] Proposing Release, *supra* note 5, at 77,223.
[48] This is likely applicable in partial swing pricing jurisdictions.

Further, in Europe, full swing pricing is more likely to be used by funds with institutional investors whose transactions are larger in size and more likely to incur transaction costs, while partial swing pricing is more likely to be used by funds with many, smaller retail investors where only larger, aggregate flows are likely to incur material transaction costs.[49] Mandating swing pricing any day a fund experiences net redemptions may result in frequent swings for many U.S. mutual funds with primarily retail investors whose activities may not result in material transaction costs, in the normal course.[50] Mandating the use of swing pricing as the only anti-dilution tool and setting uniform thresholds for all funds seems inconsistent with the European experience and the diverse investor base of U.S. funds. We urge the Commission to consider providing funds with the flexibility to employ swing pricing at net redemption thresholds based on historical data specific to a particular fund.

There may be other alternatives to mandatory swing pricing and a hard close, such as using estimated fund flows.[51] Given the wide variation of shareholder bases across the fund universe, it is possible that some funds may have sufficient information about their daily flows by 4 p.m. Eastern time to make a hard close unnecessary. Using estimates, however, always raises the possibility of being incorrect in magnitude or direction, so those concerns would need to be considered and addressed. Those funds that could work with estimates would still require regulatory comfort that estimates made in good faith that turn out to be inaccurate do not create liability. For example, we understand that European funds periodically face this experience but there is recognition (and acceptance) in Europe that swing pricing is not always accurate.[52]

iii. The Determination of Swing Factors Should be more Principles Based as Determined by Each Fund

The Proposal's approach to the calculation of swing factors is also unnecessarily prescriptive. Although European funds may consider any combination of factors they determine relevant, the Proposal requires that all funds consider the same three factors: (i) spread costs, (ii) brokerage commissions, custody fees, and any other charges, fees and taxes associated with portfolio investment sales, and (iii) the market impact (but for net redemptions, only if the amount of the fund's net redemptions exceeds 1% of a fund's net assets).[53] The European system allows for different inputs that may vary by fund, taking into account liquidity risk profiles, transaction costs, data from the past twelve months or more, and maximum cash balances, among other factors. We believe that permitting a fund to determine which inputs to consider in the calculation of its swing factor is likely to result in swings that are more tailored to each fund's circumstances.

The Commission also should recognize that the calculation of swing factors during periods of market volatility (when anti-dilution measures may be most necessary) would be particularly

[49] Inv. Co. Inst. Report, *supra* note 44, at 49 n.42.
[50] Inv. Co. Inst., Fact Book, *supra* note 23, at 48 (finding that in 2021, retail investors held 88% of the $27.0 trillion is U.S. mutual fund net assets).
[51] However, estimated flows may not always be possible for all funds, depending on shareholder bases, intermediary distribution and assets held in retirement plans.
[52] For an example of a proposed operational framework that addresses availability of fund flow information and fund process timing, see Comment Letter from the Global Association of Risk Professionals (GARP) to the SEC (Jan. 12, 2016), https://www.sec.gov/comments/s7-16-15/s71615-33.pdf.
[53] Proposing Release, *supra* note 5, at 77,202.

difficult. In fact, we believe the ability to consider fund-specific characteristics is particularly valuable in times of market dislocation, a point that has been emphasized by our European colleagues. For example, in March 2020, European fund managers could not rely on bid ask/spread information because of market disparity. The Commission de Surveillance du Secteur Financier published guidance in 2020 that permitted funds to operate with additional flexibility, such as by allowing funds to exceed the 2% swing factor limit. [54] Some of our members note that while they did not have to avail themselves of this additional flexibility, the pronouncement was generally well-received. European managers have further noted that, while swing pricing is a helpful anti-dilution tool during normal market conditions, it becomes a more subjective and good faith directional estimate during stressed market conditions. Market participants in Europe understand and accept these limitations rather than require artificial precision.

iv. The Inclusion of Market Impact Costs into Swing Factors Should be Optional

In the case of net redemptions, the Proposal would require that certain costs be incorporated into the swing factor. Specifically, the Proposal would require a fund to include market impact in its swing factor only if net redemptions exceed 1% of a fund's net assets (the "market impact threshold").[55] We believe there are two primary issues with the proposed market impact threshold. First, it is not sufficiently clear what costs would fall within the definition of "market impact costs." The Commission has not provided examples of market impact costs, and it is not clear how funds would collect the data necessary to determine such costs within the short time frame available to calculate and publish NAVs. Second, however measured, market impact costs vary primarily based on the *absolute size* of the associated transaction, and not based on the *percentage of the fund's net assets* they represent. Yet, the Commission is proposing a 1% of net assets threshold as a one-size-fits-all solution for all funds. In Europe, there is no set threshold for all funds; on the contrary, the European system allows for different inputs and threshold ranges that may vary by fund, taking into account liquidity risk profiles, transaction costs, data from the past twelve months or more and maximum cash balances, among other factors. Incidentally, it is during times of market stress that our European colleagues have found the flexibility of their regime to be critical, as in March 2020, when some European managers moved from one threshold to a different threshold to account for market dislocation.

In the case of net subscriptions, swing pricing would be required, including considerations of market impact, if the amount of net purchases exceeds 2% of the fund's net assets (the "inflow swing threshold"). The Commission states that smaller levels of net purchases are less likely to result in dilution than net redemptions, hence the difference in mandating swing pricing without a threshold for net redemptions, but then proposing a 2% threshold for net purchases. Yet, in both instances—net redemptions and net purchases—the Commission proposes a one-size-fits-all

[54] CSSF, *Swing Pricing Mechanism – FAQ*, https://www.cssf.lu/wp-content/uploads/FAQ_Swing_Pricing.pdf; Deloitte, *Regulatory News Alert: Updated CSSF FAQ on Swing Pricing in Response to COVID-19 Market Volatility* (Mar. 23, 2020), https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/risk/lu-rna-update-cssf-faq-swing-pricing-covid-19.pdf.
[55] "Market impact costs are the costs incurred when the price of a security changes as a result of the effort to purchase or sell the security. Market impact costs reflect price concessions (amounts added to the purchase price or subtracted from the selling price) that are required to find the opposite side of the trade and complete the transaction." Proposing Release, *supra* note 5, at 77,202 & n.181.

regime that does not reflect the European regime that, according to the Commission, has effectively utilized swing pricing.

We also do not support the Proposal's assumption that a pro-rata slice of all portfolio holdings would need to be sold to meet redemptions in connection with a swing factor calculation.[56] We believe funds exercise judgment in portfolio construction and how best to meet redemptions. In some cases, particularly in fixed-income portfolios, coupon and maturity activity provides cash without requiring asset sales. Assuming bid-ask spreads or transaction costs based on a fact pattern that is rarely seen in practice arguably would produce swing factors that are inaccurate at best and overstated at worst.

In addition, we believe that reliance on estimated market impact costs is likely to increase the chance of error and risk of liability, especially in larger and more sophisticated portfolios. By establishing a rule that requires the inherently difficult task of estimating market impact costs in determining a fund's swing factor, funds and their sponsors are exposed to increased risk of litigation claims based on second-guessing in hindsight that they inaccurately estimated the amount of market impact costs to include in the swing factor determination. Additionally, SIFMA AMG foresees heightened operational risk associated with making calculations to accommodate daily swings when, for most of the time, the swing threshold would not be triggered and so swings would not be implemented. Further, funds might face accounting issues, in particular with respect to GIPS compliance. The use of swing pricing as mandated by the Proposal could take mutual funds out of compliance with GIPS standards, thereby precluding their inclusion in composite strategy performance with other vehicles.

If the Commission is committed to the wide adoption of swing pricing as a liquidity risk management tool in the U.S., we urge the Commission to provide managers with the flexibility to implement swing pricing based on those factors specific to each fund and not at prescribed thresholds that unduly rely on what would be, at best, low confidence estimates of market impact costs.

v. Public Disclosure of Swing Factors Should Not be Required

SIFMA AMG believes that the requirement that funds publicly disclose their swing factors in filings on Form N-PORT would result in unintended consequences. Public disclosure could invite investors to second-guess fund calculations thereby spurring shareholder litigation. Disclosure of swing factors also could provide an avenue to savvy investors to attempt to "game the system" by strategically timing their purchases and redemptions based on expected swings. Although a few European funds selectively disclose their swing factors and swing pricing thresholds, many have chosen not to publicly disclose this information and are only required to disclose the maximum factors for these same reasons. SIFMA AMG believes that the disclosure of swing factors in public filings is unnecessary as investors would be able to see the impact of swing pricing by comparing a fund's price to its NAV assuming a fund reports both its swung and unswung NAV. We therefore recommend that the requirement to disclose swing factors on Form N-PORT should be removed from the Proposal.

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[56] *See* SIFMA AMG, Comment Letter on Proposal to Amend Liquidity Risk Management and Reporting Rules (Feb. 14, 2023).

D. Additional Considerations that Make the Implementation of Mandatory Swing Pricing in the U.S. Ill-Advised

a. The Proposal Does Not Contemplate the Need for Additional Resources That May be Necessary to Support Swing Pricing

Our members with European operations report that swing pricing committees are widely used and typically consist of members from various internal departments, including legal, fund treasury, product, and operations. These committees generally receive information on the most recent swing factors and back-tested information comparing swing pricing adjustments to actual costs incurred, as well as quarterly swing factor updates and information on any swing factor changes over a set amount of time on a quarterly, as well as cumulative, basis. These committees also generally track and communicate updates on industry best practices and standards with respect to swing pricing implementation and related calculations. The Proposal does not contemplate the existence or role of such committees in the implementation of swing pricing. While we do not believe that implementation of a swing pricing regime in the U.S. should require the establishment of an additional committee structure, the European experience illustrates that additional resources would be required to effectively build and administer swing pricing. Notably, the Proposal would require that the persons responsible for administering a fund's swing pricing provide an annual report to the fund's board of directors that includes, among other things, a "review and assessment of the fund's swing factors… including the information and data supporting the determination of the swing factors."[57] The Commission should not underestimate the amount of data and personnel time required to produce such a report, or other reports as may be necessary to implement swing pricing.[58] To fully evaluate the costs involved, further consideration of the role, operation, membership and research capabilities of such committees is required to better understand the overarching cost implications of introducing a mandated swing pricing regime in the U.S., including the additional personnel necessary to implement swing pricing processes and the data necessary to support such processes.

b. The Proposal Would Make Clear Communications to Retail Investors More Difficult

Given the complexity of swing pricing mechanics, including but not limited to the calculation of swing pricing thresholds, swing factors and market impact costs, the difficulty funds would face in preparing clear and informative disclosures and educating investors on swing pricing mechanics cannot be overstated. SIFMA AMG believes that introducing investors to swing pricing and educating them on such nuanced and complex mechanics would be a tall order. Investors would lack transparency because the impact of swing pricing on a particular purchase or redemption would not be known to them, either beforehand or after the fact.

We note that difficulties in disclosure and investor education are less of a concern in Europe because the European investor base is primarily institutional and there is a market-wide understanding that swing pricing is not a precise science. SIFMA AMG remains concerned about

[57] Proposing Release, *supra* note 5, at 77,289.
[58] Some members with European funds note that they expend a significant amount of time preparing reports, such as historical and trend analyses, and using these reports to assess the use and impact of swing factors and to periodically review the appropriateness of swing thresholds.

the ability of retail investors to understand the impact of swing pricing on their investments and believes some investors would welcome exploring an alternative investment that would be "easier" to understand. To that end, SIFMA AMG requests high-level guidance and instructions (which could be informed by investor focus groups) as to the level of detail that would be required in disclosures regarding the calculation of swing factors, thresholds and market impact costs, similar to those provided for Form N-1A filings.

c. The Proposal Would Create Additional Negative Consequences for Retail Investors

Investors are also subject to the activity of other investors. All investors receive the same adjusted NAV regardless of whether their order caused any material costs to the fund. Entering their order a day earlier or later might have a different result depending entirely on flows from others. It is possible that larger investors would be incentivized to manage the timing of their flows to avoid triggering an NAV adjustment. There also may be a disincentive for large investors to give advance warning of large flows knowing they will bear transaction costs. They currently have every incentive to communicate in advance to help funds effectively manage flows and minimize transaction costs, but that impetus would diminish under the Proposal.

The prescriptive elements of the Proposal could also trigger runs on funds where investors try to redeem before they think withdrawals will accelerate and swings will be worse.[59] In addition, the Proposal could instigate a vicious redemption cycle where net outflows trigger downward swings that harm NAV performance. This could lead investors to try to get out due to poor performance. This cycle would harm investors who have automatic investment or withdrawals set up and would inhibit investors' ability to move out of funds that are underperforming, merging away, and/or have announced other material changes.

d. The Proposal Would Create Allocation Issues for Fund of Funds

SIFMA AMG believes the proposed swing pricing requirement also would create issues for funds of funds in making allocation decisions. Each day, many funds of funds communicate with their underlying funds before the Market Close the percentage of their net redemptions or subscriptions that will result in redemptions or subscriptions from each such underlying fund. The hard close requirement would force a fund of funds to communicate to its underlying funds the specific amount of its subscriptions or redemptions before the fund of funds knows its own net subscriptions or redemptions, forcing the fund of funds to wait until the following day to adjust its holdings of underlying funds in light of its own net redemptions or subscriptions. This would thus disadvantage shareholders who invest via funds of funds (*e.g.*, target date funds, or other typical fund of funds structures) or via a fund allocation to another fund—as they also would bear the additional day of investment risk.[60]

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[59] *See e.g.*, Money Market Fund Reforms, Investment Company Act Release No. 34,441, 87 Fed. Reg. 7,248, 7,256 (Feb. 8, 2022) (noting that liquidity fees and redemption gates, while intended to temper effects of short-term investor panic, may actually have increased the risks of investor runs in March 2020).

[60] See Section IV.B., *supra*, for further discussion of the negative consequences investors would face under the Proposal.

Relatedly, top-tier funds in a fund of funds structure also would have to adjust their NAVs based on underlying NAVs being swung. This could have the potential of creating allocation and rebalancing issues for top-tier funds, including top-tier funds that would not otherwise need to adjust their allocations to underlying funds in the absence of underlying fund NAVs swinging. Additionally, since top-tier funds would need to submit their orders to underlying funds by the Market Close, top-tier funds might seek to impose an earlier cutoff time for intermediary orders than would need to be imposed for other funds. These earlier cut off times would mean investors in top-tier funds would be even more time-limited in submitting orders for processing on a same day basis.

e. The Proposal Would Create Allocation Issues for Funds that Invest in Other Funds

Consequently, SIFMA AMG believes the proposed swing requirement may impact any fund that invests as part of its investment strategy in other funds, including in reliance on Rule 12d1-4 under the 1940 Act. As is the case with fund of fund allocations, funds with investments in other funds would have to wait until the following day to acquire the information on the underlying fund's NAV. This means that such funds would likely be required to operate under a next-day pricing model.

VI. Conclusion

SIFMA AMG supports the option for U.S. mutual funds to adopt a more flexible, non-mandatory form of swing pricing, but we strongly oppose a hard close as the means to operationalize swing pricing. A hard close requirement would be unworkable in the well-established U.S. mutual fund ecosystem and would disadvantage mutual fund investors, particularly retail investors, who purchase and redeem fund shares through intermediaries and retirement savings plans. SIFMA AMG and its members recommend that the Commission convene working groups of relevant stakeholders to consider the feasibility and implications of the Proposal as well as alternative anti-dilution measures. The Proposal would have significant implications stretching far beyond investment companies themselves. If the Commission determines, however, to proceed with amendments to the swing pricing rules, we strongly urge the Commission to eliminate the prescriptive elements of the Proposal in favor of greater flexibility and discretion afforded to funds in the implementation of swing pricing.

SIFMA AMG appreciates the opportunity to comment on the proposed rules. 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) and Kevin Ehrlich (kehrlich@sifma.org) or our counsel George B. Raine (george.raine@ropesgray.com), Jennifer Choi (jennifer.choi@ropesgray.com), and Jimena Smith (jimena.smith@ropesgray.com) at Ropes & Gray LLP.

Sincerely,

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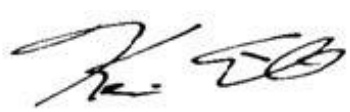

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cc: The Hon. Gary Gensler, Chair, U.S. Securities and Exchange Commission
The Hon. Hester M. Peirce, Commissioner, U.S. Securities and Exchange Commission
The Hon. Caroline A. Crenshaw, Commissioner, U.S. Securities and Exchange Commission
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