U.S. Chamber of Commerce

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February 14, 2023

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

Re: Proposed Rule, Securities and Exchange Commission; Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting (87 Fed. Reg. 77,172-77,296, December 16, 2022)

Dear Ms. Countryman:

The U.S. Chamber of Commerce's ("the Chamber") Center for Capital Markets Competitiveness ("CCMC") appreciates the opportunity to comment on the proposal by the Securities and Exchange Commission (the "Commission") that would amend its current rules for open-end funds regarding their liquidity risk management programs, require the use of swing pricing by open-end funds, and implement a "hard close" for open-end funds (the "Proposal").[1]

At the outset, the Chamber believes that the proposal should be withdrawn because of the lack of an appropriate cost-benefit analysis and the proposal also fails to meet the tri-partite mission of the Commission to facilitate investor protection, capital formation and competition.

The Commission asserts that these proposed amendments "are designed to improve liquidity risk management programs to better prepare funds for stressed conditions" and "are designed to mitigate dilution of shareholders' interests in a fund by requiring any open-end fund, other than a money market fund or exchange-traded fund, to use swing pricing to adjust a fund's net asset value ("NAV") per share to pass on costs stemming from shareholder purchase or redemption activity to the shareholders engaged in that activity." [2] The Commission further asserts that "to help operationalize the proposed swing pricing requirement, and to improve order processing more generally, the Commission is proposing a 'hard close' requirement for these funds."[3]

[1] The Proposal would require swing pricing and a hard close on all open-end funds, other than a money market fund or exchange-traded fund ("mutual funds").
[2] Securities and Exchange Commission, Release Nos. 33-11130; IC-34746; File No. S7-26-22 (December 16, 2022), 87 FR 77172, at 77172, available at https://www.sec.gov/rules/proposed/2022/33-11130.pdf. ("Proposing Release").
[3] See *id.* at 77172.

While we appreciate the Commission's concerns regarding liquidity risk and mitigating dilution, we oppose all aspects of the Proposal given that they will have deep, negative impacts on the fund industry, markets and investors. The Proposal will have wide-ranging adverse impacts on investors and all aspects of a fund, from how an investor places an order, to how a fund transmits that order through various parties and prices its shares, to the return on investment received by investors, and even the investment products available to investors.

Given the importance of the fund industry on the markets and to businesses and investors, particularly "Main Street" investors, the Proposal should only have been made public following a full and well thought out cost-benefit analysis that carefully considers potential benefits against the costs. The cost-benefit analysis included in the Proposal was inadequate. Among other deficiencies, it involved no estimation of potential costs and failed to engage with the full spectrum of stakeholders before the approval of the Proposal to understand the substantial costs involved in implementing the Proposal, especially when considering the downstream costs to investors.

The Chamber believes that the Commission should withdraw the Proposal until the Commission has completed a proper analysis, made such analysis publicly available and provided a meaningful opportunity for public comment on such analysis.

However, even apart from the lack of a sufficient cost-benefit analysis, the Chamber believes that the Proposal does not meet the three-part mission of the Commission, which is protecting investors, facilitating capital formation, and maintaining fair, orderly and efficient markets. As discussed in further detail below, the Chamber believes that the Proposal fails on all three parts of the Commission's mission. It will not protect investors, particularly "Main Street" investors. It will not facilitate capital formation. And, it will not help to maintain, fair, orderly and efficient markets.

In addition, while the Chamber acknowledges that the Commission has 261 specific numbered requests for comment in the Proposal as well as numerous other unenumerated requests for comment, this letter is intended to represent the highest areas of concern about the Proposal from the membership of the Chamber and is not intended to address any specific request for comment. The Commission should not view any lack of response to a comment as indicating that the Chamber is in favor of the issues implicated by any request for comment.

I. Swing Pricing and Hard Close – Primary Concerns

A. Proposal Would Fundamentally Change How Investors Have Always Bought and Sold Mutual Funds

Mutual funds have served investors well for over 80 years. Mutual funds are critical for capital formation and make capital available to companies both in the United States and globally. The U.S. mutual fund market is the world's most well developed and efficient fund

market that is utilized by both institutional and retail investors, particularly for their retirement needs. Investors have come to rely on mutual funds for certain key features, which are easy to understand, particularly for retail investors. These features include the ability for an investor to place a same day order that will occur at the next net asset value per share calculated by the mutual fund. These key features are easy to understand and have been a feature of mutual funds for many years.

The Proposal would change these features and upset long-standing expectations by investors and change them for a complicated and confusing process that retail investors will not be able to easily understand. Under the Proposal, when an investor places an order to either buy or sell shares of a mutual fund, that investor would not know at the time of the order whether the price they receive for the shares would be adjusted up or down by swing pricing. In effect, this would act as a hidden fee paid by investors, who would be confused as to why they are no longer receiving the fund's net asset value per share. In addition, as further explained below, the hard close requirement would end up with investors having a myriad of cutoff times for their funds, which would only serve to further their confusion about how transactions in their funds work.

The Commission claims that these changes are necessary to mitigate dilution. However, the Commission offers no evidence of dilution occurring in funds that would justify this drastic change in features or processes.[4] The best that the Commission can do is speculate about potential benefits, none of which it is able to quantify in the Proposing Release. As we explore further in this letter, the Proposal would create unnecessary changes in the current process for buying and selling mutual funds by implementing a new, untested process that will result in confusing investors rather than protecting them, harming capital formation by disrupting the fund market, and leading to less efficient and orderly markets.

B. Proposal Is a Solution in Search of a Problem

Throughout the Proposal, the Commission refers to the potential to mitigate dilution as the principal harm that the Proposal is intending to address. The Proposal relies heavily on the events of March 2020 during the onset of the COVID-19 pandemic as evidence of the dilution that the Proposal is attempting to address. However, the Commission acknowledges it does not "have specific data about the dilution fund shareholders experienced in Mar. 2020."[5]

Instead, the Proposal theorizes about dilution in mutual funds based on data from the European market and claims without any factual support that it is not aware of any differences in the European market that would cause mutual funds to act differently.[6] However, there are significant differences in the size, regulatory structure and shareholder

[4] The only evidence cited by the Commission is Europe, which is not comparable to mutual funds in terms of features or shareholder base. See *id.* at footnote 40. See also *id.* at footnote 478 ("To our knowledge, such data on fund dilution are not available for the U.S.").
[5] See *id.* at footnote 40.
[6] See *id.*

base of these markets that calls into question how transferable the experience in the European market is to the U.S. market. As Commissioner Hester Peirce noted in her statement opposing the Proposal regarding the comparability of the European and U.S. markets, "we have different 'intermediary structures between funds and their investors,' different 'regulatory frameworks and investor base,' and 'the European mutual fund sector does not depend as much as the U.S. mutual fund sector on pension plans.'"[7]

Another major difference in the markets involves geography. Unlike European investors, U.S. investors reside across six time zones, so the Proposal exacerbates the difficulties of U.S. investors living further west, especially investors in retirement plans, and leaves those investors with fewer options. The Commission has pointed to the European swing pricing model to make the case for utilizing swing pricing in the U.S.; however, the Commission is obligated by statute to do more here and mere speculation regarding how U.S. mutual funds were harmed during March 2020 is not sufficient rationale to move forward with this Proposal. The clear harm to mutual funds, shareholders and markets due to reduced choices in funds and lower returns will be much worse than any potential dilution the Proposal is trying to solve.

Furthermore, the European mutual fund market is not as large or as sophisticated as in the United States. It would seem that the European swing price model may not be a good comparison to make in terms of potential reforms in the United States.

Additionally, the Commission claims that during times of liquidity stress, "there may be incentives for shareholders to redeem fund shares quickly to avoid further losses, to redeem fund shares for cash in times of uncertainty, or to obtain a 'first-mover' advantage by avoiding anticipated trading costs and dilution associated with other investors' redemptions."[8] However, it provides scant evidence regarding this first-mover advantage other than citations to theoretical academic work. Notably, it points to the failure of the Third Avenue Focused Credit Fund as its only real-world example of this issue.[9] But, if this was a widespread problem for mutual funds, we should expect to see other examples caused by this issue and other mutual fund failures. The Commission provides none since there are no other failures to cite as examples. The best it can do is cite to academic papers.

Instead, mutual funds have held up during multiple crises going back to the technology bubble, the global financial crisis and the COVID-19 pandemic, and even to periods well before these events. Any issues in mutual funds have been isolated to single funds with unique circumstances and there have not been widespread issues. And, even in the singular

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[7] Commissioner Hester M. Peirce, Statement on Proposed Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting (Nov. 2, 2022). https://www.sec.gov/news/statement/peirce-statement-open-end-funds-110222

[8] See *Proposing Release* at 77176. Since the swing pricing and hard close pieces of the Proposal only apply to mutual funds and excludes money market funds and exchange traded funds, we only discuss mutual funds in this context.

[9] See *id.* at footnote 394 and surrounding text.

case of the Third Avenue Focused Credit Fund, it was not evidence of an issue in high-yield mutual funds since no other high-yield mutual funds failed at the same time.

The Proposal also fails to address how swing pricing could itself exacerbate redemption issues for a mutual fund by creating incentives for investors to redeem for fear of larger swing factors and performance issues in the future. This incentive does not currently exist since investors know that when they redeem, they will get the net asset value per share. Since swing pricing significantly changes the calculus for shareholders, they might decide to redeem due to the potential impact that swing pricing might have on their future redemptions. While the Commission theorizes that swing pricing is meant to mitigate such an issue, it is not clear how investors will react and the Commission provides no evidence that investors will view it in the same way as the Commission.

Of particular note, the Commission is not able to cite to any mutual funds that had issues during the events of March 2020, the timeframe that the Proposal relies heavily on as creating the need for the Proposal. Instead, the Commission concedes that there were no suspension of redemptions and is left to speculate about the potential harms of dilution on mutual funds and the potential risks of first-mover advantage during that time period, while not being able to point to any evidence of those issues in mutual funds.[10] Given this lack of evidence to support the Commission's theories regarding dilution and first-mover advantage, it is not clear what investor harm the Commission is trying to address. Furthermore, it is inappropriate to use the March 2020 crisis as a basis for regulatory action as the market stresses occurred due to a government mandated shutdown of the economy.

Mutual funds have had the option to implement swing pricing since 2016 and as the Commission acknowledges no mutual fund has used that option[11] and there has been no market pressure for mutual funds to implement it. The Commission has provided no evidence that the Proposal is in the public interest and is necessary and appropriate. Instead, the Proposal relies on no data to support it other than academic papers in order to fix a problem that no one has actually identified as a problem. However, we do know that the costs of the Proposal will be substantial. These will not only be direct monetary costs related to changing all the systems to support the Proposal but will also consist of indirect costs in the form of reduced choices in investment options and reduced returns. All of which will not protect investors or facilitate capital formation.

C. Proposal Would Have Negative Implications for Shareholders and Funds

The Proposal would have negative implications for shareholders, particularly "Main Street" investors and mutual funds. As the Commission acknowledges, the Proposal would require funds and intermediaries "to make significant changes to their business practices."[12] It

[10] See *id.* at 77183.
[11] See *id.* at 77184.
[12] See *id.* at 77212.

notes that these would include updating systems, altering processes, adopting new technology, adopting new procedures and reengineering systems. It also acknowledges that these changes will be particularly challenging for retirement plans recordkeepers. While the Commission is not able to quantify these costs, the Commission concludes in most instances that shareholders will end up bearing most, if not all, of the costs related to the changes required by the Proposal, which ultimately will end up reducing their returns.

Retirement plans and their "Main Street" investors will bear the burden of the Proposal's many unexamined consequences, from higher costs and lower returns on investment to disappearing investment opportunities. As the costs and complexity of mutual funds increase, many businesses may decide that they can no longer afford to offer retirement plans to their employees, which are "Main Street" investors. The Commission explicitly acknowledges that some smaller retirement plans "may cease to exist" and that the costs will be borne "by either investors (i.e., plan participants) or their employers that sponsor the plan" as a result of the Proposal.[13] This result is inconsistent with the recent passage of SECURE 2.0, which demonstrates Congress' clear intent to encourage small businesses to offer retirement plans.[14] This would be a step backwards from Congress' intention of ensuring that more Americans have access to retirement plans as they save for their future.

Finally, as discussed in more detail below, the Proposal will have a particularly large impact on investors in retirement plans, which will end up relegated as a second class of investors, even though they represent the majority of mutual fund assets.

D. Proposal Exceeds the Scope of the Commission's Authority

Section 2(c) of the Investment Company Act of 1940 (the "1940 Act") provides in relevant part that "the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[15] The Proposal's review of efficiency, competition and capital formation makes clear that in the aggregate none of these will be promoted. Given this record, the Proposal does not meet the standard set forth in Section 2(c).

Section 706(2)(A) of the Administrative Procedure Act (the "APA") instructs courts reviewing regulation to invalidate any agency action found to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." In exercising its rulemaking authority, the Commission has the statutory obligation to "consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation." 15 U.S.C. § 78c(f); *id*. §§ 78w(a)(2), 80a–2(c). The Commission also must "apprise itself — and hence the public and the Congress — of the economic consequences

[13] See *id.* at 77260.
[14] Securing a Strong Retirement Act of 2022.
[15] This is also required by Section 202(c) of the Investment Advisers Act of 1940 and Section 3(f) of the Securities Exchange Act of 1933.

of a proposed regulation before it decides whether to adopt the measure." *Chamber of Com. of U.S. v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005).

The Proposal, if adopted, would violate the APA by imposing new requirements on mutual funds based largely on academic theory without any actual evidence or justification for the new requirements. In addition, the Proposal provides an incomplete explanation of how it will promote efficiency, competition, and capital formation and does not provide a reasonable or coherent explanation of why the Proposal promotes those goals. The Commission explicitly acknowledges that they have no data to calculate the costs of implementing the Proposal. In addition, the Proposal would create widespread changes to mutual fund operations and change long-standing practices regarding how mutual funds are bought and sold. Nevertheless, the Commission still finds the Proposal to be in the public interest.

Given this lack of information, which clearly impacted the ability of the Commission to perform any economic analysis on the potential costs versus the potential benefits, the Commission cannot reasonably justify the Proposal.[16] The entire economic analysis states that the Commission does not have information to even attempt an estimation of costs, despite being required to do just that. At the same time, the Commission asks industry participants to provide it with economic data, but does not provide industry participants a meaningful opportunity to gather the data.

The Chamber notes that there are other methods for the Commission to use when it does not have data of this type, which is a concept release or a request for information. The Commission has used both of these procedures in the past to gather information to ensure that a proposal was in the public interest once identifying or developing the necessary economic data to support it. However, with this Proposal, the Commission is choosing to ask for this information in the form of the pending Proposal rather than doing the requisite work first. Given the widespread scope of the changes under consideration and the lack of analysis conducted on the economic consequences of the Proposal, if the Proposal is adopted, the Commission would violate the APA since it is acting in an arbitrary and capricious manner with the Proposal.

Finally, the Commission must carefully consider whether it has the statutory authority under Section 22 of the 1940 Act to adopt the Proposal at all. Section 22(c) provides in relevant part that the "Commission may make rules and regulations applicable to registered investment companies and to principal underwriters of, and dealers in, the redeemable securities of any registered investment company, whether or not members of any securities association, to the same extent, covering the same subject matter, and for the accomplishment of the same ends as are prescribed in subsection (a) of this section in respect of the rules which may be made by a registered securities association governing its members." Section 22(a) permits a registered securities association to prescribe rules for

[16] We discuss in more detail the deficiencies in the cost-benefit analysis below.

computing the minimum price for purchase and the maximum price for sale so that the price in each case will bear such relation to the current net asset value of the redeemable security. However, under Section 22(a), the rules are "for the purpose of eliminating or reducing so far as reasonably practicable any dilution of the value of other outstanding securities of such company or any other result of such purchase, redemption, or sale which is unfair to holders of such other outstanding securities."

The Proposal purports to attempt to eliminate or reduce dilution[17] of the value of other outstanding securities, however, given the wide-ranging changes required by the Proposal and the lack of economic analysis done to support the Proposal, it cannot be a "reasonably practicable" approach. With the large but unknown costs on the industry required by the Proposal, the Commission cannot determine if or whether the Proposal is reasonably practicable.

In addition, as the Proposal acknowledges, there are other tools currently used by mutual funds to eliminate or reduce dilution, such as in-kind redemptions and delaying the distribution of redemptions for up to seven days. The Commission has not adequately considered how and whether these current practices compare with the Proposal and why the Proposal would reduce dilution more effectively than current practices, especially given the lack of any issues for mutual funds during various market conditions over a long period of time using only these tools.

Additionally, the dilution Section 22 of the 1940 Act was adopted to prevent is not the same dilution that the Proposal is attempting to mitigate. The Commission even acknowledges this in footnote 3 to the Proposing Release where it says "among the abuses that served as a backdrop for the Act were practices that resulted in substantial dilution of investors' interests, including backward pricing by fund insiders to increase investment in the fund and thus enhance management fees, but causing dilution of existing investors in the fund." The dilution concerns of Section 22 were related to insiders getting advantageous pricing and creating dilution for the remaining shareholders. It has never been about potential, theoretical dilution related to transaction costs.

Finally, while the Commission states that the Proposal is attempting to address unfairness by mitigating dilution, it does not adequately consider how the Proposal itself creates unfairness for other shareholders, which is against the purposes of Section 22. The Proposal acknowledges that investors transacting in the opposite direction of flows would get a benefit but does not explore how this might be unfair to other shareholders especially since it could create arbitrage opportunities. The Proposal also does not address how having shareholders with different transaction cutoff times will be unfair to other shareholders in the mutual fund. Direct shareholders of a mutual fund will be able to

[17] We do not discuss further here whether the Commission has established whether any dilution exists to justify the Proposal in the first instance because we discussed above that the Commission has not provided evidence of any dilution in mutual funds and the Commission itself concedes in footnote 478 of the Proposing Release that it has no such data.

transact with later cutoff times than shareholders transacting through an intermediary, which includes investors in retirement plans. This difference in cutoff times will give direct shareholders the ability to act faster to the detriment of non-direct shareholders (*i.e.*, other shareholders) and could open up arbitrage and other timing opportunities for those direct shareholders that will end up treating non-direct shareholders unfairly. Of particular note, the Proposal will create unfairness for retirement plan investors, almost all of whom invest through intermediaries. Notably, these non-direct shareholders are more likely to be smaller retail shareholders without a choice in intermediary rather than larger shareholders who are able to transact directly. This would conflict with the Commission's mission of protecting shareholders.

E. Proposal's Cost-Benefit Analysis Is Inadequate

As the Proposal states in the introduction to the economic analysis: "Many of the benefits and costs discussed below are difficult to quantify. For example, we lack data that would help us predict . . . the reduction in dilution costs to investors in open-end funds as a result of the proposed amendments . . . . While we have attempted to quantify economic effects where possible, much of the discussion of economic effects is qualitative in nature."[18] As a result, the Commission is proposing to make widespread changes to mutual funds even though it has no data to properly evaluate the costs and impacts of such changes. Without sufficient data and analysis, the Commission is not able to show the economic impact of the Proposal and cannot determine whether the Proposal is necessary and appropriate. Instead of economic analysis, the Commission asks for this information from industry participants. As the Proposal states: "We seek comment on all aspects of the economic analysis, especially any data or information that would enable a quantification of the proposal's economic effects."[19] However, it is not possible to provide this information in the short timeframe provided by the Commission given the far-reaching nature of the Proposal. If the Commission has not been able to gather this information and conduct a reasonable analysis in the time it took to draft the Proposal, it is unrealistic to expect industry participants to do this work in the much shorter timeframe for comment provided by the Proposal.

In terms of the potential benefits of the Proposal, those are also unsupported by analysis or facts. The Commission does not show any harm to investors and no evidence of dilution. The Commission states the Proposal is necessary based on the events of March 2020 but concedes there was no suspension of redemptions. The Commission also acknowledges that it has no evidence of dilution impacting funds during any time period, much less during March 2020 as it states in footnote 478 of the Proposing Release: "To our knowledge, such data on fund dilution are not available for the U.S." Thus, the Proposal speculates about its potential benefits based on academic theories rather than evidence of harm.

[18] See *Proposing Release* at 77236.
[19] See *id.*

II. Swing Pricing and Hard Close – Specific Concerns

A. Swing Pricing

1. Proposed Swing Pricing Would Not Pass Transaction Costs on to First-Movers or Effectively Eliminate Dilution for Shareholders During Times of Market Stress

As the rationale for the Proposal, the Commission states that it will help to mitigate dilution by passing transactions costs on to those transacting first during times of market stress. However, to achieve this goal, the Proposal would mandate swing pricing at all times, which is inconsistent with that proposed goal. But even during times of market stress, it is not possible to accurately account for transaction costs and the Proposal would not achieve its purpose of mitigating dilution. During times of market stress, a mutual fund would need to accurately account for the impact of transacting shareholders in a short timeframe, which given the myriad of investments used by mutual funds will not be possible to do with any accuracy. In short, the Proposal would not effectively mitigate dilution and would not achieve its goal.

The Proposal itself makes clear the very limited benefits of swing pricing. The cited example from Europe found that, during the time of market stress in March 2020, the use of swing pricing in Europe might have reduced dilution by approximately 0.06% during that timeframe, which, if accurate, does not justify the scope of the changes under consideration.[20] If the reduction in dilution is that negligible during the extreme market stress of March 2020, the potential for reducing dilution during normal market conditions will be so small as to not justify the proposed changes.

The Proposal also does not accurately portray how mutual fund shareholders have acted during times of market stress. It discusses the potential for first movers during times of market stress without providing evidence of such activity and makes general conclusions about the potential for dilution without any evidence of such dilution. As discussed above, the only evidence the Proposal cites is not from the U.S. market but rather the European one, which is structured differently with a different shareholder base. It is not good evidence for how U.S. mutual funds and shareholders have acted during times of market stress or how they are impacted by such stress.

2. Proposed Swing Pricing Creates a Timing Mismatch for Long-Term Investors

Long-term investors include participants in workplace retirement plans and individuals who choose to invest in individual retirement accounts, which the Proposal states is approximately 54% of mutual fund assets.[21] We dispute the Commission's assertion that swing pricing is not an issue for these long-term investors. The Proposal requires swing

[20] See *id.* at 77200.
[21] See *id.* at 77239.

pricing to account for short-term transaction costs in an attempt to mitigate dilution. However, there is a timing mismatch to this statement. If a long-term investor happens to buy shares on a day with large net purchases, which is entirely out of their control, their shares are diluted to pay for the short-term transaction costs on that day. The impact of this dilution will compound over time the longer they hold shares. The reverse could also impact a long-term shareholder. For example, if a long-term shareholder by chance, ends up selling their shares on a day with large net redemptions, their long-term investment is effectively diluted to pay for short-term transaction costs. In both of these scenarios, swing pricing has had a negative consequence for these long-term investors just because they happened to transact on a day with large net flows. Long-term investors are more likely to have their retirement savings impacted in such scenarios, particularly since a long-term investor, such as a recent retiree, may not be able to wait to make a transaction because of the need for money at a particular point in time. The Commission must adequately address and consider the extent to which the Proposal could impact long-term investors rather than making a general statement that it would not have an impact. Again, the Commission needs to do the work to ensure the Proposal is in the public interest and is necessary and appropriate. Anything short of that risks negative consequence for shareholders and is inconsistent with the requirements of the APA.

3. Swing Pricing Will Increase Complexity for Mutual Funds and Will Discourage Retail Shareholders from Investing

The Proposal will dramatically increase complexity surrounding investments in mutual funds. For many years, mutual fund investors have known that when they submit an order, they will receive the net asset value for their shares and they will receive that day's price. However, under the Proposal, investors will no longer know whether a swing factor applies to them when they place an order. Swing pricing will act as a hidden fee on shareholders. In addition, retail shareholders will need to keep track of a myriad of cutoff times depending on the new procedures adopted by their intermediary and their geographic location. This increased complexity will hurt retail shareholders the most and will discourage them from investing in mutual funds due to the difficulty in understanding how their transactions will work under the Proposal.

B. Hard Close

1. Proposed Hard Close Will Create Different Classes of Shareholders

The Proposal would impose a hard close requirement that will require a mutual fund, its transfer agent or a registered clearing agency to receive an order to buy or sell shares by the time the fund sets its net asset value. The hard close requirement will require different intermediaries to impose different cutoff times for transactions because it is not an automatic process to transmit transactions from recordkeepers and intermediaries to mutual funds. This will mean that all mutual fund investors using an intermediary will be at a disadvantage since these investors will not be able to transact up until the time a fund

sets its net asset value.[22] Intermediaries will need to impose earlier cutoff times in order to be able to process orders, which can be as early as Noon or 1 p.m. Eastern Time assuming net asset value is set at 4 p.m. Eastern Time. As a result, all shareholders using an intermediary will be relegated to next day trading and this difference in cutoff times will effectively create different classes of shareholders. One class will be direct shareholders who will be able to transact on the same day up to a much later cutoff time. Non-direct shareholders using an intermediary will become second class citizens who will have varying and different cutoff times, which will be earlier in the day than direct shareholders. This creates arbitrage opportunities for those investors who are able to transact with later cutoff times to game the system to the disadvantage of those investors who do not have the ability to transact with a later cutoff time.

In addition, this may particularly impact shareholders who are captive to a platform, such as investors in retirement plans and other "Main Street" investors. The Proposal states that shareholders could transact directly with a fund if they wanted later cutoff times[23] but it does not recognize the reality that many shareholders cannot move to a different platform, and they are stuck with the earlier cutoff time not by their choice. For instance, the Proposal states that 54% of mutual fund assets are in retirement plans.[24] It is not possible for these individuals to move their investments because the investment options in the plan are chosen by the plan fiduciaries, not the individual plan participants. Furthermore, even if an individual plan participant wanted to divest from the retirement plan to obtain other investment options (which would be contrary to public policy), the Internal Revenue Code ("Code") places limits on when money can be withdrawn and imposes early withdrawal penalties.

The Commission states that these shareholders are long-term investors that are not unduly harmed by a delay in trading. This overlooks the fact that long-term investors buy and sell shares during the course of their employment and the contributions to the retirement plan are made on a regular basis – typically every two weeks. While the participants are long-term investors, this does not mean they are only rarely making purchases or rebalancing their accumulated savings to ensure their portfolios remain in line with their investment strategies. It also overlooks the fact that these long-term investors at some point need to sell their investments either as part of their regular distributions or other life changes. Thus, at the point that an investor wants to sell, they would be relegated to this second class without the benefit of same day trading. This delay can have consequences on retirees, many of whom have fixed expense obligations, since there can be market drops of up to 5% in a day, which an investor would have avoided with a same day trade. In addition, the Proposal would disadvantage retirement plan participants during events like those of March 2020, despite the Proposal's purported purpose being to address just such

[22] Since almost all retirement plans use an intermediary, all retirement plan participants of such retirement plans would not be able to transact up until the time a fund sets its net asset value.
[23] See *id.* at 77213.
[24] See *id.* at 77239.

instances. For example, if an unforeseen event were to occur at 2 p.m. Eastern Time, plan participants would all be forced to accept next day pricing, even though all other investors could lock in same day pricing. The high percentage of mutual funds in retirement plans means that the majority of assets in mutual funds would end up with later cutoff times and be relegated to this second-class status. Given this negative impact on the majority of assets in mutual funds, which are in retirement plans, the Commission has not met its statutory obligation to find that the Proposal is in the public interest.

Additionally, the Proposal does not consider how the hard close exacerbates time zone issues already present for investors. For investors in the Pacific time zone, an earlier cutoff time means that investors on the West Coast effectively cannot transact in mutual funds during normal business hours since a cutoff time of Noon Eastern Time would be 9 a.m. in the morning on the West Coast.[25] It would seem to go against the mission of the SEC to create different classes of investors, based upon time zones. Such a fragmentation of the American investor will degrade investor protection and potentially create arbitrage opportunities that may be harmful to the market.

2. Proposed Hard Close Negatively Impacts Retirement Plans Even More

As discussed above, the Proposal would have a negative impact on investors in retirement plans since all such investors would end up relegated as second-class citizens. However, the Proposal would also have negative impacts on retirement plan recordkeepers and intermediaries. The Proposal would negatively the 54% of mutual fund assets that are in retirement plans the most given the challenges imposed on retirement plan recordkeepers and how they would need to update their systems for a hard close.

Most retirement plans use an intermediary to process mutual fund orders for the plan. Intermediaries generally require 2 to 4 hours to process orders from retirement plans. The lag in time is due not only to ensuring the accuracy of the order, but also to ensuring compliance with the plan's unique requirements, qualification rules under the Code and the requirements of the Employee Retirement Income Security Act ("ERISA"). For example, if a participant sends a request to redeem mutual fund shares, the intermediary will verify the following ERISA, Code, and plan requirements:

a. The individual is a plan participant.

b. The redemption order either matches a purchase order or the participant has a right to a distribution.

c. If there is only a redemption order, that the distribution requirements are met-meaning the participant has separated from service, retired, requested a loan, requested a hardship withdrawal or meets other permissible distribution requirements.

[25] The impact is even greater for investors in Hawaii who would almost always have next day trading, since they would likely need to be up before dawn to place a same day trade.

d. The order complies with any applicable contribution limits.

These checks occur in addition to routine checks for accuracy. This process is repeated for each individual order that the intermediary receives from the plan each day. To satisfy the proposed amendment relating to a hard close to get that day's price, the intermediary will have to stop taking orders 2 to 4 hours before the hard close, which typically is 4:00 p.m. Eastern Time. On the East Coast, participants would have maybe half a day to place an order, while on the West Coast participants would have an hour or two to place an order to receive that day's trading price and participants in Hawaii would need to have a trade in before business hours, which is not possible. Effectively, the majority of plan participants would be relegated to next day trading.

In addition, certain transactions, such as 401(k) loans, hardship distributions (and other distributions involving domestic violence or terminal illness), asset allocations and automatic distributions, may be impacted even more because these require knowing the price to process. Retirement plans also often permit same-day exchanges within a plan. These exchanges would likely no longer be permitted. As a result, these transactions may need to be spaced out over several days. This is especially troubling with respect to loans, hardship and other distributions because individuals requesting such distributions likely need immediate access to funds for the distributable event, such as eviction.

The Commission concedes that this might be a result of the Proposal but does not think that such a delay is problematic.[26] However, the need to delay transactions will result in real negative consequences for retirement plan participants. A participant relies on accurate information to access a loan, which may be needed quickly. As stated above, if there are market drops on the days due to the delay, it results in less money to the participant. Given this negative impact, the Commission has not met its statutory obligation to find that the Proposal is in the public interest and is necessary and appropriate. It is, however, clear that the Commission has not assessed the economic impact of this Proposal to make that determination.

3. Retirement Plan Fiduciaries Would Contend with Unreasonable Burden

ERISA mandates that plan fiduciaries must exercise prudence and discharge their responsibilities solely in the interest of plan participants. If they fail to properly discharge their fiduciary duties, they risk bearing liability for losses resulting from their failure. ERISA also requires that plan fiduciaries ensure that investment options are sufficiently diversified so as to minimize the risk of large losses. These duties generally work in tandem. The Proposal, however, creates a potential conflict for plan fiduciaries.

[26] The Commission states that since it believes these transactions are a small percentage of overall retirement plan flows the "aggregate effect of the proposed hard close requirement on such transactions would not be significant." The Commission also states that "[m]ost fund shareholders are long-term investors, and thus we believe that most fund orders are not time sensitive." See *id.* at 77213.

The Proposal will inevitably limit plan fiduciaries' ability to comply with the ERISA fiduciary diversification and prudence requirements for the following reasons: the Proposal would provide those products and those firms that offer only proprietary funds a significant competitive advantage as trades, purchases and liquidations will still be able to be made at "same day" pricing while the non-proprietary funds will not have this capability. A plan fiduciary may determine that participants are disadvantaged by the restricted order requirements of the non-proprietary funds and such restrictions are not prudent. However, by switching to proprietary funds, the fiduciary may feel that the investment choices are not diverse enough (since only the mutual funds owned by a bundled provider will be able to maintain an advantage under the proposed amendment). In this situation, a plan fiduciary may feel that the fiduciary cannot satisfy one fiduciary duty without sacrificing the other. This decision places plan fiduciaries in an impossible situation.

In addition, the Proposal increases the risks of complaints and lawsuits against the plan fiduciaries. If a fiduciary decides to move to a bundled provider in order to enable participants to get same day pricing and thereby protect the economic interest of plan participants, some participants may feel that their investment choices are not diverse enough. On the other hand, if a fiduciary stays with the unbundled services provider to provide maximum diversity, some participants may feel that they are being economically disadvantaged. In either situation, the fiduciary's ability to satisfy both duties is diminished and, consequently, the risk of liability is substantially increased. Similar to the disadvantaged plan participant, this situation arises not because of market forces, or lack of knowledge, but only because the Proposal creates an untenable dilemma for plan fiduciaries.[27]

4. Increased Costs Will Reduce the Availability of Retirement Plans to Businesses Who Cannot Bear the Increased Costs

The Chamber has heard from our membership that the Proposal will chill business interest in offering retirement plans, especially among small employers. This is due to the increased costs that the Proposal will impose on retirement plans. Small businesses, in particular, are incredibly price sensitive and the increased costs to administer a retirement plan due to the Proposal will mean that small businesses likely may opt not to offer a retirement plan to their employees. This result is completely at odds with the recent adoption of SECURE 2.0, which was passed to encourage small business adoption of retirement plans, including additional tax credits to alleviate the costs of offering plans and providing matching contributions. It is unlikely that policymakers would appreciate these tax credits being

[27] This is especially troubling because class action strike suits against plan sponsors claiming breach of fiduciary duty have exploded over the past few years, with over 200 filed since 2019 with over 88 in 2022 alone. The Proposal would increase this litigation, making it more and more difficult (and expensive) to provide a plan in a voluntary system. *See* Jacklyn Willie, *Suits Over 401(k) Fees Nab $150 Million in Accords Big and Small*, Bloomberg Law (Aug. 23, 2022), https://bit.ly/3Uel7y5; Daniel Aronowitz, *The Key Fiduciary Liability Storylines of 2022* (January 10, 2023), http://bit.ly/3Hn8FbH.

utilized to offset the costs of entirely rewiring the systems that support retirement plans, particularly when no benefit has been demonstrated. Ultimately, the Proposal will exacerbate issues related to not having enough assets saved for retirement.

5. Fails to Consider Impacts on Variable Annuities and 529 Plans

The Proposal does not address the impact of the changes on variable annuities and 529 plans, which are used by "Main Street" investors for retirement savings vehicles and education savings. Given the two-tier nature of these products, the insurers issuing variable annuity contracts and administrators of 529 plans rely on the mutual fund net asset value in setting their account unit prices. Due to how these products are set up, including some that have contractual obligations that cannot be easily changed, this pricing process needs to occur prior to sending flow information to the mutual funds and it is not possible to reconcile exactly how the process would work under the Proposal. The Proposal does not discuss either of these products much less acknowledge their place in the market and the problems created by the Proposal for these products. Again, the Commission has failed to adequately consider all the negative impacts of the Proposal on shareholders, products, and markets and needs to make sure that it considers both the direct and indirect negative consequences of the Proposal on all stakeholders.

6. Will Cause Other Alternatives to Mutual Funds to Be Used, Which Are Less Regulated

The Commission acknowledges that the Proposal could cause investors to move to other investment vehicles.[28] This could be because their intermediary moves to a different vehicle or because they choose another vehicle that is simpler to understand and less complex in light of the Proposal. However, this move to other investment vehicles comes with risk and consequences that the Commission hasn't adequately considered or addressed and could end up creating the same risks in less regulated vehicles. In doing so, the Commission is picking winners and losers between investment vehicles, risking market fragmentation, reducing efficiency and increasing the potential for market manipulation. No public interest is served by having disparate regulatory schemes and requirements for similar types of products. It creates the potential for regulatory arbitrage in similar types of products, reduces market efficiency and is not in the shareholder's interest. None of this would be in service of the Commission's mission.

III. Liquidity Rule – General Concerns

The Proposal would change Rule 22e-4 under the 1940 Act, which requires open-end funds to adopt and implement liquidity risk management programs. Rule 22e-4 was only recently adopted by the Commission in 2016 and had a compliance date of December 1, 2018 for larger entities and June 1, 2019 for smaller entities. However, even though there have been

[28] See *id.* at 77264.

no liquidity issues for open-end funds since that time, the Commission is proposing to make further substantial and costly changes to Rule 22e-4.

The Proposal also would move from a principles-based approach, which has not been determined to create any issues, to a more prescriptive approach. This change will end up reducing flexibility for open-end funds to manage their liquidity risk, which they have done without any issues for many years even preceding the adoption of Rule 22e-4. In addition, the Proposal may ultimately end up increasing overall risks by requiring all open-end funds to use the same prescriptive approach. There is reduced risk to permitting funds to use a variety of approaches tailored to their funds' liquidity needs especially if there is some unaddressed issue in the prescriptive approach under consideration.

IV. Liquidity Rule – Specific Concerns

A. Proposed Changes to Liquidity Rule by Eliminating the Less Liquid Category Would Eliminate a Critical Source of Financing for Businesses

The Proposal would remove the "less liquid" category from the liquidity classifications under Rule 22e-4. Removing the less liquid category would mean that securities that take longer than seven days to settle would no longer be considered liquid and would be deemed illiquid. While other asset classes are impacted by the loss of this category, many of the securities in this category are loans, which can have a longer settlement time. Loans are a critical source of financing for businesses and the fund industry accounts for a significant portion of the market for loans. Historically, open-end funds have been the third largest buyer of loans in this market. However, the Proposal's recommendation to eliminate the less liquid category, would disrupt the loan mutual fund market and restrict an investor's choices in seeking this type of exposure and thus decrease a major source of financing for businesses. Before the Commission makes this change, it needs to conduct a thorough analysis of how its Proposal will impact the loan market rather than rely on conjecture. Otherwise, the Commission's Proposal is inconsistent with its statutory obligations because eliminating the third largest buyer of loans from the market is bound to be harmful to the loan market, businesses and the capital markets. In addition, if all funds are forced to sell at the same time due to the elimination of the "less liquid" category, it would have major implications for the loan market and other asset classes that rely on this category. The Commission has failed to consider how this forced selling would negatively impact the asset classes using the "less liquid" category, including the loan market, and the harm this would create on shareholders of impacted funds and the capital markets.

The Proposal also could have a negative impact on the market for new issuances. Since new issuances may take more time to settle, the elimination of this category will mean that open-end funds would no longer be able to be participants in this market. This would have negative implications for the new issuance market and would ultimately hurt businesses seeking financing and the capital markets, which the Commission has failed to consider or even contemplate. Before the Commission makes such a change, it needs to conduct a

thorough analysis that considers these negative consequences on funds, market participants and the capital markets.

B. Elimination of the Less Liquid Category Is Not Based on Evidence

As discussed above, the Proposal would remove the "less liquid" category from the liquidity classifications under Rule 22e-4. However, the Proposal does not adequately support the reason for this removal. None of the past problems involving liquidity in open-end funds have been due to this category of investments. Moreover, there have been no market failures or even problems for this category of investments. Instead, it seems that the Commission is relying on unproven theories regarding the potential for issues due to longer settlement times. The Proposal is seeking to fix a problem that is not supported by any actual evidence and that the Commission has not justified is necessary and appropriate through economic analysis.

C. Requirement to Assume Stressed Market Conditions at All Times Is Not Necessary or Appropriate

The Proposal would require the assumption of stressed market conditions at all times. This will reduce investor choices and reduce returns without a tangible benefit since the Commission is arbitrarily adopting this standard without any basis in data. In reviewing the flow data, the Commission decided that weekly flow data is more appropriate than daily flow data. However, the Commission disregards the weekly flow data by proposing a predetermined 10% standard. This new standard is not based on historical redemption patterns in funds and the Commission has not made the case that it is necessary and appropriate. It also reverses an agency determination to permit funds to rely on reasonably anticipated trading sizes that was only adopted in 2016 with the adoption of Rule 22e-4. The current standard is working as intended since there were no redemption issues in March 2020, as the Commission acknowledges. The requirement should remain unchanged using a principles-based approach and should continue to be based on each individual fund's circumstances rather than a one size fits all standard. Any other approach will end up harming shareholders by reducing returns and reducing investor choices and is not consistent with the mission of the Commission.

D. Proposed Changes Do Not Adequately Consider or Address the Impact to Fixed Income Securities or Other Instruments such as Derivatives

The Proposal would adopt a prescriptive standard for determining whether a sale would significantly change the market value of the investment (i.e., the market impact analysis). However, the proposed one size fits all standard for anything other than equity securities is unworkable for all asset types used by open-end funds, including fixed-income securities and derivatives. First, there often is not adequate data to apply the standard required by the Proposal and even where there is some data, it is not possible to know the market impact for many types of instruments. This will end up limiting investment types, which in turn limits investor's choices without a tangible benefit. The Commission has not

adequately considered how the standard could apply to all types of assets classes and the Proposal displays a lack of understanding of how the markets work for the many asset classes used by open-end funds. Further, removing asset-based classification would be especially deleterious for fixed income securities, given that the number of unique securities means that not every security may trade on a particular day notwithstanding that they are tradeable. The Commission needs to adequately consider the impact on various asset classes before making this change and cannot just summarily determine that the one size fits all standard will work.

E. Removal of Asset Based Classification May Create Unintended Consequences

The Proposal would remove the ability of open-end funds to apply asset-based classifications for liquidity classification. In doing this, the Proposal theorizes that asset-based classifications are not widely used, which many of our members have indicated is simply untrue. However, the Commission does not adequately consider whether there are types of instruments where such asset-based classifications are needed given the lack of information about a particular instrument. Other than making generalizations about the lack of use of asset-based classifications, the Commission needs to ensure that removing this ability is necessary and appropriate and that it will not create unintended consequences that will end up harming the ability of funds to invest in certain types of securities that will ultimately harm investors. The Commission should consider whether the current structure is functioning well and only make changes if it finds actual evidence that it is not.

V. Concerns About Comment Period

Through several comment letters, the Chamber has expressed its deep concern with the Commission's shortened and concurrent timeframes to respond to the wide array of new and complex proposals, most of which are recommending substantial changes to the regulation and operation of open-end funds. We reiterate our concern with the Commission's plainly inadequate comment periods, especially if it is genuinely seeking meaningful feedback from stakeholders, and a general failure to consider the interconnected nature of these various proposals and the cumulative impact on open-end funds. We hope that the Commission will slow down the unprecedented pace of its rulemaking agenda in favor of getting the regulations right, keeping in mind that regulations should not only protect investors, but should do so in a way that maintains fair, orderly, and efficient markets and facilitates capital formation. Simply put, the Commission has failed to provide a meaningful opportunity to comment in violation of the APA.

In addition, given the Commission's very lengthy and fast-moving agenda, we are concerned about the extensive changes that our member firms will have to make to implement the universe of new rules that are part of the Commission's agenda. The various rules under consideration will require layers of new systems, processes, and operations updates and changes to disclosure documents. The aggregate burden of coming into compliance with the Commission's fusillade of rulemaking will exhaust the resources

available to legal and compliance departments that are currently devoted to protecting investors by identifying and mitigating actions that could harm investors. Has the Commission considered these updates collectively, specifically by conducting a thorough cost-benefit analysis of the cumulative impact of the Commission's various proposals? We hope the Commission will work in good faith to consider this collective burden on all stakeholders as it considers the wide array of proposals before it.

VI. Transition Period

While the Chamber does not believe the Proposal should be adopted in its current form and should be withdrawn in its entirety pending the Commission doing extensive work to support the need for the Proposal, if the Commission still chooses to adopt any of the measures considered by the Proposal, it will need a lengthy transition period. Given the extensive changes under consideration by the Proposal, this period needs to be significantly longer than the periods contemplated by the Proposal. This period needs to be extensive since any changes could require entire systems to be rebuilt. It may not just be an enhancement to existing systems. In addition, aspects of the Proposal related to the current liquidity rule would require certain strategies and funds to be reworked in their entirety. Given how the Proposal would impact these strategies and funds, again there needs to be a significant transition period in order to not harm shareholders and the markets in any such transition. Anything less is likely to cause market dislocations that will negatively impact shareholders.

VII. Alternatives

While the Chamber gives credit to the Commission for providing alternatives and asking about alternatives, we believe the consideration of any alternatives is premature. Before even considering any alternatives, the Commission needs to do the work to consider whether the proposed changes to open-end funds are even necessary or appropriate, which it currently has not done. Given the lack of an extensive cost-benefit analysis that fully assesses the many consequences of this far-ranging regulation, this Proposal remains a solution in search of a problem. As a result, we do not believe any changes are warranted at this time and the Proposal should be withdrawn in its entirety until the Commission has done the required analysis to ensure that the Proposal is necessary and appropriate and in the public interest. Given the deficiencies in the Proposal that do not adequately support the need for any changes, we believe the consideration of any alternatives to the Proposal are premature at this time.

VIII. Conclusion

The Chamber welcomes this opportunity to comment on the Proposal. In its current form, the Chamber believes the Commission should withdraw the Proposal in its entirety until the Commission has completed its work to consider whether any changes are necessary or appropriate and in the public interest. We stand ready to assist and be a resource for the Commission and the Staff as it conducts this work.

Sincerely,

Tom Quaadman
Executive Vice President
Center for Capital Markets Competitiveness
U.S. Chamber of Commerce