

February 14, 2023

Investment Company Regulation Office  
Division of Investment Management  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-8549

Submitted via <https://www.sec.gov/rules/submitcomments.htm>

**Re Open-End Fund Liquidity Risk Management Programs and Swing Pricing;  
Form N-PORT Reporting; File Number S7-26-22**

Dear Chair Gensler,

The American Retirement Association (the ARA) writes to share our concerns about the above-referenced proposed rule relating to open-end fund liquidity risk management and swing pricing (Proposal), published by the Securities and Exchange Commission (the Commission) on December 16, 2022.<sup>1</sup> Our concerns center on the potential impacts that the “Hard Close”<sup>2</sup> element of the Proposal would have on employer-sponsored defined contribution retirement plans subject to the Employee Retirement Income Security Act of 1974, as amended (ERISA) and consequently, the retirement security of participants in those plans (DC Plans).<sup>3</sup>

- **The ARA believes that any solution for potential dilution and inequity in allocation of transaction costs in open-end funds should not “un-level the playing field” for millions of American families who own those funds through their employer-sponsored defined contribution plans or materially disadvantage or harm this important group.**

The ARA is the coordinating entity for its five underlying affiliate organizations which represent the full spectrum of America’s private retirement system: the American Society of Pension Professionals and Actuaries (ASPPA), the National Association of Plan Advisors (NAPA), the National Tax-Deferred Savings Association (NTSA), the American Society of Enrolled Actuaries

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<sup>1</sup> 87 Fed. Reg. 77172 (Dec. 16, 2022).

<sup>2</sup> The “Hard Close” element of the Proposal describes the proposed amendments to Rule 22c-1 under the Act, which would require a hard close for those funds that are required to implement swing pricing. Under the Hard Close, a direction to purchase or redeem a fund’s shares is eligible to receive the price established at the current day’s price solely if the fund, its designated transfer agent, or a registered securities clearing agency receives an eligible order before the pricing time as of which the fund calculates its NAV. Orders received after the fund’s established pricing time would receive the next day’s price. *See* 87 Fed. Reg. at 77209.

<sup>3</sup> For simplicity, the term “DC Plans” refers to individual account plans which permit participants to direct the investment of assets in their accounts. This includes all daily valued defined contribution plans, such as 403(b) plans (ERISA and non), 457 plans, profit-sharing plans, kSOPs, MEPs, METs, and PEPs.

(ASEA), and the Plan Sponsor Council of America (PSCA). The ARA's members include organizations of all sizes and industries across the nation which sponsor and/or support retirement saving plans and are dedicated to expanding on the success of employer sponsored plans. In addition, ARA has nearly 36,000 individual members who provide consulting and administrative services to sponsors of retirement plans. ARA and its underlying affiliate organizations are diverse but united in their common dedication to the success of America's private retirement system.

### Summary

The ARA has serious concerns about the Hard Close and its impact on DC Plans and participants. Not only would mandating a Hard Close require a complete overhaul of intermediaries' systems and processes, vastly increasing costs to participants, it would create inequities among investors in open-end fund and eventually, increased flows of investor money into less regulated vehicles and potentially, a push for many asset managers to create alternative funds instead. We are very concerned that retirement savings rates will suffer. The defined contribution system is the backbone of the American retirement savings landscape – especially with the continuous termination, freezing and curtailment of defined benefit plans coupled with major future problems in the solvency of Social Security.

The Proposal implicates a central characteristic of delivering secure retirement benefits to America's workers: regardless of how or where someone buys or sells mutual fund holdings, all investors are treated the same. If the Commission requires a Hard Close, a two-tiered system for open end fund investors would result and DC Plan investors would be disadvantaged. The ARA agrees with the Commission that if there are significant inequities in the allocation of the transaction costs of mutual fund trading activity that remedying such inequities is a laudable goal; however, any potential solution must not disadvantage or harm the millions of American families who own mutual funds through their employer-sponsored defined contribution plans or create significant collateral damage.

- **The ARA believes that if the proposed Hard Close is adopted, plan fiduciaries, acting in the best interest of plan beneficiaries may move plan investments to bank investment funds exempt from the Investment Company Act in order to avoid the dislocations of the rule.**

### Discussion

The Commission intends for the Proposal to support the implementation of swing pricing under a rule adopted in 2016 and to address dilution associated with investor redemptions. Our comments focus on the Hard Close, which the Commission asserts, will facilitate swing pricing while also preventing late trading and reducing operational risk.<sup>4</sup>

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<sup>4</sup> 87 Fed. Reg 77177-78. *Also see* Rule 22c-1(a)(3), 81 Fed. Reg. 82804 (Nov. 18, 2016).

Swing pricing is intended to cause a particular day's purchasing or redeeming shareholders to bear the estimated portfolio transaction costs attributable to those shareholders' activity, rather than the fund and thus, its remaining shareholders. The Commission views this allocation of portfolio transaction costs as more equitable than the status quo – where long-term investors remaining in funds absorb costs and potential dilution from the activities of redeeming shareholders. Swing pricing, in theory, would be accomplished through adjustments to a fund's daily per-share net asset value (NAV) on a client-by-client basis. According to the Commission, in the time since adoption of the 2016 swing pricing rule, no U.S. funds have implemented it, nor has the industry developed an operational solution to facilitate the take-up of swing pricing.<sup>5</sup> This, the Commission asserts, is due to funds' inability to obtain sufficient fund flow information before finalizing the day's NAV. The Commission believes a Hard Close is needed because it will provide timely investor flow information necessary to facilitate swing pricing.<sup>6</sup> If all flow details are transmitted before a fund finalizes its NAV, a fund can (in theory) implement swing pricing.

The Commission cites as a guiding principle of its Proposal that transaction activity of some investors should not generate excessive costs for other investors, unfairly reducing the value of those other investors' stakes. The ARA supports the principle of equitable allocation of the costs of mutual fund trading activity, but we believe that it is critical that any solution not place at a disadvantage millions of American families who own mutual funds through employer-sponsored DC Plans. That is, any change to the current rules must not result in disparate treatment of DC Plan investors. Treating participants in DC Plans as second-class investors could threaten retirement security, public confidence in DC Plans, and national savings rates.

Under a Hard Close, a purchase or sale order for shares of an open-end fund will be eligible for a given day's price only if the fund, its transfer agent, or a registered clearing agency receives the order before the time when the fund calculates its NAV, which is typically as of 4 pm ET. In other words, to make this work, intermediaries which process DC Plan trades in open-end mutual funds would have to process orders before 4:00 p.m. ET in order to get them to funds on time. When dealing with investors on the West Coast or with DC Plans, mid- or late-morning order cut-off times would have to be imposed to meet the deadline – the participant cutoff might be 10:00 AM, 11:00 AM or noon ET.

In many scenarios, a Hard Close would force DC Plan participants to commit to investment decisions before direct investors. The Commission acknowledges that the Hard Close would mean that intermediaries imposing earlier cut-off times for orders to be placed to receive the current day's price, to ensure that intermediaries have sufficient time to transmit their order flows to the fund before its pricing time. In other scenarios, a Hard Close could cause investors to receive the next day's NAV for their order. The ARA believes that any scenario under which DC Plan investors are

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<sup>5</sup> 87 Fed. Reg at 77177.

<sup>6</sup> The Commission also explains that a Hard Close would help prevent late trading and reduce operational risk. 87 Fed. Reg. at 77164.

treated differently, for example, where they have to commit to investment decisions at different times than direct investors is fundamentally inequitable. Moreover, it increases participants' exposure to uncertainty and risk. ERISA fiduciaries will seek to avoid the additional liability that result follows and will replace open-end funds with bank collective investment trusts (CITs) and other similar investments where same day trading can continue to allowed.

- **While the ARA focuses our comments on the adverse impact the 4:00 pm Hard Close will have on employee retirement plans, we share the skepticism of mutual fund sponsors as to whether swing pricing will provide meaningful benefits to fund shareholders in light of the various costs that will be borne by investors. A better approach would be to require mutual funds to disclose the (ordinarily small) dilutive effect of redemptions on persisting shareholders and to direct investors to ETFs if they wish to avoid such dilution of their interests.**

#### *Impact on Mutual Funds and Their Shareholders*

Mutual funds have long been the investments of choice for retirement plan fiduciaries and beneficiaries in part because of the ease in which plan investments can be made and reallocated. They comprise approximately 6.2 trillion of mutual fund assets.<sup>7</sup> If the Commission adopts of the hard 4:00 pm close as proposed we expect that other investment options will become more attractive to many beneficiaries. The Commission should expect new competitors to emerge, including new CITs and guaranteed investment contracts, which will marketed to plan fiduciaries without the benefit of the Commission's disclosure requirements and many of the other securities law protections.

#### *Intermediaries for Defined Contribution Plans*

Most DC Plans are administered by third-party recordkeepers which are responsible for collecting investment decisions made by plan participants alongside all other plan activity each day. Recordkeepers typically partner with intermediaries—custodian banks, clearing firms, or trust companies—who process the mutual fund trades. Most trades in ERISA plans are made on an omnibus basis. This system for processing orders been in place for over 20 years; it delivers tremendous benefits to participants, avoids costly and time-consuming disputes, and keeps participants focused on the long-term goal of accumulating savings for retirement. It also helps fuel the American economy by generating massive investment in mutual funds which, in turn, invest in tens of thousands of U.S. companies.

Intermediaries generate the majority of most mutual funds' order volume and fund flow activity. Mutual funds are among the most common investment options offered under DC Plans and

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<sup>7</sup> 2022 ICI Investment Company Fact Book, p 127, available at [https://www.icifactbook.org/pdf/2022\\_factbook\\_ch7.pdf](https://www.icifactbook.org/pdf/2022_factbook_ch7.pdf).

intermediary service providers are expected to efficiently handle participant investment directions involving mutual funds in order to minimize plan administrative expenses.

Typically, the intermediary transmits aggregated trades following the fund's trade cutoff time, in accordance with applicable prospectus provisions, regulations, and agreements with the fund. Recordkeepers' systems require receipt of the day's NAVs to begin the process of calculating each day's trading activity for each plan. That is, retirement plan recordkeeping systems generally are dependent on determination of the NAVs. As a result, the full set of a day's orders cannot be generated and transmitted to the fund or a transfer agent until a NAV is received for a particular day. This generally occurs between 6 pm ET and 8 pm ET. Transactions must also be evaluated against the DC Plan's terms and trading / operational rules for each fund. When an order complies with a plan terms, the transaction can be submitted to the fund for processing. Recordkeepers typically bundle transaction activity so that mutual funds can process transactions in omnibus fashion, reducing costs for funds and delivering enormous cost savings to plan participants and beneficiaries, along with effectuating no-load transactions on purchases and redemptions.<sup>8</sup> Finally, the recordkeeper updates participant records upon settlement of these transactions.

We are concerned, as the Commission acknowledges, that significant changes to the business practices related to processing transactions will be needed to adapt to the Proposal, including updating computer systems or adopting new technologies. Additionally, the reprogramming required to adapt to a Hard Close, for example, creating an estimate or using the previous day's NAVs, would introduce great operational risk and be very costly to implement. Extensive intermediary system enhancements would be required, for example, because current systems have controls in place to prevent the use of prior day NAVs. The costs of making these changes will appear as higher costs for DC Plans and participants.

- **The architecture of participant-directed retirement plans in this country is built on current transaction processes occurring after the close of business. The Hard Close would impose significant disruptions and costs adversely affecting the very type of small investors of which the Commission should be the most protective, discouraging participation in retirement plans and driving plan fiduciaries to alternative investment vehicles.**

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<sup>8</sup> The recordkeeper's role includes gathering and transmitting investment transaction requests from participants and updating participant records upon settlement of these transactions. Recordkeepers are subject to examination, subpoena and enforcement authority of the Department of Labor, the federal agency primarily responsible for enforcing ERISA. The Department has broad authority under Section 504 of ERISA to examine ERISA plan service providers.

### *ERISA Fiduciary Considerations*

The ARA is concerned that under a Hard Close, some of the activities of intermediaries processing transactions for DC Plans may become difficult to reconcile with ERISA's fiduciary duty of care. ERISA fiduciaries are required to act prudently and solely in the interest of plan participants and their beneficiaries and with the exclusive purpose of providing benefits. On top of the civil and criminal ERISA enforcement carried out by the federal government, participants in ERISA-covered plans have the right to bring a civil action against an ERISA fiduciary for benefits and breaches of fiduciary duty. Fiduciaries who do not abide by applicable ERISA principles may be held personally liable for investment losses.

An example of routine retirement plan recordkeeping activity illustrates the vexing fiduciary questions that may arise under a Hard Close. In the case of a participant loan, the recordkeeper needs to ensure that the loan is not for more than \$50,000 (this is the legal limit) and not more than 50% of the account balance (and the account balance the day the trade is made is not known, only the prior day's account balance is known); and request pro rata distributions from each fund in the account, in this case, without knowing fund NAVs on the day the trade is made. Until NAVs are provided, the recordkeeper cannot determine whether the participant's account balance will support that transaction. Lacking current day NAVs at the time a trade is processed would necessitate the use of estimates, potentially a fiduciary act.

The ARA believes that errors and disputes are inevitable in this situation. This begs the question of whether even offering mutual funds on a plan's investment platform could meet the ERISA prudence standard. Moreover, increasing the number of errors and disputes in the industry will likely cause firms to significantly increase fees, or may force a number of recordkeepers to sell their business (or exit the business) – significantly reducing competition in the space. Moreover, under a Hard Close, fiduciaries of DC Plans may have to account for participants being at a disadvantage relative to other investors. It is hard to conceive of how any such investment strategy would be considered prudent under the ERISA standard.

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Considering that mutual funds represent almost half of all DC Plan investments, we are extremely concerned that the Proposal could hurt the retirement savings of many Americans. We believe that it is critical that any proposed solution to the Commission's concerns about liquidity and dilution in open-end funds not disadvantage or treat as different Americans who own mutual funds through their DC Plans. We urge the Commission to withdraw the Proposal and consider alternative ways of eliminating inequity in how costs of mutual fund trading are allocated. We encourage the Commission to convene working groups of relevant industry participants to consider the nature and extent of dilution in the fund industry as well as the feasibility and implications of swing pricing and the Hard Close.

The ARA very much appreciates the Commission's commitment to protecting investors, including workplace retirement plan savers. The ARA shares this commitment and would welcome the opportunity to discuss this further with you. Please feel free to contact Allison Wielobob, General Counsel, at [REDACTED] or (703) 516-9300.

Thank you for your time and consideration.

Sincerely,

/s/

Brian H. Graff, Esq., APM  
Executive Director/CEO  
American Retirement Association

/s/

Allison Wielobob  
General Counsel  
American Retirement Association