IDC Independent Directors Council
Promoting Excellence in Fund Governance

February 14, 2023

Ms. Vanessa A. Countryman
Secretary
US Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting; File No. S7-26-22

Dear Ms. Countryman,

The Independent Directors Council[1] appreciates the opportunity to comment on the SEC's proposal to require swing pricing and a hard close for mutual funds, change Form N-PORT filers' reporting obligation, and amend the liquidity rule for open-end funds (Proposal or Release).[2] In representing the perspective of fund independent directors, we have a unique voice regarding the impact that the Proposal would have on fund shareholders. Our comments, which are broadly supported by the fund independent director community, are focused on the aspects of the Proposal that would likely have the greatest impact on shareholders.

I. Overview

Fund independent directors take very seriously their role in overseeing mutual funds as the investment vehicle of choice for more than 100 million American shareholders. These investors are seeking to save for retirement or achieve other important financial goals, such as saving for a down payment on a house or paying for their children's college education.

Mutual funds are subject to comprehensive requirements under the Investment Company Act of 1940 (1940 Act), other federal securities laws, and related SEC regulations. These protections, coupled with the unique governance structure created by Congress to ensure independent oversight, benefit fund

[1] The Independent Directors Council (IDC) serves the US-registered fund independent director community by advancing the education, communication, and public policy priorities of fund independent directors, and promoting public understanding of their role. IDC's activities are led by a Governing Council of independent directors of Investment Company Institute (ICI) member funds. ICI's members manage total assets of $28.3 trillion in the United States, serving more than 100 million US shareholders, and $7.4 trillion in assets in other jurisdictions. There are approximately 1,600 independent directors of ICI-member funds.

[2] *Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting*, SEC Release Nos. 33-11130; IC-34746 (Nov. 2, 2022), available at www.sec.gov/rules/proposed/2022/33-11130.pdf.

shareholders. IDC recognizes that thoughtful regulation is important, and we support sensible regulation on behalf of fund shareholders.[3]

While we acknowledge that the SEC seeks to "enhance open-end fund resilience in periods of market stress,"[4] the ways in which the Proposal would do so would threaten the core features of one of the most popular and well-regulated financial products that has benefited millions of US households for decades.[5]

Mandating a hard close effectively would treat shareholders investing through intermediaries as "second class." The vast majority of mutual fund–owning households (ninety-three percent, or about 64 million) report that they primarily purchase their mutual funds through intermediaries, including retirement plans, investment professionals such as full-service brokers and financial advisers, and discount brokers.[6] There are approximately 60 million active retirement plan participants and millions of additional former employees and retirees who participate in 401(k) plans alone,[7] along with millions of additional investors in 403(b) plans and other intermediated accounts, who would be required to place their mutual fund trades by a substantially earlier cut-off time than other investors or receive the next day's price. In an era

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[3] *See, e.g.,* Plouché, Cynthia, *IDC Governing Council Chair's Remarks, 2022 IDC Fund Directors Conference* (Oct. 25, 2022), available at https://www.ici.org/speeches-opinions/22-fdc-plouche (characterizing "the compliance framework established by Rule 38a-1 [as] an example of regulation done right"); IDC Comment Letter *re: Tailored Shareholder Reports, Treatment of Annual Prospectus Updates far Existing Investors, and Improved Fee and Risk Disclosure far Mutual Funds and Exchange-Traded Funds; Fee Information in Investment Company Advertisements*, File No. S7-09-20 (Dec. 22, 2020), available at https://www.sec.gov/comments/s7-09-20/s70920-8177989-227067.pdf (strongly supporting the efforts of the SEC to encourage disclosures in shareholder reports that are concise, understandable, and visually engaging); IDC Comment Letter *re: Exchange-Traded Funds*, File No. S7-07-08 (May 19, 2008), available at https://www.sec.gov/comments/s7-07-08/s70708-8.pdf (commending the SEC for proposing rules that would ease the burdens associated with bringing new products to market while maintaining a high level of investor protection); and IDC Comment Letter *re: Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies,* File No. S7-28-07 (Feb. 15, 2008), available at https://www.sec.gov/comments/s7-28-07/s72807-51.pdf (expressing strong support for the efforts of the SEC to provide concise, clear, and standardized disclosure to fund investors).

[4] Release at 13.

[5] The Proposal comes in the midst of a tsunami of regulatory activity for mutual funds that is unprecedented in its pace, reach, and complexity. The cumulative, "stacking" effect presents near-impossible challenges for stakeholders trying to analyze proposals, engage in the comment process, and implement new regulatory requirements contemporaneously. In an ultra-competitive and consolidating industry, we are concerned about the continued viability of many smaller and mid-sized mutual fund complexes, and the near insurmountable barriers to entry.

[6] *See* Figure 4.1 in *Profile of Mutual Fund Shareholders, 2022, ICI Research Report* (Nov. 2022), available at https://www.ici.org/system/files/2022-11/22-rpt-profiles.pdf. Mutual fund shareholders surveyed include households owning long-term mutual funds and/or money market funds.

[7] *See* Investment Company Institute, 401(k) Resource Center, available at https://www.ici.org/401k (accessed Feb. 14, 2023).

when real time pricing is increasingly the expectation, rather than the exception, significantly narrowing the window to be eligible for a given day's price would be extremely unattractive to investors.

Other aspects of the Proposal are highly prescriptive and adopt a "one-size-fits-all" approach. Mandatory swing pricing for the vast majority of open-end funds is a very blunt instrument with negative collateral impacts. Swing pricing is just one potential tool in a fund's toolbox that could address dilution—an issue that is not relevant to all open-end funds. We strongly question why the SEC would mandate the use of just one tool for approximately 8,400 mutual funds.[8] The Proposal would do so without regard to the circumstances and risks of each fund and whether or not dilution is in fact significant for any given fund. In our view, any assessment with respect to dilution must be flexible and fund-specific.

Likewise, the proposed liquidity amendments are rigid and prescriptive. Without question, sufficient and appropriate liquidity is necessary for an open-end fund structure. But an overemphasis on liquidity can be self-defeating if it detracts from the other core characteristics of open-end funds. Mutual funds are investment vehicles through which shareholders assume some degree of risk for a return on investment. If liquidity were the main driver for an investor's decision, the marketplace offers many other instruments that provide greater liquidity and cash-equivalent features.

IDC is gravely concerned about the harm to shareholders if the Proposal were to be adopted. A large swath of investors would be disadvantaged, and considerable operational costs would ultimately be borne by fund shareholders. Moreover, we are deeply concerned that financial intermediaries, when faced with the compliance costs associated with the Proposal, would decide against offering mutual funds in favor of other pooled investment products that may be less regulated and lack independent oversight. There is a clear risk that the Proposal would have this effect.

We therefore oppose the following:

- A "hard close" because it would disadvantage shareholders in intermediated accounts, including those who invest through 401(k) and other retirement plans.

- Swing pricing as a mandatory tool for mutual funds because it would create confusion among shareholders, detract from the clarity and transparency of a fund's NAV, and ignore the facts and circumstances of particular funds and their investors. We discuss an alternative approach below.

- The proposed amendments to the rule governing liquidity risk management programs because they do not take into account the circumstances and risk profiles among different types of funds

[8] Figure is sourced from ICI, including its Monthly Trends Report, and represents long-term open-end mutual funds as of December 31, 2022. Data include mutual funds that invest primarily in other mutual funds. Under the Proposal, all registered open-end funds (other than money market funds and ETFs) would be subject to mandatory swing pricing and the hard close requirement. We generally refer to the long-term funds subject to these elements of the Proposal as "mutual funds" or "funds."

investing in different asset classes, as well as the tools already in place to provide the liquidity necessary to satisfy fund redemptions.

We describe our concerns in greater detail below.

II. The Role of Mutual Funds in the Marketplace

Mutual funds have long served as an exceptional investment vehicle for everyday investors. More than half of all households in the United States own mutual funds.[9] Among mutual fund-owning households, 50 percent own four or more funds.[10] The advantages of these financial products include a unique governance structure with independent oversight by boards, the clear majority of which are composed of at least 75 percent independent directors or trustees,[11] as well as same-day pricing, professional management, diversification, cost effectiveness, stringent regulation, extensive disclosure, and convenience.[12] More than 100 million shareholders invest in mutual funds, and mutual funds have approximately $17.3 trillion in total net assets.[13] We believe that strong, sensible regulation has contributed to the growth of mutual funds.

The success and strength of mutual funds, however, cannot be taken for granted. Widespread investing in mutual funds can quickly be placed at risk. Competition among investment products is fierce. Mutual funds, in the aggregate, have experienced outflows in recent history, and assets of large 401(k) plans have been increasingly held in collective investment trusts (CITs) over the same period.[14] The SEC's Proposal to impose a hard close, mandatory swing pricing, and more stringent liquidity risk management rule provisions would rapidly accelerate these trends.

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[9] *See* Investment Company Institute, vol. 28, no. 10, *Characteristics of Mutual Fund Investors, ICI Research Perspective*, 3 (Oct. 2022), available at https://www.ici.org/system/files/2022-10/per28-10.pdf ("Characteristics of MF Investors").

[10] *See* Characteristics of MF Investors, 7.

[11] *See* Independent Directors Council, *Overview of Fund Governance Practices, 1994-2020* (Oct. 2021), available at https://www.idc.org/system/files/2021-10/21_pub_fund_governance.pdf.

[12] We note that 95 percent of mutual fund investors report that the cost effectiveness of mutual funds is important to them, and 88 percent look for professional management. *See* Holden, Sarah, *Jump In for Mutual Fun, ICI Viewpoints* (May 25, 2021), available at https://www.ici.org/viewpoints/21_view_mutualfun.

[13] Figure is sourced from ICI, including its Monthly Trends Report, and represents total net assets in long-term open-end mutual funds as of December 31, 2022.

[14] *See* Investment Company Institute, *2022 Investment Company Fact Book: A Review of Trends and Activities in the Investment Company Industry*, Figure 3.18, available at https://www.icifactbook.org/ ("2022 Fact Book") (depicting assets held in collective investment trusts of large 401(k) plans in 2020 based on tabulations of DOL Form 5500 data gathered from 401(k) plans with 100 participants or more); Figure 3.6 (depicting net new cash flow to mutual funds).

If adopted as proposed, the likely consequence of the Proposal would be the substantial displacement over time of mutual funds offered through intermediated channels. The vast majority of mutual fund–owning households report that they primarily purchase their mutual funds through intermediaries.[15] Approximately 49 million US households own mutual funds through employer-sponsored retirement plans. The potential impact of this Proposal is immense.[16]

In the Release, the SEC appears to assume that intermediaries are likely to change their systems, should the Proposal be adopted in its current form.[17] We question this assumption. Given the competitive market and the availability of other pooled investment vehicles that are not regulated by the SEC as registered investment companies, many intermediaries could very well choose to replace mutual funds with non-registered investment products that are not subject to burdensome regulations. We believe an intermediary faced with the decision of implementing expensive and intensive operational changes or offering other products—not subject to the same restrictions—would seriously consider and, in many cases, choose the latter.

We are troubled by the possibility of extensive displacement of a well-regulated, shareholder-focused investment product that has withstood the test of time by products such as CITs and separately managed accounts that are significantly less regulated and do not have the same degree of robust investor protection.[18] Unique features of mutual funds, such as independent board oversight, stringent rules governing conflicts of interest, and extensive disclosure and reporting requirements are hallmarks of investor protection, and stand in stark contrast to other investment products.

It is particularly disconcerting that, in the context of this Proposal, the SEC's actions, not market forces, would have the effect of driving investors to less-regulated products. In light of the resulting harm to shareholders, we urge the SEC to seriously consider any such unintended consequences as it contemplates the Proposal and the sweeping impact that the Proposal would have on the fundamental characteristics of mutual funds and the shareholders who invest in them.

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[15] 2022 Fact Book Figure 7.7. *See also Navigating Intermediary Relationships*, Investment Company Institute and Independent Directors Council (Dec. 2022), available at https://www.idc.org/files/2022/22-ppr-navigating-intermediary-relationships.pdf.

[16] *See* Figure 1.8 in Schrass, Daniel and Bogdan, Michael, 2022, "Profile of Mutual Fund Shareholders, 2022," *ICI Research Report* (Nov. 2022), available at https://www.ici.org/system/files/2022-11/22-rpt-profiles.pdf. *See also* Characteristics of MF Investors, 10.

[17] Release at 140.

[18] We also question whether a migration of assets from mutual funds to non-pooled products (*e.g.*, SMAs) would lead to any lessening of systemic risk or "first mover advantage." *See* Stahel, Christof, *Strategic Complementarity among Investors With Overlapping Portfolios* (Sept. 1, 2022), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3952125.

The proposed regulatory action is based on limited data. In the Release, the SEC acknowledges it "do[es] not have specific data about the dilution fund shareholders experienced in Mar. 2020."[19] The SEC also observes that it is "not able to quantify many of the costs associated with the proposed swing pricing framework"[20] and it "cannot predict how many intermediaries will choose to . . . offer products that would not be subject to the proposed hard close requirement . . . in place of mutual funds."[21] We are profoundly concerned about the uncertainty conveyed by these statements.

We are also wary of the disproportionate impact the Proposal would have on small funds and their shareholders. Long recognized as a source of innovation, the health of small funds and new entrants into the market are critically important to capital formation, a core part of the SEC's mission. The onerous burdens and costs of compliance, drains on staffing resources, and operational challenges that smaller funds would face when trying to comply with the Proposal could create insurmountable barriers to entry and may well lead to more industry consolidation.

We urge the SEC not to move forward with the Proposal.

III. Specific Comments

The SEC's Proposal is rigid and prescriptive and, if adopted as proposed, would fundamentally alter the core characteristics of mutual funds. We focus on three major components of the Proposal that would have the greatest detrimental impact on fund investors: (i) the imposition of a hard close, (ii) mandatory swing pricing, and (iii) certain aspects of the enhanced liquidity risk management amendments.

A. Hard Close

The proposed "hard close" would provide that a direction to purchase or redeem a fund's shares is eligible to receive the current day's price only 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 net asset value (NAV). The proposed hard close is intended to effectuate mandatory swing pricing. In addition, the Proposal references the goal of helping to prevent late trading of fund shares.

The imposition of a hard close mandate does not take into account the value that shareholders place on same-day pricing. The SEC acknowledges that "[t]he extent to which the hard close proposal would affect investors largely depends on the value investors place on their ability to obtain same-day pricing . . . ."[22]

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[19] Release at 23, fn. 40.

[20] Release at 292.

[21] Release at 309.

[22] Release at 144.

Yet same-day pricing, even for long-term shareholders, is a core characteristic of mutual funds. A hard close would be a seismic change to how mutual funds are priced and distributed and would negatively affect shareholders owning mutual funds through intermediaries, as order cut-off times for these investors would be moved substantially earlier, and likely not in a uniform way across intermediaries.

The hard close mandate would treat a broad swath of investors—those in intermediated accounts, including retirement plans,[23] 529 plans, and variable insurance products—as "second class" and materially limit their ability to obtain same-day pricing. These investors would be required to place their trades hours prior to the time at which the NAV is calculated. We understand that it could be as early as 10:00 am Eastern Time (*i.e.*, 7:00 am Pacific Time) for some intermediaries, and the time could vary among intermediaries. We question how the Proposal can express strong concerns over "first mover advantage," yet create an unlevel playing field for different types of fund investors.

As a result of the Proposal, investors in intermediated accounts would be required to make their investment decisions well in advance of other shareholders and possibly at different times in different intermediated accounts, or receive the next day's NAV without the ability to consider subsequent market events when making their investment decisions. For example, investors subject to earlier cutoff times would not have the ability to invest with the awareness of or ability to consider market events that take place after that cut-off time, such as interest rate decisions from the Federal Reserve, which are often announced in the afternoon, Eastern Time. Multiple cutoff times would disadvantage impacted shareholders by limiting their ability to obtain same-day pricing and lead to significant shareholder confusion.

The Proposal appears to diminish the importance of same-day pricing for shareholders who invest through intermediaries. The Release provides, "[m]ost fund shareholders are long-term investors, and thus we believe that most fund orders are not time sensitive."[24] We firmly disagree. Whether a shareholder is a long-term investor or not, on a day that an investor seeks to purchase or redeem shares, it is difficult to see how the investor would not care about receiving same-day pricing. We also see no reason why retirees who have participated in a 401(k) or other employer-sponsored retirement plan for decades would place any different value on same-day pricing when taking a withdrawal from their retirement plan account. IDC strongly objects to the assumption that long-term investors do not value same-day pricing.

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[23] 401(k) plans hold $6.3 trillion in assets as of September 30, 2022, in more than 625,000 plans, on behalf of about 60 million active participants and millions of former employees and retirees. *See* Investment Company Institute, 401(k) Resource Center, available at https://www.ici.org/401k (accessed Feb. 14, 2023).

[24] Release at 145.

It is also of concern that the Proposal would disadvantage retirement plan participants,[25] while at the same time Congress is focused on encouraging and expanding retirement savings, as evidenced by its recent bipartisan action to pass the SECURE 2.0 Act.[26]

The Release states that the hard close mandate would "help prevent late trading of fund shares," while citing to "several instances of late trading in the early 2000s"[27] and pointing to the SEC's jurisdictional limitations in examining certain types of intermediaries. It is surprising that the SEC would justify its far-reaching hard close Proposal on a very dated and limited basis. The answer cannot be to fundamentally alter the operations of an industry in response to a compliance concern that was addressed nearly 20 years ago.

The Release offers no evidence that late trading is occurring today. We are not aware of recent enforcement cases related to late trading or recent Risk Alerts from the SEC regarding late trading. If late trading in fact remains a concern, the SEC could work through its Examinations Division to assess the matter, rather than promulgate a sweeping rule that is well beyond the scope of that specific compliance concern.

B. Mandatory Swing Pricing

The goal of swing pricing—the process of adjusting a fund's price above or below its NAV per share—is to pass on the costs stemming from purchase or redemption activity to the shareholders associated with that activity. The SEC proposes to mandate swing pricing across the vast majority of mutual funds to address its concerns about dilution.

To be sure, if dilution is significant for a particular fund, swing pricing is one tool that might be considered in light of the circumstances and risks of a fund. Other tools, however, also are available. For example, a fund may look to large trade notifications from institutional investors, redemptions in kind, redemption fees, interfund lending, or credit facilities. As a general matter, having access to a variety of tools enables a fund and its adviser to take into account particular circumstances and risks when managing its portfolio in the best interests of its shareholders. Swing pricing should not be viewed as a universal panacea and mandated across open-end funds.

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[25] We note that the average 401(k) account balance as of year-end 2020 was $87,040, and the median account balance was $17,961. *See* Investment Company Institute, vol. 28, no. 11, *401(k) Plan Asset Allocation, Plan Balances, and Loan Activity in 2020, ICI Research Perspective*, 8 (Nov. 2022), available at https://www.ici.org/system/files/2022-11/per28-11.pdf.

[26] Securing a Strong Retirement Act of 2022 aims to increase the number of American workers participating in retirement plans by creating new plan options that will be easier for employers to set up and maintain, making automatic enrollment a standard feature in new retirement plans going forward, and significantly enhancing the tax credits available to small employers offering retirement plans and non-high paid workers contributing to those plans.

[27] Release at 130.

We strongly oppose a mandatory one-size-fits-all application of swing pricing for mutual funds. Swing pricing is associated with a number of challenges. The SEC has acknowledged "the potential for swing pricing to increase the volatility of a fund's NAV in the short term and its operational costs."[28] Many market participants also have identified operational challenges with implementing swing pricing.[29] Effective implementation of swing pricing requires accurate and timely flow information, and it introduces greater risk with a greater potential for pricing errors.

At a minimum, even when swing pricing works as intended, it could harm small shareholders who happen to redeem on the same day as large institutional investors, and therefore receive a lower NAV than they otherwise would receive.[30] In addition, the significant operational costs associated with the implementation of swing pricing would ultimately be borne by funds and their shareholders.

The challenges with swing pricing are illustrated by the fact that the measure is expressly permissible in the United States, but no fund complex has implemented it domestically. While we understand that the SEC seeks to address its concerns about dilution with mandatory swing pricing, dilution is not relevant to all funds, and we are not convinced that swing pricing is an effective solution. We are seriously concerned that this single, limited tool would be mandated across mutual funds.

Moreover, an approach that would fundamentally alter the NAV, the bedrock of mutual fund share calculation, is inherently troubling. Shareholders understand the straightforward formula for calculating the daily net asset value:

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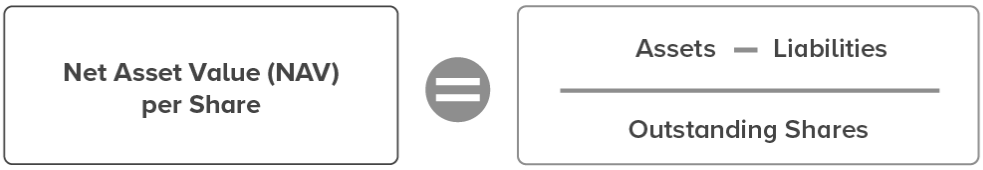
[28] *Investment Company Swing Pricing*, SEC Release Nos. 33-10234; IC-32316 (File No. S7-16-15) (Oct. 13, 2016), at https://www.sec.gov/rules/final/2016/33-10234.pdf.

[29] *See* Industry Comments on Proposed Rule on Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release, SEC Release No. IC-31835 (File No. S7-16-15) (*e.g.*, *Fidelity Management & Research Company Comment Letter* (Jan. 13, 2016) (noting "the existing operational systems supporting the mutual fund industry will not support effective swing pricing"), available at https://www.sec.gov/comments/s7-16-15/s71615-45.pdf; *Dechert LLP Comment Letter* (Jan. 13, 2016) (expressing "concerns similar to those expressed by a number of participants in the fund industry that swing pricing raises operational challenges regarding its implementation under the current market structure in the United States"), available at https://www.sec.gov/comments/s7-16-15/s71615-70.pdf; *T. Rowe Price Comment Letter* (Jan. 13, 2016) (noting "there are serious operational challenges that will not make it possible to use swing pricing in the [United States] in the same way that it is currently applied in other jurisdictions"), available at https://www.sec.gov/comments/s7-16-15/s71615-72.pdf.

[30] In addition, purchasers of shares on a day that swing pricing impacts the NAV due to net redemptions would buy at a price lower than if the NAV was calculated without regard to a swing factor. The next day, assuming that the NAV is not swung again, the purchaser would receive a windfall through a higher NAV, all other things being equal. Again, swing pricing is an imperfect tool, leading to odd results at times, that should not be mandated across mutual funds.



The NAV is fundamental to the "mutual" character of open-end funds. The imposition of swing pricing would detract from the clarity and transparency of the NAV. Swing pricing is not an intuitive concept, and as proposed, would alter the NAV. It is not a tool that US investors are familiar with or have seen in operation, and it would cause significant shareholder confusion. We are particularly concerned about individual investors, such as retirees in 401(k) plans, who redeem and receive a lower, adjusted NAV, on a day when there happens to be additional redemption activity that is beyond their control.

Likewise, swing pricing would introduce operational and complexity risks to the daily valuation systems that have operated effectively for decades. Calculating the swing factor in the case of net redemptions, for example, would require:

> "*[G]ood faith estimates* . . . for selling a pro rata amount of each investment in the fund's portfolio to satisfy the amount of net redemptions: (1) spread costs; (2) brokerage commissions, custody fees, and *any other charges, fees, and taxes* associated with portfolio investment sales; and (3) if the amount of the fund's net redemptions exceeds the market impact threshold, the *market impact*."[31]

From this language alone, it is clear that the Proposal would introduce an enormous amount of uncertainty, subjectivity, and potential for error into what has historically been a straightforward calculation of the fundamental NAV.

The SEC in part relies on Europe's experience with swing pricing to justify its Proposal. The Proposal, however, does not take into account significant differences between the voluntary use of swing pricing in Europe and the mandatory framework contemplated by the Proposal in the United States.

The use of omnibus accounts and processing by intermediaries is limited in Europe, compared to the US. In particular, while a significant portion of shareholders in the United States invest through employer-sponsored retirement plans, Europe has a much smaller percentage of its total assets in intermediated vehicles such as 401(k) plans, variable annuities, 529 college savings plans, and others that rely on the calculation of the NAV on a daily basis.

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[31] Release at 115 (emphases added). Recognizing the judgment involved in calculating the swing factor, the Proposal would require that swing factor adjustments be publicly reported on Form N-PORT. Rather than layering on yet another regulatory requirement to mitigate the less-than-perfect characteristics of swing pricing, we urge the SEC to recognize the limitations of the tool and refrain from mandating swing pricing for mutual funds.

Most shareholder trades in Europe are denominated in currencies, which can be readily processed by funds and intermediaries without estimation, with a lesser portion in share or unit amounts or a percentage of assets held. In the United States, however, orders can be denominated in shares, percentages of holdings, and currencies.

In light of the different practices in Europe and the United States, voluntary swing pricing in Europe should not be used to justify the introduction of mandatory swing pricing in the United States. In our view, it compares apples and oranges.

C. Liquidity Risk Management

The liquidity risk management amendments would impact approximately 11,200 funds with a variety of objectives, strategies, and risk profiles.[32] It is important to recognize that these funds are investment products for which shareholders, pursuant to the prospectus and other required disclosures, are assuming some degree of risk in exchange for some degree of return. Fund boards are sensitive to the fact that the funds they oversee are investment products that shareholders invest in to put their money to work. There are many other financial products available in the marketplace for investors seeking a highly liquid, "cash-like" product. While liquidity risk management is essential and necessary, it must be balanced with funds' investment objectives, strategies, and risk profiles.

The liquidity risk management practices of mutual funds are already robust, thanks in part to the SEC's comprehensive liquidity risk management rules implemented in 2016 that in some respects codified existing practices.[33] To the extent that any funds' liquidity practices raise concerns about their ability to meet their redemption obligations, the SEC can address those concerns in a more targeted, flexible, and appropriate manner.

Liquidity risk management is multi-faceted and inherently fund-specific, requiring consideration of many factors, including the fund's investment strategy, the liquidity of its portfolio investments, investor flows (in normal and reasonably foreseeable stressed conditions), characteristics of its shareholder base, fund liabilities, and available liquidity tools.

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[32] Figure is sourced from ICI, including its Monthly Trends Report and Monthly ETF Report, and represents long-term open-end mutual funds and exchange traded funds (ETFs) as of December 31, 2022. Data include mutual funds that invest primarily in other mutual funds and ETFs that invest primarily in other ETFs. Data exclude ETFs not registered under the 1940 Act.

[33] Currently, a fund is required to (i) adopt and implement a written liquidity risk management program, under which the fund must assess, manage, and periodically review its liquidity risk; (ii) classify each portfolio investment into one of four liquidity "buckets" at least monthly; (iii) determine and maintain a minimum amount of its portfolio in "highly liquid investments"; and (iv) limit illiquid investments to 15 percent of net assets. *See Investment Company Liquidity Risk Management Programs*, SEC Release No. IC–32315, 81 Fed. Reg. 82142 (Nov. 18, 2016), available at www.gpo.gov/fdsys/pkg/FR-2016-11-18/pdf/2016-25348.pdf.

It is within this context that we observe that the Proposal is rigid and overly prescriptive. For example, the Proposal would require each fund to assume the sale of 10 percent of each portfolio investment. Yet the outflows that funds face—even in stressed conditions—vary widely and are typically well below 10 percent.[34] This proposed level appears arbitrary, and the negative impact is compounded by the fact that it would be imposed on all funds, regardless of their flows and their overall liquidity risk profile.

By way of another example, the proposed requirement that a fund maintain a highly liquid investment minimum (HLIM) equal to or higher than 10 percent of the fund's net assets is an arbitrary, rigid threshold that does not have a nexus to a particular fund's specific liquidity risk factors, even in stressed conditions. If a particular HLIM were to be set, it should be grounded in, among other things, liquidity risk factors specific to the fund, such as fund-specific flow history and projections (including in stressed conditions), rather than requiring that a fixed percentage apply across virtually all funds.

In addition, we are concerned about the proposed elimination of the "less liquid" bucket. In general, liquidity determinations are not binary in nature, *i.e.*, liquid versus illiquid, and are based on market conditions and circumstances facing the particular fund. Portfolio managers may view, among other things, the fund's holdings along a spectrum—from most to least liquid (which may have the potential for higher long-term returns)—consistent with the objectives of the fund. The concept of "reasonably anticipated trading size," for example, inherently takes into account the judgment necessary to ascertain the liquidity of a particular financial instrument. By eliminating the less liquid bucket, the Proposal would add greater rigidity to liquidity determinations across the spectrum of securities traded at any given point in time.

Overall, the rigidity of these and other aspects of the Proposal could have the effect of dictating fund portfolio management decisions, rather than highlighting different levels of market risk and opportunity. Some funds (*e.g.*, bank loan funds) may no longer be able to satisfy the liquidity rule's requirements and would need to liquidate or undergo costly and uncertain conversions to new fund types. These outcomes are problematic, particularly for funds that have not experienced liquidity-related concerns.

In sum, we believe that the proposed liquidity amendments would impose costs and burdens on shareholders and their funds, without providing commensurate benefits. Liquidity risk management is operating in a robust fashion today under the SEC's liquidity risk management rule.[35] The Proposal

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[34] The SEC's own analysis of weekly fund flows from 2009 through 2021 shows that outflows greater than 6.6% occurred only 1% of the time. Release at 47.

[35] *Investment Company Liquidity Risk Management Programs*, SEC Release No. IC–32315, 81 Fed. Reg. 82142 (Nov. 18, 2016), available at www.gpo.gov/fdsys/pkg/FR-2016-11-18/pdf/2016-25348.pdf.

suggests that there would be increased resiliency (for funds and markets generally) and reduced dilution,[36] but the Proposal's economic analysis neither quantifies these benefits nor provides evidence or reasons to believe they would be meaningful. In effect, the Proposal's liquidity-related provisions would create an imbalance by elevating liquidity considerations above other characteristics of open-end funds that define them as investment products.

IV. Alternative Approach

For the scale of change that the Proposal seeks to effectuate, the SEC has neither demonstrated sufficient need nor provided adequate evidence.[37] If the SEC still believes there are significant dilution issues to be addressed for certain funds,[38] we urge that it consider an alternative approach—rather than a mandatory, one-size-fits-all measure—that would appropriately balance the costs of the measure with the benefits. We note that the Release appears to show flexibility by posing questions on whether swing pricing should be adopted as "an optional tool" or "a default tool" to be implemented "unless certain conditions are met."[39]

To the extent that the SEC believes there might be significant dilution in certain funds, we recommend a more tailored approach. For example, rather than mandating a single specific tool, such as swing pricing for all mutual funds, the SEC should require that a fund and its adviser first determine whether dilution is in fact a significant concern for the particular fund. If it is determined that dilution is a significant concern, then the fund should determine an appropriate fund-specific course of action to mitigate dilution. This two-step approach should be agnostic as to the tool, if any, that the particular fund would

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[36] More specifically, the SEC states: "we expect the Proposal to: (1) enhance open-end funds' liquidity; (2) improve funds' anti-dilution and resilience mechanisms for any given level of liquidity; and (3) increase the transparency of open-end funds' liquidity management practices. Together, the proposed amendments may mitigate liquidity externalities in the open-end fund sector by improving the ability of funds to meet redemptions without imposing significant trading costs on investors. This, in turn, may reduce the first-mover advantage associated with the dilution from trading costs and curtail run risk in open-end funds, which is consistent with recent analyses discussing how more robust liquidity management may mitigate this risk. The proposed amendments may also reduce the likelihood or the extent of future government interventions." Release at 231-232 (internal citations omitted).

[37] *See* SEC Commissioner Uyeda, Mark, *Statement on Proposed Rule: Open-End Fund Liquidity Programs and Swing Pricing; Form N-Port Reporting* (Nov. 2, 2022), available at https://www.sec.gov/news/statement/uyedar-statement-open-end-funds-110222 (noting "[t]he concerns appear to be more theoretical, rather than grounded in fact.").

[38] *Id.* (stating "[w]holesale changes to how fund investors purchase and redeem their shares are not needed to address these concerns").

[39] Release at 99. The Release then offers the following example: "A fund [could] be required to implement swing pricing unless its board of directors makes certain determinations (*e.g.*, that the fund and its shareholders are unlikely to experience significant dilution in connection with investor purchases and redemptions) and the fund maintains records of such determinations." *Id.*

use to address its dilution concerns. We recognize that board oversight would be important, as well as ongoing reporting as to the effectiveness of any anti-dilution measure.

We believe that this type of fund-specific analysis has more merit than an across-the-board mandate of a particular tool (*i.e.*, mandatory swing pricing). We recommend that such a process-based approach be the subject of additional study and input from various stakeholders, including through a concept release. IDC and the fund independent director community stand ready to assist the SEC in this endeavor.

V. Conclusion

IDC is deeply concerned about the harm to shareholders posed by the Proposal. The Proposal threatens to undermine the core features of mutual funds—a well-regulated, shareholder-focused investment product that has served investors over decades. Under the Proposal, a large segment of investors would be treated as second-class and face severe limitations on their ability to obtain same-day pricing. Investor protection would be undercut as the likely impact of the Proposal would be the widespread displacement of mutual funds with alternative investment products that may be less regulated and lack the same degree of robust investor protection. We urge the SEC not to move forward with the Proposal.

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If you have any questions regarding our letter or would like additional information, please contact Lisa Hamman, Associate Managing Director, at 202-371-5405 or me at 202-326-5463.

Sincerely,

/s/ Thomas T. Kim

Thomas T. Kim
Managing Director
Independent Directors Council

cc: The Honorable Gary Gensler
The Honorable Hester M. Peirce
The Honorable Caroline A. Crenshaw
The Honorable Mark T. Uyeda
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