February 14, 2023

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

RE: Open-End Fund Liquidity Risk Management Programs and Swing Pricing (Release Nos. 33-11130; IC-34746; File No. S7-26-22)

Dear Ms. Countryman:

Charles Schwab & Co, Inc.[1] ("CS&Co"), Charles Schwab Investment Management, Inc., doing business as Schwab Asset Management[2] ("CSIM" or "Schwab Asset Management"), Schwab Retirement Plan Services[3] and Charles Schwab Trust Bank[4] (collectively, "Schwab") appreciate the opportunity to provide comments on the November 2022 proposal by the Securities and Exchange Commission (the "Commission") to overhaul liquidity risk management programs and require swing pricing for open-end funds (the "proposal").[5]

Schwab has long championed the benefits of open-end funds for individual investors. CSIM began offering open-end funds in 1989, and today is one of the largest asset managers in the United States, advising more than 100 funds with assets of more than $670 billion. CS&Co.

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[1] The Charles Schwab Corporation (NYSE: SCHW) is a leading provider of financial services, with 33.8 million active brokerage accounts, 2.4 million corporate retirement plan participants, 1.7 million banking accounts, and $7.05 trillion in client assets as of December 31, 2022. Through its operating subsidiaries, the company provides a full range of wealth management, securities brokerage, banking, asset management, custody, and financial advisory services to individual investors and independent investment advisors. Its broker-dealer subsidiaries, CS&Co, TD Ameritrade, Inc., and TD Ameritrade Clearing, Inc., (members SIPC, https://www.sipc.org), and their affiliates offer a complete range of investment services and products including an extensive selection of mutual funds; financial planning and investment advice; retirement plan and equity compensation plan services; referrals to independent, fee-based investment advisors; and custodial, operational and trading support for independent, fee-based investment advisors through Schwab Advisor Services. Its primary banking subsidiary, Charles Schwab Bank, SSB (member FDIC and an Equal Housing Lender), provides banking and lending services and products. More information is available at https://www.aboutschwab.com.

[2] As of December 31, 2022, Charles Schwab Investment Management, Inc., dba Schwab Asset Management™ ("Schwab Asset Management") manages approximately $670 billion on a discretionary basis and approximately $27.1 billion on a non-discretionary basis. Schwab Asset Management provides non-discretionary advisory services to the Schwab Trust Bank Collective Investment Trusts, including research and recommendations relating to asset allocation, portfolio construction, cash-flow monitoring and advisor selection and retention. Some trusts include multiple unit classes. More information is available at www.schwabassetmanagement.com.

[3] As of December 31, 2022, Schwab Retirement Plan Services, Inc. ("SRPS") provides bundled recordkeeping services for approximately 1,178 defined contribution retirement plans totaling $215.3 billion in assets and 1.5 million plan participants. Schwab Retirement Plan Services, Inc. provides a full-service, bundled recordkeeping solution for qualified and non-qualified retirement plans. Additional information is available at https://workplace.schwab.com/.

[4] Charles Schwab Trust Bank (Trust Bank) is a fiduciary-oriented bank focused primarily on the retirement plan market to provide Trust & Custody services for employer sponsored benefit plans. As of December 31, 2022, Trust Bank holds approximately $349.4 billion in assets.

[5] 87 Fed. Reg. (December 16, 2022) at 77172.

launched our pioneering mutual fund marketplace in 1984 in order to offer more choice and convenience to our clients, providing unprecedented access to funds from different fund families that employ a variety of strategies. For more than three decades, our clients have been able to choose among thousands of no-load, no-transaction fee funds to find the fund or funds that work best for their financial goals. It is through our clients' eyes – including the shareholders of the Schwab Funds and Schwab ETFs – that we respond to the proposals.

Overview

Schwab believes strongly that robust liquidity management programs are a cornerstone of the mutual fund industry. We supported the Commission's 2016 Liquidity Rule, which we believe has provided investors with increased protection, enhanced transparency into the liquidity of funds and ensured that funds are able to meet redemption obligations in volatile environments while mitigating dilution for shareholders. A key characteristic of the 2016 reforms is that they allow asset managers to develop and tailor a liquidity management program to the specific characteristics and needs of each fund. This flexibility has proven to be critically important, avoiding a one-size-fits-all approach that could hinder the management of a fund and negatively impact shareholder returns. In our view, the 2016 reforms are working so effectively that we question whether the new rule proposal is necessary at all. Indeed, the liquidity risk management reforms in the current proposal, while cloaked in a desire to protect shareholders, are so prescriptive and place so many restrictions on the management of funds that they are likely to make mutual funds an unattractive investment option. Together with the proposal's unworkable requirements for swing pricing and a "hard 4 p.m. close," these changes would undermine decades of growth that have made open-end funds a key element of the portfolios of tens of millions of individual investors. It is retail investors who stand to lose the most from this misguided proposal.

Our letter addresses these key points:

- The proposal would dramatically decrease the appeal of mutual funds for individual investors, particularly for retirement savers. The result is likely to be a significant decline in mutual fund usage by individual investors, reducing choice, increasing complexity and ultimately driving investors to other investment options. We believe it is not hyperbole to say that this proposal will completely reshape the fund landscape, harming tens of millions of investors.
- The evidence does not support the Commission's assertion that significant dilution occurs in open-end funds during stressed markets, particularly during the March 2020 volatility that the Commission cites as a key basis for the proposed reforms. Current liquidity management practices have proven sufficient to manage redemptions in volatile markets.
- Swing pricing, in addition to presenting overwhelming (and, to date, unresolved) operational challenges, would result in a significant decrease in transparency for investors, who would not know whether a swing factor was being applied to their transaction until well after they made the transaction request. Therefore, this tool would not have the desired impact on client behavior, though it would be a would be a

fundamental change to the investing experience. We do not believe swing pricing would be an effective remedy for the perceived dilution problem.

- As we argued when it was first proposed in 2003, the so-called "hard 4 p.m. close" would negatively impact tens of millions of individual mutual fund investors who benefit from the advantages that intermediaries provide. In practice, the vast majority of investors would not be able to trade up to the Market Close time, as intermediaries would need to impose a cut-off time well before Market Close. The proposal would be especially harmful to retirement plan participants, virtually all of whom would receive next-day pricing for their mutual fund transactions instead of same-day pricing.
- The proposal would result in a clear advantage for investors who bypass intermediaries and invest directly with the fund, many of which are likely to be institutional investors. These direct at fund investors would be able to trade up until Market Close, potentially taking advantage of late swings in the market, while mutual fund investors who invest through an intermediary would be shut out of the ability to react to such market developments. The resulting imbalance would eliminate the long-acknowledged benefits to investors of mutual fund supermarkets and other intermediaries, effectively reversing 40 years of innovations that have made mutual funds one of the most popular investment vehicles in history. It creates an opportunity for fund arbitrage, increases complexity and confusion for individual investors and will reduce the competitive landscape for mutual funds.
- The Commission's assumptions about how funds manage in volatile markets are flawed and do not reflect the realities of how portfolio managers operate. In particular, the Commission appears to think that all funds manage liquidity in the same way, creating a one-size-fits-all approach to liquidity risk management, with the Commission dictating in minute detail how funds should manage risk. The proposal fails to recognize that funds can have significantly different levels of liquidity risk based on their investment strategies and goals. A fund with a strategy that involves investment in less liquid assets needs to have a different liquidity risk management plan than an equity index fund that consists almost entirely of highly liquid securities. We strongly support the current principles-based framework, which has the flexibility needed for funds to manage risk in the manner best suited to the particular characteristics of the fund.
- Several of the alternatives outlined in the proposal merit further consideration and should be the focus of a joint effort between the Commission and the fund industry to flesh out the details and better assess the impact on individual investors, institutional investors and asset manager operations.

Evidence Does Not Show That Dilution Occurred or That Funds Experienced Liquidity Events

The Commission's rule proposal is based in no small part on the assertion that "the large outflows open-end funds faced in March 2020, combined with the widening bid-ask spreads funds encountered when purchasing or selling portfolio investments at that time, likely contributed to the dilution of the value of funds' shares for remaining investors."[6] Crucially, however, the Commission notes in a footnote that "we do not have specific data about the

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[6] 87 Fed. Reg., at 77178.

dilution fund shareholders experienced in Mar. 2020"[7] and offers the fact that European funds, which saw similar market conditions as the COVID-19 pandemic began, increased their use of swing pricing as evidence that dilution must have been occurring among U.S. funds. This was not CSIM's experience.

We reviewed 2020 fund flow data for all Schwab Funds[8], including equity funds, fixed income funds and multi-asset mutual funds. Over the course of the entire year, there were only five instances, representing 0.03% of all fund/date combinations, in which the flows for any fund on any date exceeded +/- 10% of net assets. Only one of those occasions involved outflows of more than 10% of net assets, and that was 10.8%. The other four occasions involved *inflows* that exceeded 10% of net assets. If we expand the parameters to include all fund/date combinations where flows exceeded +/-5% of net assets, there were 22 occasions, or 0.14%. The majority of those instances took place in or around March 2020. But the rarity of these situations, even in volatile markets, does not warrant a dramatic regulatory response.

In addition, Schwab conducted an analysis of true trade costs, including transaction costs, to determine dilution impact and found that there is no significant correlation between flows and trade costs. Investing always involves transaction costs, whether the investor is trading a share of common stock, shares of a mutual fund or any other investment vehicle. Investors understand this. In our analysis, which included a specific review of March and April 2020, some cases that saw fund outflows resulted in gains to the funds, while in other cases, we did see minimal dilution. Yet other cases showed no measurable trade costs at all.

We recognize that our fund flow experience in 2020 was unique to our particular funds and that other fund families may have experienced higher degrees of liquidity stress due to the characteristics of their funds. As the Commission notes in the proposal, its review of liquidity-related data as reported on Forms N-PORT and N-RN during that period indicated that a majority of funds did not reclassify the liquidity of the assets in their funds. The Commission takes this as evidence that "liquidity risk management program features of some funds adjusted slowly, making them less effective during the stress period for managing liquidity risk."[9] We question whether that is an accurate conclusion. The Commission notes that 83 percent of all mutual funds classify as "highly liquid."[10] It stands to reason that a majority of funds did not reclassify the liquidity of the assets not because of some failing in their liquidity risk management program, but because the bulk of the assets were already highly liquid and did not require reclassification.

The Commission also notes that during the March 2020 period it heard anecdotal concerns from some funds about their ability to manage their liquidity. The Commission, in response to requests from some funds, provided "emergency relief that would provide additional flexibility for interfund lending and other short-term funding to help meet redemptions," but observes in a footnote that "although the Commission provided this relief for a period of time, we understand

[7] 87 Fed. Reg., at 77178.
[8] For the purposes of this letter, "Schwab Funds" refers to mutual funds, since both exchange-traded funds and money market funds are specifically excluded from the Commission's proposal.
[9] 87 Fed. Reg. at 77183.
[10] 87 Fed. Reg. at 77196.

funds did not generally use it."[11] A fund exploring the option of relief does not strike us as an indication of a systemic problem. Rather, it could be an indication of the seriousness with which portfolio managers take liquidity management, and their desire to be prepared for any potential situation. We do not believe that a small number of funds that may have had liquidity concerns particular to their portfolio requesting – but never using – specific relief warrants the radical overhaul to liquidity risk management programs that the Commission is contemplating in the rule proposal.

For these reasons, we do not think the Commission's one-size-fits-all approach to liquidity risk management is appropriate. Asset managers need the flexibility to tailor a liquidity risk management program to the particular needs and circumstances of their funds. The liquidity of securities in large cap equity funds, for example, differs significantly from the liquidity of securities in bank loan funds. Our experience in 2020 is clear: Our liquidity risk management program, strengthened as a direct result of the Commission's 2016 reforms, worked as intended during the 2020 market volatility. Indeed, we believe that fund industry's track record in navigating the market volatility of March 2020 speaks for itself: the current liquidity risk management structure is working. Liquidity is being managed effectively through existing tools such as redemptions in kind, lines of credit, large order notifications, interfund lending programs and shortened settlement of portfolio trades. The Commission has provided little evidence to the contrary.

Swing Pricing Is Not an Effective Tool to Combat Perceived Dilution

At the heart of the Commission's proposal is the requirement that funds employ swing pricing on any day in which a fund has net redemptions or any day on which net purchases exceed 2% of the fund's net assets. This marks the third time in seven years that the Commission has proposed a significant expansion of swing pricing in the U.S. fund marketplace. The Commission first proposed that mutual funds be permitted to use swing pricing to mitigate potential shareholder dilution in its 2015 liquidity risk management proposal,[12] which was finalized in 2016. More recently, the Commission proposed requiring money market funds to use swing pricing;[13] that proposal is still under consideration by the Commission. The Commission has expressed a clear enthusiasm for swing pricing, despite being repeatedly told that the mechanism presents insurmountable operational challenges for U.S. funds.[14] Schwab believes that those operational concerns remain and, as argued above, that shareholder dilution is not a concern that warrants the massive undertaking that developing and implementing a workable version of swing pricing would entail.

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[11] 87 Fed. Reg. at 77182.

[12] Investment Company Swing Pricing (Release Nos. 33-10234; IC-32316; File No. S7-16-15), adopted October 13, 2016. 81 Fed. Reg., at 82084.

[13] Money Market Fund Reforms (Release No. IC-34441; File No. S7-22-21), proposed December 15, 2021. 87 Fed. Reg., at 7248.

[14] See Schwab Comment Letter, Money Market Fund Reforms (Release No. IC-34441; File No. S7-22-21), April 11, 2022, at 8. ("Schwab Money Market Fund Comment Letter".) Available at https://www.sec.gov/comments/s7-22-21/s72221-20123438-279687.pdf. See also Schwab Comment Letter, Open-End Fund Liquidity Risk Management Programs and Swing Pricing (File No. S7-16-15), January 13, 2016, at 14. Available at https://www.sec.gov/comments/s7-16-15/s71615-44.pdf.

Throughout this proposal, the Commission references swing pricing as a "commonly employed anti-dilution tool in Europe"[15] and seems frustrated that the U.S. mutual industry has not embraced swing pricing. Swing pricing is a mechanism by which a fund adjusts its current net asset value ("NAV") so that some of the cost of redeeming a share is borne by the redeeming shareholders, not solely by the investors remaining in the fund. As noted above, the Commission adopted a rule in 2016 permitting U.S. funds to implement swing pricing. At the time, the Commission noted, "We appreciate…concerns that swing pricing may have costs that, for some funds, may not be justified by the benefits….Accordingly, we believe that the use of swing pricing by funds as an anti-dilution tool at this time should be optional rather than mandatory, and are adopting this permissive approach."[16] Yet, in the current release, the Commission complains that "despite over five years passing since adoption, the industry has not developed an operational solution to facilitate implementation of swing pricing, nor have individual market participants."[17] As numerous commenters have pointed out[18], there are significant differences between the European mutual fund system and the U.S. mutual fund industry – most notably the fact that the NAV is struck for U.S. mutual funds at the end of the day while in Europe the NAV is struck the next day – that make swing pricing operationally challenging to implement in the U.S., as well as unfair to individual investors. The Commission's solution to these challenges is to blame the industry for moving too slowly and to mandate swing pricing as a means to force it on U.S. investors, without providing empirical evidence that dilution is a widespread issue in the U.S. or proposing workable solutions to the long-standing operational challenges.

The Commission's proposal for swing pricing would require the calculation of a swing factor for every day that a fund has net redemptions, no matter the size, and for every day that a fund has net purchases above 2%. This creates an unnecessary burden of work to make these complicated calculations. We believe that on the vast majority of days that have net redemptions, the delta between redemptions and inflows is small and a swing factor will not be necessary. Yet fund staff will have to calculate and publish a swing factor, even if that swing factor is zero. This process is likely to be confusing to investors. We also expect this process would result in an even later time for publishing that day's NAV, to allow for the determination to be made as to whether a swing factor will be applied. As other commenters have noted, a calculation of a swing factor on every day that has net redemptions is out of step with the European model that the Commission purports to be emulating.[19]

The proposal also would require that a fund calculate the swing factor by making a good faith estimate of the costs the fund would incur if it sold a *pro rata* amount of each investment in its portfolio, also known as a "vertical slice" of the portfolio. We believe the Commission's assumption that a fund that sees 2 percent net redemptions would react to that by selling a 2 percent vertical slice of the portfolio is flawed. The very essence of the job of a portfolio manager is to always best position the fund to maximize returns. Portfolio managers facing net redemptions will look to sell securities efficiently, taking into consideration what's happening in

[15] 87 Fed. Reg. at 77177.
[16] 81 Fed. Reg. (November 18, 2016), at 82092.
[17] 87 Fed. Reg., at 77177.
[18] See, e.g., Comment Letter of David Blass, General Counsel, Investment Company Institute, Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release (File Nos. S7-16-15 and S7-08-15), January 13, 2016.
[19] See, e.g., Comment Letter of the Securities Industry and Financial Markets Association Asset Management Group (SIFMA AMG) and Comment Letter of the Investment Company Institute (ICI), as submitted to the current comment file.

the broader markets at the time, the performance of specific underlying securities, the tax consequences, the trading costs, the overall liquidity of the portfolio and many other factors. Their analysis of how best to manage redemption requests will never be to simply match the requests by selling a vertical slice of the portfolio. The Commission further justifies mandating how the swing factor would be calculated by assuming that a portfolio manager would sell only highly liquid investments, which "generally would not account for the effect of leaving remaining investors with a less liquid portfolio or potential longer-term rebalancing costs."[20] Again, the role of a portfolio manager is to manage the portfolio in as efficient a manner as possible, both in the moment and over the long term. We think the Commission underestimates the ability of portfolio managers to manage changing market circumstances.

As Schwab articulated in its 2022 comment letter[21] regarding the Commission's proposal to require swing pricing for money market funds, swing pricing would create a significant lack of transparency for investors, who would not know whether a swing factor was being applied to their redemption until well after they made the redemption request – and after any opportunity to cancel the order if the investor does not want to make the redemption with a swing factor applied. We continue to question how an investor would be deterred from redeeming if the investor was not aware of whether the redemption would receive the calculated NAV or an NAV reduced by a swing factor. The fact that a swing factor *might* be applied to a mutual fund transaction would likely make mutual funds less attractive as an investment option to other types of investments, such as exchange-traded funds, where there is no risk of a swing factor being applied.

Schwab does not believe that shareholder dilution is an issue that requires a massive Commission intervention, as has been proposed. In our experience, dilution concerns can be mitigated with existing tools, including redemptions in kind, large order notification, redemption fees and extended settlements.

The Hard 4 p.m. Close Would Unnecessarily Disadvantage Millions of Fund Investors and Result in a Dramatic Transformation of the Mutual Fund Ecosystem

Another concerning aspect of the Commission's proposal is the requirement "that the fund, its transfer agent or a registered clearing agency…would have to receive the order before the pricing time, which is typically 4 p.m. ET."[22] Due to the nature of the processing of mutual fund transactions by intermediaries, the proposal would require investors to submit orders well before the Market Close of 4 p.m. Eastern Time in order to receive that day's price. The proposal hearkens back to the Commission's 2003 proposal on the pricing of mutual fund shares,[23] which was considered but never adopted. At the time of the 2003 proposal, Schwab pointed out that it was a 1997 No-Action Letter from Commission staff that stated that a customer order may be deemed as having been received by a fund in accordance with Rule 22c-1 of the Investment Company Act of 1940 if it was received by an intermediary, such as a brokerage firm or a

[20] 87 Fed. Reg., at 77205.
[21] Schwab Money Market Fund Comment Letter, at 8.
[22] 87 Fed. Reg., at 77184.
[23] 68 Fed. Reg. (Amendments to Rules Governing Pricing of Mutual Fund Shares, Release No. IC-26288; File No. S7-27-03), December 17, 2003.

retirement plan recordkeeper, prior to Market Close.[24] As a direct result of that interpretation, most funds continue to this day to receive the vast majority of their orders each day as aggregated orders from intermediaries after Market Close. The Commission considered but ultimately decided against changing that interpretation in 2003 after facing a storm of criticism.

In the two decades since the Commission's ill-advised 2003 proposal, mutual funds have grown enormously, from $7.4 trillion in assets in 2003 to nearly $27 trillion in assets at the end of 2021.[25] As a result, the negative impacts to individual investors, as well as to funds themselves, of the potential imposition of a hard 4 p.m. close have grown even larger. Among the most significant impacts are:

- *Earlier cut-off times for mutual funds as opposed to other types of investments will make mutual funds an unattractive investment option.* A requirement that funds must receive all orders prior to Market Close would force intermediaries to establish an earlier cut-off time for individual investors, such as 2 p.m. Eastern Time (11 a.m. on the west coast and even earlier in Alaska and Hawaii) to give the intermediary sufficient time to process purchase and redemption orders before submitting them to the fund, its designated transfer agent or a registered clearing agent by Market Close. Investors would thus have different cut-off times for different types of investments, creating confusion for investors and a competitive disadvantage for mutual funds. If there is news in the window between the earlier cut-off time and Market Close, mutual fund investors would be unable to alter a previously entered order or place a new order in reaction to the news. They would receive the next day's price. Investors could lose confidence in mutual funds if, for example, they are unable to sell in a declining market until the next day. Equities, exchange-traded funds, closed-end funds and bank collective trust funds all would continue to accept orders up to Market Close. Mutual funds will simply become a less attractive investment option for most investors. We do not believe that regulators should create rules that provide advantages for certain types of investments over other types of investments.
- *Discourages investing through intermediaries.* With intermediaries forced to have an earlier cut-off time, the hard 4 p.m. close proposal would create a strong disincentive to investing in mutual funds through intermediaries. Intermediaries like Schwab have evolved to meet customer demand for consolidation of their investments in one place. Investors over the years have become used to investing in mutual funds through a broker-dealer and seeing their investments from multiple asset managers through that intermediary. Investors log into a single website, see their entire portfolio on a single web page, and receive a single statement and consolidated tax reporting. This also allows an investor to better manage their asset allocation and determine how a particular investment fits into their broader strategy. The proposal would upend this consolidated experience. We believe strongly that the Commission should not adopt a regulatory change that discourages investors from investing through intermediaries.

[24] Charles Schwab & Co., Inc. No-Action Letter, July 7, 1997. Available at: https://www.sec.gov/divisions/investment/noaction/1997/cschwab070797.pdf).

[25] *2004 Mutual Fund Fact Book*, Investment Company Institute (available at: https://www.ici.org/doc-server/pdf%3A2004_factbook.pdf), at 1; *2022 Investment Company Fact Book*, Investment Company Institute (available at: https://www.icifactbook.org/pdf/2022_factbook.pdf), at 45.

- *Drives investors to invest directly with a fund, though for many funds that is not an option for retail investors.* The proposal would encourage investors to have numerous accounts at different fund families in order to take advantage of the full trading day. But we do not believe this is a realistic outcome for retail investors. In our experience, direct at fund investors typically are larger institutional investors. In fact, many fund families – Schwab Funds included – no longer permit individual investors to open an account directly with the fund. The rule would create an opportunity for fund arbitrage, particularly by institutional investors that would be more likely to maintain relationships with hundreds of fund families, directly harming the retail investors that the rule is ostensibly seeking to protect. Investors who invest directly with the fund would effectively have a "last mover advantage," since they would have access to more market information and have more time to react than retail investors and retirement plan participants facing an earlier cut-off time.
- *Results in fewer investors receiving the benefits of mutual fund supermarkets.* The proposal would also reduce the many positive aspects of mutual fund supermarkets that have developed over the last four decades. Mutual fund supermarkets have become enormously popular primarily because they allow investors to comparison shop among funds offered by different fund families. At Schwab and other broker-dealers, supermarkets are able to give investors advice to assist them in choosing funds that best meet their needs, often exposing investors to fund choices they may not even be aware of. This comparison shopping encourages robust competition in the fund industry, which puts downward pressure on operating expense ratios and other costs, to the benefit of the investor. We believe strongly that forcing investors out of mutual fund supermarkets would lower their returns.
- *Increases costs for individual investors.* We also believe that moving to a hard 4 p.m. close would raise costs for investors because it would raise costs for mutual fund companies and those costs would be passed along to shareholders. As noted, most mutual funds receive the vast majority of their orders through intermediaries. Since the intermediary is aggregating all of its client orders into a single order that is sent to the fund company, a fund receives a relatively small number of orders. Many fund companies would likely have to build substantial infrastructure to handle thousands of individual orders from direct shareholders – and the cost of building and maintaining that infrastructure is likely to be passed on to investors. This is not even considering the costs that a transfer agent would charge the fund for account opening and maintenance of those direct shareholder accounts, including processing applications, performing Know Your Customer and other anti-money laundering reviews, delivering statements, providing tax reporting, and delivering fund proxy statements and other regulatory documents. This would be particularly disadvantageous to smaller and newer fund families, which may not have the means to build that infrastructure nor the means to compete with large, established fund companies through advertising and other forms of investor outreach to attract investors. We believe that the end result would be a decrease in competition and significant consolidation in the mutual fund industry.

Hard 4 p.m. Close is Unworkable for Retirement Plans.

A hard 4 p.m. close would have particularly dramatic negative impacts on retirement plan participants. According to the Department of Labor's Employee Benefits Security Administration, in 2020 there were more than 110 million participants in a defined contribution plan through their workplace, with more than $8.3 trillion in assets.[26] Mutual funds are a core element of almost every defined contribution plan. The proposal for a hard 4 p.m. close would create profound disruption in the retirement plan space, harming these participants' ability to save for retirement.

If a hard 4 p.m. close is imposed, it is likely that retirement plan participants would have an even earlier cut-off time – perhaps as early as 11 a.m. Eastern Time (or 8 a.m. on the west coast), because of the added complexity of aggregating and pricing orders at the individual and the plan level. For an investor who has both a brokerage account and a retirement plan, this could mean three different cut-off times – one for her equity holdings, one for her mutual fund holdings, and one for her mutual fund investments in her retirement plan.

Moreover, the proposal would likely mean that retirement plan participants would no longer be able to execute same-day exchanges from one fund family to another fund family. Today, plan participants frequently request to sell assets from one fund option in the plan and use the proceeds to buy shares of another fund option in the plan. It is unlikely that this would be possible under the Commission's proposal because the ability to process the purchase and redemption the same day relies on receiving that day's NAV before processing the exchange. More likely, the sell order would be executed on the day the order is placed (if received by the intermediary's cut-off time) and the corresponding buy order would be executed on the day after the request is made. Final settlement would occur the day after that – so participants would likely not have confirmation of the result of their request until 2 or even 3 days after the transaction request is made. This situation would also result in a participants' money being "out of the market" for the day in between the execution of the sell and buy orders – potentially frustrating investors who wish to sell in a declining market or buy in a rising market.

As a result of these challenges for the operation of retirement plans, a hard 4 p.m. close could raise questions about whether a retirement plan sponsor is fulfilling its fiduciary duty to participants. Plan sponsors would likely have to seriously consider eliminating mutual funds entirely as an investment option in retirement plans in favor of exchange-traded funds or other investment vehicles in order to ensure that participants can trade until Market Close.

Alternative Approaches Merit Further Consideration

The Commission does outline in the rule proposal a number of alternatives to the combination of swing pricing with a hard 4 p.m. close. However, the short comment period allowed by the Commission has not given sufficient time to do the work necessary to explore these alternatives in order to provide the Commission staff with a fair assessment or a recommendation. We would

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[26] Employee Benefits Security Administration, Private Pension Plan Bulletin: Abstract of 2020 Form 5500 Reports, October 2022, at 7. Available at https://www.dol.gov/sites/dolgov/files/EBSA/researchers/statistics/retirement-bulletins/private-pension-plan-bulletins-abstract-2020.pdf.

support further industry analysis of ideas like a dynamic liquidity fee, requiring large order notifications and other ways to enhance transparency for investors about the liquidity of a fund.

The Commission's Proposed Changes to Liquidity Risk Management Programs Reduce Flexibility and Create a One-Size-Fits-All Approach That Does Not Reflect Real World Fund Management Practices

The Commission has also proposed a series of changes to liquidity risk management programs, including significant updates to the process for making liquidity determinations, an overhaul of the system of classifying the liquidity of assets, and mandating new liquidity requirements for funds. The proposal would also change and expand the reporting requirements on Form N-PORT. Unfortunately, as with other elements of the Commission's proposal, these changes stem from a flawed assumption by the Commission that liquidity risk management programs are failing to work today. As noted above, none of the Schwab Funds[27] experienced liquidity stress during 2020. We believe our liquidity risk management program worked as intended. Further changes will not benefit retail investors.

As we discuss below, the proposed changes restrict the flexibility that we believe is central to a successful liquidity risk management program. They also suffer from a misunderstanding of how portfolio managers operate in the real world, resulting in a one-size-fits-all approach that assumes all funds are managed in the same way. On the contrary, the lack of program flexibility, the unrealistically conservative parameters, the required increase in highly liquid holdings and the likelihood that more assets will misleadingly be reclassified to lower liquidity tiers will detract from the retail investor experience by reducing returns and limiting investing options. Additionally, larger open-ended portfolios may bump up against conservative fund asset caps and be restricted in investment selection based on their liquidity profile.

First, the Commission proposes to revise the current requirement that a fund must use a "reasonably anticipated trade size" (which has become known in the industry as "RATS") standard when determining the liquidity of its portfolio. Instead, the Commission would require a hyper-specific "stressed trade size" that assumes "the sale of 10% of the fund's assets by reducing each investment by 10%."[28] This is an example of the Commission taking an element of current liquidity risk management programs that can be tailored to the specific characteristics of every fund and instead mandating an arbitrary standard. As noted above, Schwab Funds experienced a movement of greater than 10% of assets on just five occasions in the entire year of 2020 – 0.03% of the time – and on none of those occasions were there any concerns about the liquidity of any of the funds. In our view, the 10% standard is unreasonably high. In the Commission's own economic analysis, it found that *weekly* fund outflows of 6.6% occurred approximately one percent of the time over the period from 2009 through 2021.[29] Outflows of 10% or more, even over the course of a week, are exceedingly rare across all funds, particularly larger funds. We question how the Commission can point to this as evidence that a 10% outflow should be the baseline standard for determining the liquidity of a fund. Again, larger funds are at a disadvantage over smaller funds due to the prescriptive "RATS" when in practice larger funds

[27] "Schwab Funds" excludes money market funds and exchange-traded funds. See footnote 8.
[28] 87 Fed. Reg., at 77187.
[29] 87 Fed. Reg., at 77245.

tend to have more options to generate liquidity through cash management. Also, pro rata trading is rarely the norm to meet redemptions. Our recommendation is that the Commission maintain the current "RATS" framework because it allows for a more precise and meaningful liquidity estimation through an empirical, product-specific analysis.

Second, the Commission proposes to consolidate the four "liquidity buckets" that were established by the 2016 Liquidity Rule into three buckets by eliminating the "less liquid investment" bucket. The proposal also redefines an "illiquid investment to include investments whose fair value is measured using an unobservable input that is significant to the overall measurement."[30] As with other elements of the proposal, the Commission cites the March 2020 market volatility as the reason for these changes, noting that "open-end funds faced a significant amount of investor redemptions" and that it believes "additional changes…would assist funds in managing investor redemptions in future stressed conditions."[31] Of course, "facing" a significant amount of investor redemptions is not the same as failing to meet those redemption requests, and, as has been established, no funds in March 2020 were unable to meet redemption requests. The Commission notes in particular that the most common investment in the current "less liquid" category is bank loans, but acknowledges that bank loan funds were able to meet redemption requests during the March 2020 market turmoil. Nevertheless, without any evidence that the category is hindering the ability of funds to meet redemption requests, the Commission is proposing eliminating the category. The result would be to characterize more assets as illiquid. We believe this would unnecessarily alarm investors, who might believe their investment is less liquid than it really is.

Similarly, we have concerns with treating all Level 3 investments as illiquid. The proposal would include in the definition of an illiquid security "investments whose fair value is measured using an unobservable input that is significant to the overall measurement."[32] Yet this definition conflates fair valuation with illiquidity, failing to recognize that there are situations in which a large portion of securities are required to be fair valued that have nothing to do with the liquidity. In fact, the Commission acknowledges in the proposal that "observability is a valuation concept and may not always correspond to liquidity."[33] This change has the potential to create large increases in illiquid investments during certain market closures (such as weather events). If these valuation events were to occur over a month or reporting period end, they could increase the percentage of illiquid securities in a fund for reasons unrelated to the liquidity of the fund. This, in turn, would create enormous investor confusion if their normally highly liquid investment was unexpectedly deemed illiquid.

Third, the Commission proposes to set a specific minimum value impact standard "that defines more specifically what constitutes a significant change in market value."[34] Under the proposed definition, the market value of an investment would be considered significantly changed when "any sale or disposition of more than 20% of the average daily trading volume of those shares, as measured over the preceding 20 business days"[35] for listed securities and "a decrease in sales

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[30] 87 Fed. Reg., at 77191.
[31] 87 Fed. Reg., at 77190.
[32] 87 Fed. Reg., at 77191.
[33] 87 Fed. Reg., at 77192.
[34] 87 Fed. Reg., at 77188.
[35] 87 Fed. Reg., at 77186.

price of more than 1%" for over-the-counter securities. Again, this strikes us as unnecessarily specific and prescriptive. As every investor knows, historical data is not always a great predictor of the future. This lack of flexibility may result in misleading liquidity classifications. Vendors will still have differing market data inputs for the calculations, limiting the intended standardization of classifications. Various investment types actively trade above the proposed minimum value impacts with high degrees of liquidity. Also, daily trading data for fixed income is not always readily available. One size clearly does not fit all.

Fourth, the Commission proposes requiring all funds, regardless of investment strategy or portfolio components, to maintain a minimum of 10% of the fund's assets in highly liquid assets (the "Highly Liquid Investment Minimum" or "HLIM"). Currently, the vast majority of funds primarily invest in highly liquid assets and are therefore not required to maintain an HLIM. Here, again, is an instance in which the Commission has steered to a one-size-fits-all solution, by requiring all funds to adhere to a regulator-mandated standard. Moreover, as we noted above with regard to the stressed trade size proposal, a 10% requirement seems arbitrary, given that such a level of redemptions is so exceedingly rare. The requirement could, for certain funds, require a significant and ongoing change to the portfolio, potentially reducing investor returns, in service to the possibility of a level of redemptions that even the Commission acknowledges is exceedingly rare. Mutual funds would be at a clear disadvantage when compared to exchange traded funds as HLIMs are not required for in-kind ETFs. We recommend retaining the current rule, which allows funds to make their own decisions about highly liquid investment minimums based on the particulars of each fund.

Finally, the Commission proposes requiring funds to increase the amount of information reported on Form N-PORT, increase the frequency of Part F of Form N-PORT reporting and make more of the information in those reports available to the public monthly. We believe that the resources necessary to meet all of the proposed reporting changes will significantly increase costs for funds – costs that are likely to be passed on to shareholders. The proposal requires funds to provide monthly detailed holding reports, completed in a prescriptive format in accordance with Regulation S-X, which requires U.S. Generally Accepted Accounting Principles (GAAP) adjustments. It is unclear to us how this complex information will be beneficial to investors. We recommend leaving the current reporting regime in place. To the extent that the Commission believes a shorter filing period for Form N-PORT would be beneficial to its monitoring of fund level liquidity and swing pricing factors, we recommend that the reports be required in no less than 45 days after month end, rather than the 30 days required by the rule proposal.

Conclusion

Schwab's typical approach to commenting on Commission rule proposals over the years has been to acknowledge aspects of the proposal we support and suggest alternatives to elements of the proposal that we think are flawed and can be improved. Unfortunately, we find little in this proposal to support and do not believe that the issues we have identified with the proposal can be addressed without a fundamental rethinking of the Commission's goals, nor do we believe that the Commission has provided persuasive data supporting its assumptions in developing the proposal. We believe the basic premise of the proposal – that current liquidity risk management programs are inadequate and that a major overhaul of the way mutual funds work for investors is the only way to address that – is fundamentally incorrect. Our experience, even in the volatile markets of March 2020, provides no evidence that significant dilution is occurring or that investors are being harmed by liquidity shortfalls in mutual funds.

The Commission has proposed a series of reforms that we believe will not only fail to strengthen mutual funds but will dramatically reduce the appeal of mutual funds for individual investors. Adoption of the proposal in its current form will, in our view, hasten the demise of the mutual fund, an investing vehicle that has thrived for more than 80 years. The one-size-fits-all approach is so prescriptive, so operationally challenging, and so unfriendly to investors that we question how long the mutual fund industry would be able to survive under these rules. There are clearly other investment products, particularly exchange-traded funds, that would be much more appealing options for individual investors than mutual funds under the kinds of requirements the proposal envisions. Advisers would need to carefully consider the impact an earlier cutoff time, well before Market Close, might have on advice interactions and recommendations in light of other products that can be traded until U.S. markets have closed. We fear the Commission's approach to mutual funds in this proposal is akin to the famous quote from the Vietnam War: "We had to destroy the village in order to save it."

We therefore encourage the Commission to work with the industry to develop less intrusive, principles-based options that will strengthen investor protections without creating a one-size-fits-all series of mandated reforms that will result in mutual funds investors fleeing these products in droves.

Thank you very much for the opportunity to offer our perspective on these issues. We would be happy to answer questions or provide any additional information as the Commission continues to explore this topic.

Sincerely,

Rick Wurster

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