GARP | Global Association of Risk Professionals

January 12, 2016

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release

File Number S7-16-15

Response to Proposal to SEC on Swing Pricing and Transparency for Omnibus Accounts

Dear Mr. Fields:

I. Summary

The Global Association of Risk Professionals (GARP)[1], in consultation with its Buy-Side Risk Managers Forum Swing Pricing Sub Committee[2] (Swing Pricing Committee or Committee), reviewed the SEC's proposed Liquidity Risk Management guidance with the objective of responding to the SEC's request for comments. The comments herein are based on, among other things, feedback from the Committee's participants who reviewed in detail the many issues raised to implementing swing pricing for open-ended funds in the U.S., and the proven benefits the adoption of swing pricing would bring to investors and the marketplace.

Specifically, GARP is providing comments on two aspects of the proposed rule: 1) the adoption of swing pricing; and 2) liquidity risk management for fund liabilities (i.e., the redeemable equity claims of individual mutual fund investors).

[1] The Global Association of Risk Professionals (GARP), http://www.garp.org, is a not-for-profit global membership organization dedicated to preparing professionals and organizations to make better-informed risk decisions. The GARP community represents over 150,000 risk management practitioners and researchers from banks, investment management firms, government agencies, academic institutions and corporations from more than 195 countries. GARP's mission is to educate, train and set global standards in financial and energy risk management. The association administers the Financial Risk Manager (FRM®) and Energy Risk Professional (ERP®) exams; certifications

management via comprehensive professional education and training for professionals of all levels.

[2] The Swing Pricing Committee consisted of: AllianceBernstein, BlackRock, Deutsche Asset Management, Goldman Sachs Asset Management, J.P. Morgan Asset Management, Neuberger Berman, Nuveen Fund Advisors, LLC, MFS Investment Management, Oppenheimer Funds and Western Asset Management.

II. Swing Pricing

GARP, and the Swing Pricing Committee, evaluated in detail the SEC's proposal on swing pricing and strongly agrees with the proposal to allow U.S. open-end mutual funds to employ swing pricing on a voluntary basis. However, significant operational challenges exist today which will likely impede the broad adoption of swing pricing by U.S. open-end mutual funds without material changes to the existing mutual fund-related infrastructure. To this end, the Committee met several times to identify and discuss the current operational challenges, develop approaches which may form the basis for further discussions among industry stakeholders to allow for the successful implementation of swing pricing in the U.S. mutual fund industry, and to set out a preliminary proposal, based in part on the successful implementation of swing pricing in Europe, that may allow for the voluntary adoption of swing pricing for open-ended U.S. mutual funds.

As a result of these discussions, we are describing herein a "roadmap" for evolving the US infrastructure to enable swing pricing. Making these changes will take time, and will involve significant expenditures for fund companies, fund distributors, and fund service providers alike, all of which will need to be explored further by the SEC through broader engagement with relevant stakeholders. While the changes suggested in the proposal outlined in this letter will in all probability result in material implementation costs for industry participants, it is our belief that the long-term benefits of enabling swing pricing for U.S. open-end mutual funds outweigh the one-time costs related to implementation for industry participants.

We would like to make you aware that our analysis of swing pricing and the recommendations herein, including the strong recommendation to move forward with the proposal to employ swing pricing for U.S. open-end mutual funds, were based in part on the policies, governance and investor considerations set forth in the December, 2015 Association of the Luxembourg Fund Industry (ALFI) guidelines[3]. The ALFI guidelines objectively address many of the issues raised in the SEC's request for comment as they relate to these areas of importance surrounding the adoption and implementation of swing pricing. We urge the SEC to consider them when promulgating its rules and other guidance related to swing pricing.

Swing pricing results in a number of benefits to end investors and contributes to systemic stability. These benefits and contributions include, but are not limited to, the following.

1) Protecting investors from market effects associated with the current U.S. mutual fund practice of allocating transactions costs to all investors in a mutual fund (based on units of ownership) versus properly aligning transaction versus either redeeming or subscribing investors.
2) Providing a price signal to mutual fund investors based on the transaction and market impact costs their subscriptions and redemptions create. This price signal should attenuate pro-cyclical behavior (i.e., by reducing first mover advantage).
3) Reducing perceived (by some) systemic risks associated with open-end funds (i.e., run on funds).

[3] http://www.alfi.lu/sites/alfi.lu/files/Swing-Pricing-guidelines-final.pdf.

EMEA Swing Pricing – Historical Context

The European (EMEA) mutual fund sector adapted market practices to allow swing pricing to be adopted by open-end funds[4]. As a result, swing pricing has been increasingly used[5] effectively and successfully in EMEA as part of the daily Net Asset Valuation (NAV) process for many years to eliminate the dilutive effect of redemptions and subscriptions on long-term investors in open-end funds. Their experiences have shown that swing pricing can reasonably allocate the costs of fund redemptions and subscriptions to transacting investors (i.e., bid-offer spreads and other fees) if administered using proper governance and disclosure policies (See, ALFI guidelines).

In EMEA, swing pricing is feasible operationally as "actual" trade flows based on estimated prices and trades occurring on the trade date (T) are available on a timely basis on T, providing the information necessary to appropriately swing the NAV of a fund. Individual fund dealing cut-offs for redemptions and subscriptions are generally between 11:00 A.M. and 12:00 P.M. GMT, with valuations and pricing occurring starting around 4:00 P.M. GMT. This "early" dealing cut-off provides sufficient time for funds to obtain final trade flows from internal systems (i.e., for self-administered funds) or from trading platforms of third party distributors (e.g., dealers, retirement plan record-keepers, clearing firms). Trading platforms collect all of that day's activity and supply it to the fund's transfer Agent (TA) where the TA then applies an estimated fund price to generate "estimated" trade values for that trading day. Those values are then passed on to the TAs to aggregate and send estimated subscription and redemption data to the fund manufacturers, enabling them to make a swing pricing decision on T. Once swing pricing decisions are made the "actual" fund prices are released to the TAs and the distributors for them to create final trades for that day's activity.

U.S. Mutual Funds – Operational Issues Affecting Swing Pricing

Ideally, U.S. open-end mutual funds should have the ability to implement swing pricing in a manner analogous to the EMEA model described above. However, there are existing operational and infrastructure support differences in the U.S. versus EMEA that prevent replicating the EMEA approach. Specifically, in the U.S., trade flows are generally not available for funds that are sold via third party distributors until early the morning of T+1. This is due to a variety of factors, including:

- Currently under prospectus guidelines, redemptions and subscriptions may be submitted by investors to the TA or to the third party distributors, as agents for the funds, up until 4:00 P.M. ET (versus 11:00 A.M. to 12:00 P.M. GMT in EMEA), which has defined the investor experience to date, a very important consideration in implementing swing pricing as noted below. However, for the reasons set forth in the immediate following bullet points, simply changing prospectuses would not allow the U.S. mutual fund industry to replicate the EMEA approach;

[4] EMEA funds generally use "partial" swing pricing, whereby the NAV is swung when net subscriptions or redemptions exceed specified % threshold(s) of NAV.
[5] See ALFI Survey results. http://www.alfi.lu/sites/alfi.lu/files/ALFI-Swing-Pricing-Survey-2015-FINAL.pdf

- Legacy system constraints and the batch nature of technology systems supporting TAs and other fund service providers (i.e., systems rely on batch computing processes for data aggregation and reporting);
- Certain platforms of third party distributors (e.g., retirement plan record-keepers, insurance companies, trust companies) require that actual fund prices are received before making trade allocations across accounts; and
- The majority of fund trades flow through National Securities Clearing Corporation (NSCC) or Defined Contribution Clearance & Settlement (DCC&S) which introduces an additional layer of feeds and flow processing.

Currently, without trade flows at end-of-day on T, U.S. fund managers lack the requisite data to determine whether the NAV of a fund should be swung based on net redemptions or subscriptions that exceed prescribed thresholds.

Swing Pricing Implementation Roadmap for U.S. Mutual Funds

In order to implement swing pricing, U.S. mutual fund managers would require access to trade flows occurring on T. Two potential alternatives were evaluated that would allow for earlier fund manager access to trade flows to make swing pricing decisions.

Alternative 1: Implement an Earlier Trade Date Flow Cut-Off Time: Follow the EMEA approach and require "actual" trade date flows at an earlier cutoff (e.g., between 12 P.M. and 2 P.M. ET) to allow for leveraging the prior day's NAV to generate an estimated impact; or

- **Analysis and Conclusions:** Following EMEA market practice would essentially require moving dealing cut-offs from 4:00 P.M. ET to an earlier time (e.g., 12:00 P.M. to 2:00 P.M ET). This approach works in EMEA. As such, a number of ways to obtain earlier estimates of actual trading flows to allow trade date flows to be used to determine whether to swing the NAV of a fund were evaluated. It was found that obtaining earlier estimates of sufficient trade flows would be difficult given the fact that TAs and platform providers do not have a complete set of flows until approximately 4:00 P.M. ET (i.e., only partial flows could be provided earlier in the day). The strong view was that partial flows would not be sufficient to accurately determine whether to swing the NAV of individual funds. Further, there is a long history in the U.S. mutual fund market of providing clients the flexibility to submit redemption and subscription requests up until 4:00 P.M. ET (fund valuation point). We are very concerned about markedly changing the investor experience and ability to redeem or subscribe in funds up until the close of the U.S. equity markets. Among other reasons, swing pricing should be introduced in a way that is not overly disruptive to the end investor. As such, this alternative was ultimately dismissed as not viable.

Alternative 2 *(Proposed Roadmap)*: Use Actual Flows on T and Prior Day NAV: Use "actual flows entered on T before 4 P.M. ET, leverage the prior day's NAV to generate an estimated impact, and push the NAV release to later in the evening.

- **Analysis and Conclusions:** We were concerned about presenting a positive and constructive roadmap from which to build for adopting swing pricing in the U.S. mutual fund industry. As such, it was concluded that the most viable approach which could be proposed at this time would involve shifting the NAV calculation time to later in the day on T and asking TAs and other providers of fund flows to send estimated flows on the evening of T. Notably, this approach has

a number of downstream impacts on third party service providers, including fund administrators, TAs, dealers, insurance companies, trust businesses, 401K retirement plan administrators and the NSCC which are noted in the details of the proposal below.

Using the proposed roadmap (Alternative 2) as a foundational approach to implementing swing pricing in the U.S., the following principal elements would need to be adopted by the SEC to allow swing pricing to be implemented for U.S. open-end funds.

1) Define an "estimated" flow as a subscription or redemption executed on T prior to the prospectus cutoff using the prior day's NAV to create a capital flow into a fund.
2) Maintain dealing cut-off for redemptions and subscriptions at 4:00 P.M. ET as is current market practice.
3) Require providers of fund flows (e.g., TAs, dealers, retirement plan record-keepers, trust companies) to provide "estimated" trading flows occurring on T by 6:00 P.M. ET.
    a. This change would require one-time changes to systems and processes for these third party providers. Manufacturers (i.e., asset managers) would also need to modify their systems to receive these flows.
4) Leverage the existing NSCC pipes to allow third party distributors to send estimated flows to TAs and downstream to fund managers by 6:00 P.M. ET.
    a. This requirement would require system changes by the NSCC to run an early batch of fund flows.
5) Shift the NAV publication time from 6:00 P.M. ET to 8:00 P.M. ET (bypassing the 6:00 P.M. newspaper cut off for publishing prices, recognizing technological advances obviate reliance on this historical practice).
    a. This shift in NAV publication time would also require process changes for third parties involved in publishing and/or consuming the end-of-day official NAVs (e.g., fund administrators, transfer agents, other third party service providers). It would also impact the distribution of funds (such as fund-of-funds providing NAVs to other distributors).
6) Provide a safe harbor to allow fund managers to rely on "estimated" flows and actual prices occurring on T to determine whether to swing the NAV of a fund and calculate the swung NAV by 8:00 P.M. ET. [6]
7) Provide a safe harbor to also allow fund managers the option to adjust the prior day NAV to reflect market movements relative to fund benchmarks which may occur post fund valuation for the purpose of determining whether to swing the NAV. Such adjustments will enhance precision on swing pricing decisions (i.e. capture situations where market moves would result in a swing pricing threshold being exceeded, thus swinging the NAV for the trading day).
8) Maintain the existing batch process and feeds of "final" flows from third party distributors through the NSCC to TAs and fund managers.
9) Continue to rely on "final" flows for actual trading (i.e., redemptions and subscriptions) that will take place on T+1 in the market.

    As noted in #7 above, actual (i.e., final) flows occurring on T will vary slightly from "estimated" flows used to swing the NAV of individual funds. Thus, SEC rules/guidelines on swing pricing would need to ensure that fund managers will not

[6] The time may need to be extended for more complex funds such as fund of fund structures.

be held liable for decisions made in good faith to swing the NAV of a fund based on "estimated" flows that would vary from the decision made using actual fund flows.

10) Mandate a two year (24 month) lead time for fund service providers and fund manufacturers to modify systems and processes to support estimated cash flows by 6:00 P.M. ET and NAV publication by 8:00 P.M. ET to facilitate swing pricing.

Proposed SEC Rule 22c-1(a) (3) (i) (A)

Further to the above, following a lengthy discussion considering the various operational and practical issues related to implementing swing pricing, the Swing Pricing Committee fully supported the "reasonable inquiry" standard expressed in proposed SEC Rule 22c-1(a) (3) (i) (A). For funds distributed through intermediaries, the process of determining swing pricing will necessarily involve receiving and evaluating net purchase and share activities as communicated through intermediaries. Because of operational and timing considerations, many of these will be preliminary estimates that funds will require in order to determine whether swing thresholds are met.

Financial Intermediaries

SEC swing pricing provisions should also incorporate additional requirements for financial intermediaries (as defined in Rule 22c-2)[7] to provide, at the request of a fund, timely estimates of the net purchase or redemption activity to support the fund's reasonable inquiry. This requirement would assist funds in carrying out their inquiries and help ensure implementation of an appropriate swing pricing mechanism. As is the case for redemption fees under Rule 22c-2, a rule requiring the provision of estimates if requested is important to ensure financial intermediaries actually do provide the requested information on a timely basis.

Conclusion on Swing Pricing

It is strongly recommended that the SEC include within any proposed swing pricing guidelines for U.S. mutual funds the foundational roadmap approach outlined in this Response. Doing so will ensure that processes and support systems will be modified as required to allow swing pricing to be successfully implemented for U.S. open-end funds relying on third parties to distribute and process funds. Further, the draft approach outlined herein would enable swing pricing to be implemented without impacting clients' (i.e., end investors) ability to transact up to 4:00 P.M. ET.

GARP and the Swing Pricing Committee fully support voluntary adoption of swing pricing by the U.S. mutual fund industry. The comments herein, and the roadmap, are being advanced to assist in the process of ensuring that swing pricing can be effectively implemented by the U.S. mutual fund industry. It is recognized that the roadmap outlined will require system and process enhancements for U.S. mutual fund participants such as fund managers, TAs, fund administrators, third party distributors and the NSCC. However, we strongly believe changes to allow for swing pricing are warranted. As has been successfully demonstrated in EMEA, swing pricing is a proven way to protect non-transacting investors from transaction costs and reduce first mover advantage and related systemic risk from open-end funds.

[7] The definition of a financial intermediary in Rule 22c-2 may need to be expanded depending on the information required to be obtained.

III. Transparency for Omnibus Accounts

GARP, also in consultation with the Swing Pricing Committee discussed the SEC Liquidity Risk Management Proposal (LRM), including the proposed LRM guidelines. There was unanimous agreement that mutual funds need effective LRM programs.

In order to truly conduct an effective LRM program, fund managers need granular information on both the assets and liabilities of each mutual fund. For a mutual fund, liquidity risks can arise from the possible inability to meet potential demands for redemptions by the fund's investors. Details of the portfolio asset side are well known to the fund manager. However, fund managers whose funds rely on third party distributors do not have much transparency about the fund's own investors. Additional transparency related to investors would enhance a fund manager's ability to measure redemption profiles across future time buckets to help ensure sufficient liquidity to meet redemptions under normal and/or adverse market environments.

Other than pursuant to Rule 22c-2, there are no regulatory requirements for third party distributors to provide fund managers with details on underlying investors. The data regarding investors necessary to measure redemption profiles is currently either not provided at all, or if it is provided is often incomplete, inconsistently formatted and/or not submitted on a daily basis. This prevents fund managers from optimally evaluating the profile of their investors for basic attributes affecting redemptions, such as:

- Distribution of investors by type (e.g., pension fund, insurance company, retirement).
- Investor concentration (i.e., large concentrations by individual investors).
- Duration of investment by investor (i.e., length of time in fund).
- Size of investment by investor.

It should be noted that the additional data requested on the behavior of fund investors does not require any facts that would compromise personally identifiable information (PII). There is substantial room to improve the fund manager's understanding of the subscription and redemption characteristics of investors without impinging in any way on PII. Fund managers having details on the nature of their investors (i.e., the liabilities of a mutual fund) would materially enhance their ability to measure structural redemption behavior across individual funds under management.

Investor details provide an important lens through which to evaluate potential redemptions based on generic attributes. As a basic example, retirement (i.e., 401K investors) tend to rebalance their investments on a very infrequent basis (i.e., often only once or twice over decades long periods). Pension funds invest counter-cyclically given prescribed asset allocation approaches (e.g., 60% fixed income and 40% equity) which result in pension funds buying fixed income products when prices decline. Thus, 401K and pension fund investors in open-end funds would tend to have liabilities that are resilient to price declines for fixed income holdings versus other institutional investors that might redeem assets more quickly in adverse markets.

Given the importance of access to investor details for LRM purposes, it is requested that the SEC provide for access to transaction level details (including investor attributes) on fund liabilities for mutual funds distributed by third party distributors. This would require changes to SEC guidance and regulations on how intermediaries interact with funds (such as Section 22c-2 of the Investment

Company Act of 1940, as amended). Such changes would improve the ability of fund managers to measure and manage liquidity risk.

While the state of redemption modelling of mutual funds is, for most managers, a relatively undeveloped discipline today, in a world where concerns about systemic risk remain and where the ability to analyze "big data" is only improving, increasing transparency for fund managers by providing, through rulemaking or guidance, more access to relevant investor data builds a very positive bridge for improving the ability to manage redemption risk.

While banks are very different from asset managers, they do face an analogous asset/liability matching problem. However, banks enjoy access to details on both assets and liabilities (i.e., in the latter case "deposits"). This enables the development of deposit modelling which facilitates better asset liability management and liquidity risk measurement. SEC guidance and/or rule changes to require third party distributors to provide additional transparency would enable fund managers to have substantially the same level of access to mutual fund liabilities. This level of transparency would enhance a fund manager's ability to effectively measure and manage liquidity risk for open-end funds.

IV. Proposed Next Steps

Given the aforementioned downstream impacts on fund service providers and other parties, it is strongly recommended that the SEC convene working groups comprised of affected firms (e.g., fund managers, dealers, the NSCC, TAs, fund managers and other third party service providers) to analyze the details of this proposed roadmap to confirm feasibility of implementation and supporting details. However, given the proven benefits of swing pricing to investors, the objective of the working groups would be to finalize a mutually agreeable approach and recommendation(s) to successfully implement swing pricing for the U.S. mutual fund industry in a timely manner. Similarly, increasing the availability of investor level data to mutual fund managers can only lead to improved liquidity risk management over time.

With regard to any aspect of the above, GARP stands ready to assist the SEC and the mutual fund industry in exploring approaches and providing further details that would allow for the implementation of these recommendations and the option of adopting swing pricing by U.S. open-end funds.

We want to thank you for allowing us this opportunity to comment on these important issues. Should you require any additional information, or have any inquiries, please feel free to contact me at: [redacted], or +1[redacted].

Yours truly,

Richard Apostolik
President and CEO

Cc: Swing Pricing Committee