February 14, 2023

*VIA ELECTRONIC DELIVERY*

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

Dear Ms. Countryman:

RE: **Proposed Rule: Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT, Release Nos. 33-11130, IC-34746, File No. S7-26-22 (Nov. 2, 2022)**

Virtu Financial, Inc. ("Virtu")[1] respectfully submits this letter in response to the above-referenced rule proposal issued by the Securities and Exchange Commission (the "SEC" or "Commission") on November 22, 2022 (the "Proposal").[2] Among other items, the Proposal would (i) introduce changes to the way open-end funds (other than money market funds ("MMFs") and certain exchange-traded funds ("ETFs")) classify the liquidity of their investments and require a minimum of at least 10% percent highly liquid assets; (ii) require open-end funds (other than MMFs and certain ETFs) to use "swing pricing" in certain circumstances and implement a "hard close" to operationalize swing pricing; and (iii) provide for more frequent and more detailed reporting of fund information on Form N-PORT, including information about funds' liquidity and use of swing pricing.

Virtu has long been a vocal proponent of smart, data-driven regulation that supports the goals of enhancing transparency, fostering robust competition among market participants, and ensuring the high quality of the retail investor experience. While we recognize that the intent of the Proposal is to enhance the regulatory construct governing liquidity risk management of open-end funds, we respectfully submit that the Commission has not meet its burden in justifying why the proposed changes are needed or the benefits of the proposed changes, and in doing so, the Commission has deviated from its mission and statutory authority.

---

[1] Virtu is a leading financial firm that leverages cutting edge technology to deliver liquidity to the global markets and innovative, transparent trading solutions to its clients. Virtu operates as a market maker across numerous exchanges in the U.S. and is a member of all U.S. registered stock exchanges. Virtu's market structure expertise, broad diversification, and execution technology enables it to provide competitive bids and offers in over 25,000 securities, at over 235 venues, in 36 countries worldwide. As such, Virtu broadly supports innovation and enhancements to transparency and fairness which enhance liquidity to the benefit of all marketplace participants.

[2] U.S. Securities and Exchange Commission, Proposed Rule, *Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT*, Release Nos. 33-11130, IC-34746, File No. S7-26-22 (Nov. 2, 2022) (the "Proposal"), *available at* https://www.sec.gov/rules/proposed/2022/33-11130.pdf.

As Commissioner Peirce noted in her dissenting statement,[3] we question why the Commission has decided to take such a heavy hand in overhauling a rule that has served the marketplace and investors well since it was first adopted in 2016, and that was substantially enhanced by amendments made just five years ago. While we recognize that some open-end funds experienced volatility and heavy outflows during March 2020, we believe that the existing regulatory regime served its purpose well and that the approach outlined in the Proposal is yet another example of an effort by the Commission to impose overly prescriptive requirements without justifying what has changed in the marketplace that warrants the imposition of new rules.

As described below, we are particularly concerned about (i) certain aspects of the Proposal's contemplated amendments to the framework for open-end funds to classify the liquidity of their investments into various categories, which we believe deprives fund managers of much needed flexibility to adapt to changing market conditions, and (ii) the Proposal's mandated use of swing pricing, which, despite being an available alternative under existing rules since 2016, has been deemed unnecessary as a measure to address investor concerns by the marketplace.

**Liquidity Risk Classification Determinations**

Under the existing Rule 22e-4, a fund is required to classify each portfolio investment based on the number of days within which it *reasonably expects* the investment would be convertible to cash, sold or disposed of, without *significantly changing its market value*. Under this framework, funds have considerable discretion in how they classify investments – they are free to classify investments individually or by asset class and may use different reasonably anticipated trade sizes and have different standards for evaluating value impact.

The Proposal would limit this discretion by mandating new, objective standards for making liquidity determinations and changing certain aspects of the liquidity categories. Specifically, the Proposal would "provide objective minimum standards that funds would use to classify investments, including by: (1) requiring funds to *assume the sale of a set stressed trade size*, rather than the rule's current approach of assuming the sale of a reasonably anticipated trade size in current market conditions; and (2) *defining the value impact standard* with more specificity on when a sale or disposition would significantly change the market value of an investment."[4] The Proposal also would remove classification by asset class, requiring funds to classify by individual investment. Specifically, in determining the liquidity classification of each investment, a fund would be "required to measure the number of days in which the investment is reasonably expected to be convertible to U.S. dollars without significantly changing the market value of the investment, while assuming the sale of 10% of the fund's net assets by reducing each investment by 10%."[5]

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

[4] Proposal at 42.

[5] Proposal at 46.

*Assumed Trade Size*

The Proposal's contemplated change from "reasonable size" to 10% of the fund's net assets (calculated by applying the assumed 10% factor to each individual investment) is not reflective of how an asset manager would actually generate cash to cover a 10% redemption scenario. If a fixed percentage is to be used, it should be based on raising the funds required for redemption, regardless of the per-investment percentages. Many portfolios have liquidity/risk-reducing components surrounding less-liquid, core investments, and therefore applying the 10% factor to individual investments would result in a misleading and skewed assessment of liquidity risk for the portfolio.

*Value Impact Standard*

Similarly, the Proposal's contemplated change to a value impact standard ignores the significant differences that exist across markets for the relationship between relative order size and market impact.

For example, for equity securities listed on U.S. or foreign exchanges, the Proposal contemplates measuring value impact based on an approach that only takes into account a security's average daily trading volume ("ADV"). Specifically, selling or disposing of more than 20% of the security's ADV – measured based on transactions over the preceding twenty business days – would indicate a level of market participation that is *significant* under the Proposal. We respectfully submit that the use of such an ADV approach is overly simplistic, as we believe the primary driver of cost is volatility, not volume. The prescribed calculation of ADV would also cause confusion because of the proposed treatment of holidays (where the preceding twenty-day measuring period would include those days where U.S. markets are open but where one or more international markets are closed).

**Swing Pricing**

Equally concerning is the Proposal's contemplated requirement that open-end funds use "swing pricing" in periods of significant inflows or outflows. When the Commission first adopted a rule governing liquidity for open-end funds in 2016, swing pricing was offered as a ***voluntary option*** (as a provision of Rule 22c-1 under the Investment Company Act). As reflected in the Proposal, no funds opted into the provision following the adoption of the 2016 rule.[6]

The market has spoken, yet the Commission still appears to be intent on mandating an overhaul of the regulatory framework governing mutual fund pricing without adequately

---

[6] Proposal at p. 19 ("In the time since the adoption of the [2016] rule, no U.S. funds have implemented swing pricing. While swing pricing has been a commonly employed anti-dilution tool in Europe, including among U.S.-based fund managers that also operate funds in Europe, U.S. funds face unique operational obstacles in its implementation.")

assessing whether mandated swing pricing will address the liquidity issues that the Proposal is meant to solve. As Commissioner Peirce noted in her dissent, the "2016 liquidity reforms gave US registered open-end funds the authority to use swing pricing, but they have not used it. The Commission has decided that swing pricing is just too valuable a tool to leave unused at the bottom of the junk drawer…".[7] Market dynamics clearly establish that mandatory swing pricing is not warranted or that the implementation costs do not outweigh any potential benefits. Many mutual funds have chosen instead to spend resources on advanced technology and tools to minimize market impact to the benefit of the investor. Mutual funds currently employ fair value pricing to address concerns such as market timing. The addition of swing pricing to funds that already employ fair value pricing may add an additional impact to tracking error for the funds, adding to investor confusion. There does not appear to be the same concern for dilution in the U.S. mutual fund investor base, otherwise a firm that offers swing pricing might be able to use that to gain market share – yet, to the best of our knowledge, none has to date.

The Proposal also fails to adequately consider or justify the significant costs and burdens that will be attendant to system and process changes required by the new "hard close" needed to implement swing pricing. As the Proposal recognizes, "[i]ntermediaries would need to reengineer their systems to ensure disseminated order information reaches the transfer agent or Fund/SERV before 4 p.m."[8] We agree with Commissioner Peirce's observation that mandating a hard close "would have cascading consequences; some intermediaries likely would set their own internal cut-off times -- including adopting a blanket policy of processing orders at the next day's price. Retirement plan recordkeepers, the Release admits, could have a particularly rough transition. It would not just be fund administrators and intermediaries who would have to alter their current practices and expectations, investors interested in securing same-day pricing would have to adjust too, but the Commission thinks it's worth it."[9]

While we respectfully submit that the existing regulatory framework is fit for purpose and is the superior approach, if the Commission chooses to move forward with mandated swing pricing, we suggest the following changes:

- A swing threshold should exist for net redemptions as well and should be determined independently by the open-end funds themselves (similar to fair value pricing);
- The inclusion of market impact should be determined by the open-end funds themselves. Where estimates are easily obtained (and in some cases already used by the funds), they can be incorporated for all purchase and redemption scenarios. Where they are more difficult to estimate, the Proposal's contemplated Swing Threshold Framework may be confusing because of the proposed "cutoff" limits – i.e., requiring

[7] Peirce dissent.
[8] Proposal at p. 144.
[9] Peirce dissent.

market impact costs to be added in when net redemptions exceed 1% and net purchases exceed 2%. Establishing strict cutoffs may create a discontinuity when examining the data.

* * *

While Virtu strongly supports the goals of enhancing transparency, promoting competition, and protecting investors, we firmly believe that any regulatory action should only be taken where there is a clear market failure that needs to be addressed and where there is a clear benefit that will inure to investors and the marketplace.

Respectfully submitted,

Kevin O'Connor
Head of Analytics

cc: The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
The Honorable Mark T. Uyeda, Commissioner
The Honorable Jaime E. Lizarraga, Commissioner
Mr. William A. Birdthistle, Director, Division of Investment Management