SEC AMENDS LIQUIDITY RULE REPORTING AND DISCLOSURE REQUIREMENTS

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On June 28, 2018, the Securities and Exchange Commission ("SEC") amended certain disclosure requirements related to the "Liquidity Rule" — Rule 22e-4 — for open-end funds (except money market funds) registered under the Investment Company Act of 1940.[1] The amendments (1) remove the requirement for funds to disclose publicly the aggregate percentage of their assets that fall into four liquidity classifications specified in the Liquidity Rule, (2) replace that public disclosure requirement with a new disclosure requirement for fund shareholder reports, and (3) permit funds to classify a single investment into multiple liquidity classifications in three defined circumstances. According to the adopting release, the SEC adopted the first two changes to address concerns that public disclosure of aggregate liquidity classification data may confuse or mislead investors and that Form N-PORT (a monthly portfolio holdings report funds must file with the SEC) may not be the best way to communicate liquidity risk information to investors. The release indicates that the SEC adopted the third change to ease administrative cost burdens on funds when classifying certain holdings, while improving (or at least not affecting) the accuracy of liquidity classification reporting.

NO PUBLIC DISCLOSURE OF LIQUIDITY CLASSIFICATIONS

As originally adopted,[2] the Liquidity Rule would have required funds to publicly disclose on Form N-PORT, on a quarterly basis, the aggregate percentage of their assets that fall into each of four liquidity classifications (or "buckets"). While the actual bucketing requirement remains in place, the amended rule replaces the public disclosure requirement with a requirement that funds provide in their shareholder reports narrative discussions of the operation and effectiveness of their liquidity risk management programs. The narrative would go into the annual or semiannual report, depending on the fiscal half-year during which the fund's board had reviewed the operation of the program.

According to the adopting release, these narrative discussions should "provide investors with enough detail to appreciate the manner in which a fund manages its liquidity risk" and may include "information that was provided to the board about the operation and effectiveness of the [fund's liquidity risk management] program, and insight into how the program functioned over the past year."[3] The adopting release also offers some additional examples of information funds could, but are not required to, include, such as (1) the role of the classification process, the 15% illiquid investment limit, and the highly liquid investment minimum in a fund's liquidity risk management process; (2) particular liquidity risks a fund faced over the past year and how those risks were managed and addressed; and (3) a discussion of other metrics (spreads, turnover, or shareholder concentration issues, as applicable) and their effect on fund liquidity risk management. (The wording of the release on this point seems calculated to limit the potential for “disclosure creep,” where the SEC staff in future years reads more and more detail into the requirements.)

The SEC also adopted a related change to make nonpublic (but not eliminate) the disclosure required under Form N-PORT about the percentage of a fund's highly liquid investments segregated to cover, or pledged to satisfy margin requirements in connection with, certain derivatives transactions. The adopting release explained that this information is only relevant when considered together with the actual liquidity classification information, which would no longer be disclosed publicly.

CLASSIFICATION OF A SINGLE INVESTMENT INTO MULTIPLE LIQUIDITY “BUCKETS”

While funds will still be required to make nonpublic filings with the SEC classifying their assets into four liquidity buckets, the amended rule allows a fund to classify a single investment into multiple liquidity buckets in circumstances where: (1) for internal risk management purposes, funds classify holdings proportionally across buckets based on an assumed sale of the entire position; (2) subadvisers have different views of the liquidity classification of a single holding that is held in multiple “sleeves” of a fund's portfolio; or (3) different features affecting liquidity may justify treating a holding as two or more separate investments for liquidity classification purposes (e.g., an asset that includes a put option on part of the fund's holding of the asset). The SEC also clarified that funds using the classification-splitting approach on Form N-PORT may apply such splitting for all classification purposes under Rule 22e-4.

REPORTING OF CASH HOLDINGS

The amended rule also requires funds to report, on Form N-PORT, their cash and cash equivalent holdings that were not reported in Parts C (Schedule of portfolio investments) and D (Miscellaneous securities) of the form. This disclosure will be made publicly available each quarter. The SEC believes the additional data will assist it with monitoring funds' use of cash and assessing the composition of funds' “highly liquid investment minimums,” which funds are required to maintain under the Liquidity Rule.

LIQUIDITY RULE COMPLIANCE DATES

The effective date of the amended rule is September 10, 2018. For larger entities,[4] the compliance date for the Form N-PORT amendments is June 1, 2019, with the first Form N-PORT due July 30, 2019. Larger entities that distribute annual or semiannual shareholder reports after December 1, 2019 would be subject to the new shareholder report disclosure requirement (which is contained in Item 27(d)(7)(b) of Form N-1A). For smaller entities, the compliance date for the Form N-PORT amendments is March 1, 2020, with the first Form N-PORT due April 30, 2020. Smaller entities that distribute annual or semiannual shareholder reports after June 1, 2020 would be subject to the new shareholder report disclosure requirement.

The following chart describes the compliance dates for various Liquidity Rule components, updated as applicable:

Liquidity Rule Requirements	**Compliance Dates**
Form N-1A • Statement Regarding Liquidity Risk Management Program [Item 27(d)(7)(b)]	Shareholder reports distributed after 12/1/19 for larger entities Shareholder reports distributed after 6/1/20 for smaller entities
Rule 22e-4 ▪ Board designation of Program Administrator [§(b)(2(ii)]	Board Meeting Prior to 12/1/18 for larger entities 6/1/19 for smaller entities

Rule 22e-4
▪ Liquidity Risk Management Program [§(b)]
  ▪ Assessment, management, and periodic review of liquidity risk [§(b)(1)(i)]
  ▪ Limit on illiquid investments [§(b)(1)(iv)]
  ▪ Policies and procedures regarding redemptions in-kind [§(b)(1)(v)]
	12/1/18 for larger entities
	6/1/19 for smaller entities

Form N-LIQUID ▪ Part A. General Information ▪ Part B. Above 15% Illiquid Investments ▪ Part C. At or Below 15% Illiquid Investments	12/1/18 for larger entities 6/1/19 for smaller entities

<u>Form N-CEN</u> ▪ Item C.20. Lines of credit, interfund lending, and interfund borrowing ▪ Part E.5. In-Kind ETF (The *effective date* for amendments to Form N-CEN remains June 1, 2018)	12/1/18 for larger entities 6/1/19 for smaller entities
<u>Rule 22e-4</u> ▪ Initial Board approval of the liquidity risk management program [§(b)(2)(i)]	Board Meeting Prior to 6/1/19 12/1/19 for smaller entities
<u>Rule 22e-4</u> ▪ Full portfolio classification [§(b)(1)(ii)] ▪ Highly liquid investment minimum [§(b)(1)(iii)] ▪ Annual Board Reporting [§(b)(2)(iii)] ▪ Recordkeeping requirements relating to portfolio classification [§ (b)(3)(i)] and highly liquid investment minimum [§(b)(3)(iii)]	6/1/19 for larger entities (originally 12/1/18) 12/1/19 for smaller entities (originally 6/1/19)
<u>Form N-LIQUID</u> ▪ Part D. Assets that are Highly Liquid Investments Below the HLIM (The compliance dates for other parts of Form N-LIQUID are not delayed; these remain December 1, 2018)	6/1/19 for larger entities (originally 12/1/18) 12/1/19 for smaller entities (originally 6/1/19)
<u>Form N-PORT</u> ▪ Item B.2.f. Cash and cash equivalents not reported in Parts C and D	6/1/19 for larger entities

▪ Item B.7. Highly Liquid Investment Minimum ▪ Item C.7. Liquidity Classification Information ▪ General Instructions – F. Public Availability (The *effective date* for liquidity-related amendments to Form N-PORT remains January 17, 2017; under temporary rule 30b1-9(T), larger fund groups would have been required to begin filing reports on Form N-PORT by April 30, 2019 (for the period ending March 31, 2019). Given the revision of the compliance date for the disclosures related to liquidity on Form N-PORT, larger entities must include those disclosures in their reports on Form N-PORT no later than July 30, 2019 (for the period ending June 30, 2019).)	(originally 12/1/18) 3/1/20 for smaller entities (originally 6/1/19)

Notes

[1] *See* Investment Company Liquidity Disclosure Release No. IC- 33142 (June 28, 2018), https://www.sec.gov/rules/final/2018/ic-33142.pdf.

[2] *See* Investment Company Liquidity Risk Management Programs Release No. IC- 32315 (Oct. 13, 2016), https://www.sec.gov/rules/final/2016/33-10233.pdf.

[3] *See supra* footnote 1 at p. 18.

[4] “'Larger entities' are defined as funds that, together with other investment companies in the same 'group of related investment companies,' have net assets of $1 billion or more as of the end of the most recent fiscal year of the fund. 'Smaller entities' are defined as funds that, together with other investment companies in the same group of related investment companies, have net assets of less than $1 billion as of the end of its most recent fiscal year.” Investment Company Liquidity Risk Management Programs; Commission Guidance for In-Kind ETFs, Investment Company Release No. IC-33010 (Feb. 22, 2018), www.sec.gov/rules/interim/2018/ic-33010.pdf at n. 5.

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