

MEMO# 31106

February 23, 2018

SEC Extends Compliance Dates for Elements of Liquidity Rule; SEC Staff Issues Bucketing FAQs

[31106]

February 23, 2018 TO: ICI Members

Investment Company Directors SUBJECTS: Compliance

Disclosure

Exchange-Traded Funds (ETFs)

Fund Accounting & Financial Reporting

Fund Governance

Investment Advisers

Operations

Portfolio Oversight

Risk Oversight

Transfer Agency RE: SEC Extends Compliance Dates for Elements of Liquidity Rule; SEC Staff Issues Bucketing FAQs

The SEC adopted Rule 22e-4 (the “liquidity rule”) and related reporting requirements in October 2016.[\[1\]](#) On February 21, the SEC adopted an interim final rule that extends by six months portions of the liquidity rule and related reporting requirements.[\[2\]](#) Also this week, the staff of the Division of Investment Management issued a new set of FAQs related to investment classification (or bucketing) and related obligations.[\[3\]](#)

Summary of Interim Final Rule and Guidance

The interim final rule extends by six months the compliance dates for the liquidity rule’s classification requirements and other elements that are tied to the classification requirements.[\[4\]](#) Consequently:

- The new extended compliance dates for implementation of the classification and classification-related elements are June 1, 2019 for larger fund groups, and December 1, 2019 for smaller fund groups.
- The other rule and reporting requirements will go into effect as originally scheduled: December 1, 2018 for larger fund groups, and June 1, 2019 for smaller fund groups.

The following liquidity rule and reporting requirements are subject to the extended

compliance dates set forth above:[\[5\]](#)

- Specific Rule 22e-4 elements:
 - Investment classification (§(b)(1)(ii))
 - Highly liquid investment minimum (“HLIM”)(§(b)(1)(iii))
 - Board oversight
 - Initial approval of the liquidity risk management program (§(b)(2)(i))
 - Annual board reporting (§(b)(2)(iii))
 - Recordkeeping requirements related to the above items
- Specific Form N-LIQUID reporting item: Part D (assets that are highly liquid investments below the HLIM)
- Specific Form N-PORT reporting items:
 - Item B.7. (HLIM)
 - Item B.8. (liquidity aggregate classification information)
 - Item C. 7. (liquidity classification information)

All other rule elements and related reporting items (including, among others, implementation of a written liquidity risk management program; assessment, management, and periodic review of liquidity risk; and board approval of the designation of the program administrator) are subject to the existing compliance dates. Notably, funds must comply with the revised 15% illiquid investments limitation and related Form N-LIQUID reporting requirements by the existing compliance dates. But because funds may not have implemented the rule’s classification requirements (pursuant to which funds will classify “illiquid investments”) by their existing compliance dates, the Release provides guidance about how those funds may comply with the 15% illiquid investments limitation—short of full investment classification—during the period of the six-month extension.[\[6\]](#) The Release states that In-Kind ETFs (which are not subject to the rule’s classification requirements, but are subject to the rule’s 15% illiquid investments limitation) also may rely on this guidance, both during and after the extension period.

While the SEC has adopted this interim final rule,[\[7\]](#) the Release still requests comment by April 27, 2018. The interim final rule’s effective date will be 30 days after publication in the Federal Register.

SEC Staff’s Bucketing FAQs

Following earlier FAQs released in January relating primarily to sub-advised funds and ETFs, the newest FAQs relate primarily to bucketing and related obligations. More specifically, these FAQs address: use of the rule’s asset class classification method; permissible practices with respect to the rule’s “reasonably anticipated trading size” requirement and price impact standard; classification of investments in other pooled investment vehicles (e.g., mutual funds and ETFs); compliance monitoring under the rule; provisional investment classifications; timing and frequency of investment classifications; pre-trade activity and the 15% illiquid investments limitation; reporting events to fund boards and the SEC; and how ETFs that are not In-Kind ETFs may consider their in-kind redemption activity in connection with their investment classification and highly liquid investment minimum obligations. The staff also has revised earlier FAQ #13, which sets forth methods that an In-Kind ETF may use to test whether its cash use is de minimis.

Potential Future SEC Actions

The SEC’s liquidity-related work may not be complete. The press release announcing the

SEC's adoption of the interim final rule stated, "[T]he Commission anticipates considering in the future proposed amendments to Form N-PORT and Form N-1A related to disclosures of liquidity risk management for open-end management investment companies." [8]

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endnotes

[1] *Investment Company Liquidity Risk Management Programs*, SEC Release No. IC-32315 (Oct. 13, 2016), available at www.sec.gov/rules/final/2016/33-10233.pdf. See Institute Memorandum No. 30334, dated October 21, 2016, for a detailed summary of the liquidity rule and related reporting and disclosure requirements.

[2] *Investment Company Liquidity Risk Management Programs; Commission Guidance for In-Kind ETFs*, SEC Release No. IC-33010 (Feb. 22, 2018)(the "Release"), available at www.sec.gov/rules/interim/2018/ic-33010.pdf.

[3] Available at:
www.sec.gov/investment/investment-company-liquidity-risk-management-programs-faq.

[4] In 2017, ICI submitted two comment letters, one to SEC Chairman Clayton and the other to the SEC (available at www.sec.gov/comments/s7-03-18/s70318-3129373-161935.pdf and www.sec.gov/comments/s7-03-18/s70318-3129402-161936.pdf), requesting and providing support for a one-year delay in the compliance dates for the liquidity rule's investment classification and related requirements.

[5] See Release at 30 for a useful summary chart.

[6] Release at 25-29.

[7] The Administrative Procedure Act permits an agency to dispense with prior notice and comment when it finds, for good cause, that notice and comment are "impracticable, unnecessary, or contrary to the public interest." The SEC makes this finding in the Release.

[8] Available at www.sec.gov/news/press-release/2018-24.