

MEMO# 31136

March 16, 2018

SEC Proposes Amendments to Liquidity-Related Disclosure Requirements

[31136]

March 16, 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 Proposes Amendments to Liquidity-Related Disclosure Requirements

The SEC voted in favor of proposing amendments to open-end funds' liquidity-related disclosures earlier this week.[\[1\]](#) Most notably, the proposed amendments to Form N-PORT would eliminate the reporting of aggregated liquidity classification (or bucketing) information. This means that, if adopted, funds would not have to report any bucketing information to the public. Rather, funds would be required, in their annual reports to shareholders, to discuss the operation and effectiveness of their liquidity risk management programs during their most recently completed fiscal years. Comments are due 60 days after the Proposing Release is published in the Federal Register. ICI will submit a comment letter to the SEC.

Background

The SEC adopted Rule 22e-4 (the "liquidity rule") and related reporting requirements in October 2016.[\[2\]](#) Since then, ICI has been working with members to implement these requirements. ICI also has continued its engagement with the SEC, submitting comment letters in July and November of 2017.[\[3\]](#) In February of 2018, the SEC adopted an interim final rule that extends by six months bucketing-related portions of the liquidity rule and related reporting requirements.[\[4\]](#) And, in January and February of 2018, the staff of the Division of Investment Management issued FAQs related to sub-advised funds, ETFs, and bucketing ("Liquidity FAQs").[\[5\]](#)

Summary of Proposed Amendments to Form N-PORT

The proposed amendments to Form N-PORT would:

- Eliminate the reporting of aggregated bucketing information;
- Permit funds, when reporting investment-specific bucketing information to the SEC, to “split” an investment among buckets in certain circumstances; and
- Require funds to report their holdings of cash and cash equivalents.

We discuss each below.

Elimination of Aggregated Bucketing Information

Under Form N-PORT, as adopted by the SEC in 2016, Item B.8 requires a fund to report the aggregate percentage of its portfolio investments that falls into each of the four liquidity buckets. This is a monthly reporting item, and this information would be disclosed to the public for the third month of each fiscal quarter with a 60-day delay. In addition, Item C.7 of Form N-PORT requires a fund provide to the SEC the liquidity classification for each of its portfolio investments, a non-public disclosure item.

Under the proposed amendment to Item B.8, this aggregated bucketing reporting item would be eliminated. In effect, funds would not be required to provide bucketing information to the public. (The SEC still would receive investment-specific bucketing information under Item C.7, which it presumably could aggregate for its own internal purposes.) The Proposing Release outlines the concerns that commenters, including ICI, have voiced about public reporting of bucketing information.[\[6\]](#)

Also, the proposal would re-designate as a non-public disclosure item the percentage(s) of a fund’s highly liquid investments that are segregated to cover, or pledged to satisfy margin requirements in connection with, derivatives transactions that are classified as moderately liquid, less liquid, or illiquid.

“Splitting” an Investment Among Liquidity Buckets

Form N-PORT currently requires a fund to classify each investment into a single liquidity bucket. Under proposed amendments to Item C.7, a fund would be permitted (but not required) to split an investment into multiple buckets in three specified circumstances:

- if a fund has multiple sub-advisers with differing liquidity views;
- if portions of the position have differing liquidity features that justify treating the portions separately; or
- if the fund chooses to classify the position through evaluation of how long it would take to liquidate the entire position (rather than basing it on the sizes it would reasonably anticipate trading).[\[7\]](#)

Disclosure of Cash and Cash Equivalents

Form N-PORT currently does not require funds to specifically report the amount of cash and cash equivalents that they hold. New Item B.2.f. would require funds to report “cash and cash equivalents not reported in Parts C and D.” The Proposing Release explains that this new disclosure item would “provide more complete information that will be useful in analyzing a fund’s HLIM [Highly Liquid Investment Minimum], as well as trends regarding

the amount of cash being held, which also correlates to other activities the fund is experiencing, including net inflows and outflows.”[\[8\]](#) The Proposing Release looks to US generally accepted accounting principles for purposes of defining cash equivalents.

Summary of Proposed Amendments to Form N-1A

Form N-1A currently requires no liquidity-specific disclosures in funds’ annual reports to shareholders. Form N-1A would be amended to require funds, as part of Management’s Discussion of Fund Performance (“MDFP”), to “[b]riefly discuss the operation and effectiveness of the Fund’s liquidity risk management program during the most recently completed fiscal year.” The Proposing Release presents this as an alternative that would address commenters’ concerns about public dissemination of bucketing information, while still providing accessible and useful liquidity risk management disclosure to investors. The Proposing Release also addresses how a fund might fulfill this new disclosure requirement.[\[9\]](#)

Compliance Dates

As with the Form N-PORT and the liquidity requirements generally, the SEC proposes a tiered set of compliance dates for “larger entities” and “smaller entities.”[\[10\]](#) More specifically, the SEC proposes to align the compliance dates for these proposed amendments to Forms N-PORT and N-1A with the revised compliance dates for Form N-PORT. While not entirely clear, we interpret this section to mean that the extended compliance dates set forth in the SEC’s Liquidity Extension Release[\[11\]](#)—June 1, 2019 for larger entities and December 1, 2019 for smaller entities—would apply to all of these proposed amendments.[\[12\]](#) This means that, for larger entities, the Form N-PORT amendments would first be reflected in a fund’s Form N-PORT filing covering the month ended June 30, 2019, and that the Form N-1A disclosure addressing the operation and effectiveness of the fund’s liquidity risk management program would apply to fiscal years ending on or after June 30, 2019.

Additional Anticipated SEC Staff Actions

The Proposing Release indicates that the SEC staff anticipates publishing “aggregated and anonymized” information about the fund industry’s liquidity (gathered through Form N-PORT filings). It notes that a periodic staff report on the aggregated liquidity of funds may provide similar benefits as the staff’s aggregated Form PF periodic reports about private funds. In addition to publishing a periodic staff report, the Proposing Release states that the staff will provide an analysis of the Form N-PORT liquidity data to the SEC and present to the SEC by June 2020 a recommendation addressing whether and, if so how, there should be public dissemination of fund-specific liquidity classification information.

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endnotes

[1] *Investment Company Liquidity Disclosure*, SEC Release No. IC-33046 (Mar. 14, 2018)(the “Proposing Release”), available at www.sec.gov/rules/proposed/2018/ic-33046.pdf. Chairman Clayton and Commissioners Piowar and Peirce voted in favor of the proposal’s issuance, and Commissioners Stein and Jackson voted against it.

[2] *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.

[3] 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. Among other things, the letters (i) requested and provided support for a one-year delay in the liquidity rule’s bucketing and related requirements; and (ii) requested that the SEC ease compliance with the rule’s bucketing requirements, including through targeted amendments (e.g., amending Form N-PORT to eliminate public reporting of bucketing information).

[4] *Investment Company Liquidity Risk Management Programs; Commission Guidance for In-Kind ETFs*, SEC Release No. IC-33010 (Feb. 22, 2018)(the “Liquidity Extension Release”), available at www.sec.gov/rules/interim/2018/ic-33010.pdf. See Institute Memorandum No. 31106, dated February 23, 2018, for a detailed summary of the interim final rule.

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

[6] Proposing Release at 9-13. The SEC broadly characterizes the concerns as relating to the information’s subjectivity; its lack of context; and its potential to highlight one risk (*i.e.*, liquidity risk) over others.

[7] See Proposing Release at 23-26 for a discussion of these three categories. See also Liquidity FAQs 7 and 8 for additional information about the first category. The initial liquidity proposal contemplated the splitting of investments into multiple buckets. See Proposing Release at n.54.

[8] Proposing Release at 28-29.

[9] Proposing Release at 15-16.

[10] Proposing Release at n.68: “‘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.”

[11] See *supra*, note 4.

[12] The Proposing Release states, “We believe that aligning the compliance date for all liquidity-related reporting requirements will allow funds to holistically implement all liquidity reporting and disclosure requirements at the same time and may make the requirements

less burdensome.”

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