

MEMO# 30334

October 21, 2016

SEC's New Liquidity Risk Management Requirements for Mutual Funds and ETFs

[30334]

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TO: ACCOUNTING/TREASURERS MEMBERS No. 33-16
BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 41-16
BROKER/DEALER ADVISORY COMMITTEE No. 38-16
CHIEF RISK OFFICER COMMITTEE No. 33-16
CLOSED-END INVESTMENT COMPANY MEMBERS No. 23-16
COMPLIANCE MEMBERS No. 34-16
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ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 28-16
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INVESTMENT COMPANY DIRECTORS No. 32-16
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SEC RULES MEMBERS No. 62-16
SMALL FUNDS MEMBERS No. 48-16
TRANSFER AGENT ADVISORY COMMITTEE No. 52-16
UNIT INVESTMENT TRUST MEMBERS No. 13-16
VARIABLE INSURANCE PRODUCTS ADVISORY COMMITTEE No. 25-16 RE: SEC's NEW LIQUIDITY RISK MANAGEMENT REQUIREMENTS FOR MUTUAL FUNDS AND ETFS

The SEC unanimously adopted a liquidity risk management program rule and related disclosure requirements for mutual funds and open-end ETFs ("funds") last week.[\[1\]](#)

The SEC's adoption of these liquidity requirements finalizes the package of reforms first proposed in September 2015.[\[2\]](#) Collectively, the new rules, form amendments, and new form will:

- Require funds to establish liquidity risk management programs under new Rule 22e-4 under the Investment Company Act (the "liquidity rule"); and

- Require funds to provide additional liquidity-related disclosures on Form N-1A, Form N-PORT, Form N-CEN, and Form N-LIQUID.

I. Summary of the Liquidity Risk Management Program Rule (Rule 22e-4)

Rule 22e-4 requires funds to establish written liquidity risk management programs. The SEC's objective is to "create a regulatory framework that would reduce the risk that a fund will be unable to meet its redemption obligations and minimize dilution of shareholder interests by promoting stronger and more effective liquidity risk management across open-end funds."^[3] The SEC points to variations in the quality of funds' liquidity risk management practices and the growth in fixed income and alternative funds employing more complex investment strategies as rationales for the rulemaking.

A. Scope of the Rule

As in the proposal, only open-end funds (except for money market funds) are subject to the liquidity rule. Unlike the proposal, the rule distinguishes between "In-Kind ETFs"^[4] (subject to the rule, but excluded from the investment classification^[5] and "highly liquid investment minimum"^[6] requirements (each described below)) and all other open-end ETFs (subject to all generally applicable rule provisions). The Release acknowledges that In-Kind ETFs have different liquidity risks than funds (including other ETFs) that redeem in cash. The Release cautions that if an In-Kind ETF were to use more than a *de minimis* amount of cash (as determined in accordance with its written policies and procedures) to meet redemptions, however, it would not qualify as an In-Kind ETF and would need to comply with the full set of rule requirements applicable to other ETFs.^[7]

UITs were fully excluded from the proposed rule; they are excluded from the final rule's generally applicable requirements, although their principal underwriters or depositors are subject to a separate initial limited liquidity review requirement.^[8]

B. Elements of the Rule

Fund liquidity risk management programs must include the following elements:

- *Assessment, management, and periodic review of a fund's liquidity risk.* A fund must assess, manage, and periodically review (at least annually) its liquidity risk, based on certain specified factors. "Liquidity risk" is defined as the risk that a fund could not meet redemption requests without significant dilution of remaining investors' interests in the fund.^[9] The specified factors (streamlined in the final rule) are:
 - Investment strategy and liquidity of portfolio investments during both normal and reasonably foreseeable stressed conditions (including whether the investment strategy is appropriate for an open-end fund, the extent to which the strategy involves a relatively concentrated portfolio or large positions in particular issuers, and the use of borrowings for investment purposes and derivatives);^[10]
 - Short-term and long-term cash flow projections during both normal and reasonably foreseeable stressed conditions;^[11] and

- Holdings of cash and cash equivalents, as well as borrowing arrangements and other funding sources.

All ETFs also must consider:

- Relationship between the ETF's portfolio liquidity and the arbitrage function; and
 - Effect of the composition of baskets on the overall liquidity of the ETF's portfolio.[\[12\]](#)
- *Classification of the liquidity of portfolio investments.* As with the proposal,[\[13\]](#) a fund must classify portfolio investments using a uniform "days-to-trade" framework. But under the final rule, a fund must, taking into account relevant market, trading, and investment-specific considerations, classify each portfolio investment into one of four buckets,[\[14\]](#) based on the number of days in which the fund reasonably expects the investment would be convertible to cash (or simply sold or disposed of, in the case of the third and fourth buckets) in current market conditions[\[15\]](#) without significantly changing the market value of the investment.[\[16\]](#) A fund must review its classifications at least monthly in connection with its Form N-PORT filings, and more frequently if changes in relevant market, trading, and investment-specific considerations[\[17\]](#) are reasonably expected to materially affect one or more of its investments' classifications. The final rule text no longer includes prescribed factors for making these classifications, but the Release provides detailed guidance for funds to consider, which generally corresponds to and elaborates on the proposed classification factors.[\[18\]](#)

The rule text also includes the following additional key provisions related to this classification requirement:

- A fund may classify investments by asset class, unless market, trading, or investment-specific considerations with respect to a particular investment are expected to significantly affect the liquidity characteristics of that investment compared to other portfolio holdings within that asset class;[\[19\]](#)
- A fund must determine whether trading varying portions of a position in a particular investment, in sizes that the fund would reasonably anticipate trading, is reasonably expected to significantly affect the liquidity of that investment (and if so, the fund must take this determination into account when classifying the liquidity of that investment);[\[20\]](#) and
- A fund must take into account certain considerations for highly liquid investments that it has segregated to cover certain derivatives transactions.[\[21\]](#)

- *Determination of a highly liquid investment minimum.* A fund must determine a minimum percentage of its net assets to invest in “highly liquid investments” (i.e., cash or investments that are reasonably expected to be converted to cash within three business days without significantly changing the market value of the investment), based on the factors it uses to assess its liquidity risk.[\[22\]](#) A fund must review its minimum at least annually. In-Kind ETFs and funds primarily holding highly liquid assets[\[23\]](#) are exempt from this requirement.

In a significant improvement from the proposal,[\[24\]](#) a fund that is below its minimum may continue to purchase non-highly liquid investments, provided it does so in accordance with “shortfall” policies and procedures,[\[25\]](#) which must include board reporting.[\[26\]](#) Shortfalls also could trigger reporting to the SEC via a non-public filing.[\[27\]](#)

- *Limitation on illiquid investments.* Rule 22e-4 prohibits a fund from purchasing any illiquid investments[\[28\]](#) if, immediately after the acquisition, more than 15 percent of its net assets would be illiquid investments. If a fund breaches the 15 percent limit, it must report the incident to the board within one business day, with an explanation of the extent and causes of the occurrence, and how the fund plans to bring its illiquid investments back within the limit within a reasonable period of time.[\[29\]](#) If the fund remains in breach 30 days from the occurrence (and at each consecutive 30 day period thereafter), the fund board must assess whether the plan presented to it for bringing this percentage back into compliance continues to be in the best interest of the fund. A fund also must report a breach of this limitation on a confidential basis to the SEC within one business day of the occurrence.[\[30\]](#)
- *Redemptions in kind.* A fund that engages in, or reserves the right to engage in, redemptions in kind and any In-Kind ETF must establish policies and procedures regarding how and when it will engage in such redemptions in kind.
- *Board involvement.* A fund’s board must initially approve the fund’s liquidity risk management program and the designation of the fund’s adviser or person(s) to administer the program. Unlike the proposal, the board is not obliged to approve the fund’s highly liquid investment minimum (unless the fund is below its minimum and seeks to change it), or material changes to the program.[\[31\]](#) The board also must review, at least annually, a written report on the adequacy of the program and the effectiveness of its implementation (which must include, if applicable, the operation of the highly liquid investment minimum, and any material changes to the program). As noted above, the board must receive reports if a fund drops below its highly liquid investment minimum or breaches the 15 percent limit on illiquid investments. Finally, the Release notes that neither the guidance nor the final liquidity rule places the responsibility for determining whether a specific security is liquid or illiquid on the fund’s board.[\[32\]](#)

C. Cross Trades

The Liquidity Program Release addresses funds’ use of Rule 17a-7 to engage in cross trades with affiliates,[\[33\]](#) as did the proposal. The Release recognizes that cross trades may be an effective liquidity risk management tool, but also warns of the potential for abuse. The SEC continues to maintain that considering liquidity is relevant in determining whether a transaction satisfies Rule 17a-7’s requirements. For instance, it states that it may be prudent for advisers to subject less liquid assets to careful review (and potentially even a

heightened review) before engaging in such transactions; that a fund's Rule 17a-7 procedures generally should contemplate how the fund meets the rule's requirements with regard to less liquid assets; that a fund could consider specifying the sources of the readily available market quotations to be used to value the assets and establish specific criteria for determining whether market quotations are current and readily available; and that a fund's policies and procedures might also provide for assessing the quality of quotations provided by dealers.[\[34\]](#)

D. Recordkeeping

A fund must maintain:

- a written copy of the program and certain associated fund policies and procedures ;
- copies of certain materials provided to the fund board; and
- a written record of the policies and procedures related to how the highly liquid investment minimum, and any adjustments thereto, were determined (including materials provided to the board related to a fund falling below its highly liquid investment minimum).

II. New Disclosure Requirements

Funds must provide liquidity-related information on the following new or amended forms:[\[35\]](#)

- **Form N-1A:** The SEC has amended Item 11 to require disclosure (i) of the number of days in which the fund typically expects to pay redemption proceeds to redeeming shareholders (along with differences according to payment method, if applicable), and (ii) describing the methods the fund typically expects to use to meet redemption requests (e.g., sales of portfolio assets, holdings of cash or cash equivalents, lines of credit, interfund lending, and/or in-kind redemptions), and whether those methods are used on a regular basis or only in stressed market conditions.

Unlike the proposal, funds will not be required to file credit agreements as exhibits to their registration statements.[\[36\]](#)

- **Form N-PORT:** A fund must report the aggregated percentage of its portfolio representing each of the four classification categories,[\[37\]](#) and this information will be publicly available on a quarterly basis. A fund also must report to the SEC, on a confidential basis, position-level liquidity classification information and information regarding its highly liquid investment minimum (if applicable).[\[38\]](#) Finally, a fund must report to the SEC and publicly disclose the percentages of its highly liquid investments that are segregated to cover, or pledged to satisfy margin requirements in connection with, certain derivatives transactions.[\[39\]](#)
- **Form N-CEN:** A fund must disclose information regarding lines of credit and interfund borrowing and lending (including use of each during the period). An ETF must report whether it is an In-Kind ETF as defined in the liquidity rule.
- **Form N-LIQUID:** This new form—which funds must file pursuant to new Rule 30b1-10[\[40\]](#)— requires a fund to confidentially notify the SEC when the fund's level of illiquid investments that are assets exceeds 15 percent of its net assets (within one business day of the occurrence), or when its highly liquid investments fall below its minimum (within one business day after the fund's highly liquid investments have

been below its minimum for more than seven consecutive calendar days). A fund also must make a subsequent filing with the SEC once its percentage of illiquid investments that are assets falls to or below 15 percent of net assets.

III. Compliance Dates

Compliance dates for the various requirements are as follows:

- Most funds must comply with the liquidity rule by December 1, 2018, while fund complexes with less than \$1 billion in net assets must do so by June 1, 2019 (these compliance dates also apply to new Rule 30b1-10 and new Form N-LIQUID).
- The compliance date for the Form N-1A amendments is June 1, 2017. The compliance dates for the liquidity-related reporting requirements of Form N-PORT and Form N-CEN are December 1, 2018 for most funds, and June 1, 2019 for fund complexes with less than \$1 billion in net assets.

IV. ICI Activity in Connection with New Fund Requirements

These new liquidity requirements (together with the new fund reporting requirements and swing pricing provisions) will bring about significant changes for the fund industry. To assist members in analyzing and implementing them, ICI will:

- Host a one-day conference on November 17 in Boston, at which we will cover these new requirements in depth. We will be joined by senior SEC staff. Information about this event and registration can be found at www.ici.org/events/upcoming/conf_16_sec_rules.
- Devote panels to these subjects at ICI's Securities Law Developments Conference in Arlington, VA (outside Washington, D.C.) on December 6. We will be joined by senior SEC staff. Information about this event and registration can be found at www.ici.org/events/upcoming/conf_16_seclaw.

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endnotes

[1] *Investment Company Liquidity Risk Management Programs*, SEC Release No. IC-32315 (Oct. 13, 2016)(the "Release"), available at www.sec.gov/rules/final/2016/33-10233.pdf. Unless otherwise indicated, references to "funds," "mutual funds," and "open-end funds" do not include money market funds. At the same time, the SEC adopted new fund reporting requirements and amended rules to permit mutual funds to use swing pricing. Requirements regarding fund reporting and swing pricing are summarized in Institute Memoranda Nos. [30331](#) and [30333](#), respectively. For a shorter summary of the new liquidity, swing pricing, and enhanced fund reporting requirements, see Institute Memorandum No. [30316](#), dated October 14, 2016.

[2] *Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release*, SEC Release No. IC-31835 (Sept. 22, 2015), available at www.sec.gov/rules/proposed/2015/33-9922.pdf.

Institute Memorandum No. [29367](#), dated September 28, 2015, provides a detailed summary of the proposal. We provide links to and summaries of ICI's numerous comment letters on the proposal in Institute Memorandum No. [29643](#), dated January 14, 2016, and Institute Memorandum No. [29920](#), dated May 18, 2016.

[\[3\]](#) Release at 8.

[\[4\]](#) The rule defines an "In-Kind ETF" as "an ETF that meets redemptions through in-kind transfers of securities, positions, and assets other than a *de minimis* amount of cash and that publishes its portfolio holdings daily."

[\[5\]](#) The Release explains that the liquidity classification information for In-Kind ETFs is less necessary for the SEC, investors, and other potential users of this information because, unlike for mutual funds, the daily identity and weightings of ETF portfolio holdings are well known to authorized participants and other ETF liquidity providers. Furthermore, the Release notes that the investment classification requirement incorporates a "convertible to cash" concept that is generally not relevant for an In-Kind ETF (except in managing cash holdings to no greater than a *de minimis* amount of cash). Release at 274, 276-277.

[\[6\]](#) Similarly, the highly liquid investment minimum incorporates the same irrelevant "convertible to cash" concept as the investment classification requirement. As a result, the Release states that it is more appropriate for an In-Kind ETF to assess its liquidity risk through considerations of the ETF-specific risk factors discussed below (*see infra*, note 12 and accompanying text). Release at 277.

[\[7\]](#) By way of example, the Release explains that an ETF that normally redeems in-kind but delivers all cash to a single authorized participant that elects to receive cash, would not be an ETF that uses a *de minimis* amount of cash. Depending on the circumstances, however, an ETF that delivers cash only on one occasion may be able to conclude that it qualifies as an In-Kind ETF in later years if such circumstances are not repeated. On the other hand, if market conditions change and the ETF can no longer meet redemptions without more than a *de minimis* amount of cash, it would no longer qualify as an In-Kind ETF.

The Release states that an In-Kind ETF should describe in its written liquidity risk management program policies and procedures how it analyzes its ability to redeem in-kind in all market conditions such that it is unlikely to suddenly fail to continue to meet the In-Kind ETF definition, the circumstances in which the In-Kind ETF may use a *de minimis* amount of cash to meet a redemption, and what amount of cash would qualify as such. As part of its policies and procedures, an In-Kind ETF generally also should describe how it will manage and/or approve any portion of a redemption that is paid in cash and document its determination that such a cash amount is *de minimis*. In making these determinations, the Release notes that an In-Kind ETF may consider, if applicable: (i) the amount (both in dollars and as a percentage of the entire redemption basket) and frequency with which cash is used to meet redemptions; and (ii) the circumstances and rationale for using cash to meet redemptions. Release at 266-267.

[\[8\]](#) Specifically, "On or before the date of initial deposit of portfolio securities into a registered UIT, the UIT's principal underwriter or depositor must determine that the portion of the illiquid investments that the UIT holds or will hold at the date of deposit that are assets is consistent with the redeemable nature of the securities it issues, and must maintain a record of that determination for the life of the UIT and for five years thereafter."

[9] ICI objected to the proposed definition's requirement that a fund assess the risk of meeting redemptions "without materially affecting the fund's net asset value." The final definition is in accord with the recommendation in the ICI's May 2016 comment letter. The reference to "reasonably foreseeable stressed conditions" has been removed from the final definition, but kept in two of the underlying factors. The SEC also notes that the requirement to assess and manage liquidity risk does not require elimination of all adverse impacts of liquidity risk. Release at 61.

[10] Consideration of the appropriateness of the strategy for an open-end fund was not an element of the proposed rule. In this regard, the SEC cautions that "primarily holding securities with extended settlement periods beyond seven days may not be appropriate for an open-end fund, as primarily having such extended settlement holdings may raise concerns with the fund's ability to meet redemptions within seven days, particularly if the fund has not established adequate other sources of liquidity." Release at 69-70.

[11] See Release at 76-83 for SEC guidance on cash flow projections.

[12] The Release explains that these additional factors are necessary because market participants may find it more difficult to evaluate opportunities and ultimately participate in the arbitrage process (because of challenges in pricing, trading, and hedging their exposure to the ETF) if an ETF has a significant amount of illiquid securities in its portfolio. If the arbitrage function fails to operate efficiently, investors could buy and sell ETF shares at prices that are not at or close to the NAV per share of the ETF, which may raise concerns under the Investment Company Act regarding whether all fund shareholders are being treated equitably. Similarly, the Release notes that the composition of an ETF's creation and redemption baskets can affect the liquidity of its portfolio. For example, the Release suggests that an ETF whose basket does not reflect a *pro rata* share of the fund's portfolio may alter the liquidity profile of the ETF's portfolio and may adversely affect the fund's future ability to meet cash redemptions or mitigate shareholder dilution. Release at 270-273.

[13] The proposal called for six buckets covering varying time intervals, based on the number of days in which a fund's position (or portion thereof) would be convertible to cash at a price that does not materially affect the value of that asset immediately prior to sale. ICI strongly opposed this aspect of the proposal. Among other things, ICI questioned the complexity and granularity (e.g., use of six buckets) of the proposal; the difficulty of classifying portions of portfolio assets and accounting for material price impact; and the inclusion of prescribed classification factors within the rule text.

[14] The four categories are: "highly liquid investments" (cash and investments convertible into cash in three business days or less), "moderately liquid investments" (investments convertible into cash in more than three calendar days but in seven calendar days or less), "less liquid investments" (investments able to be sold or disposed of in seven calendar days or less), and "illiquid investments" (investments that cannot be sold or disposed of in seven calendar days). Cash settlement within the applicable time frames is required only in the first two buckets. With respect to the "highly liquid investments" category, the Release states, "We anticipate that a fund could determine that a broad variety of investments within different asset classes could be classified as highly liquid investments, depending on facts and circumstances." Release at 116. Potential examples of "less liquid investments" include certain foreign securities and US bank loan participations. Release at 119.

[15] The "current market conditions" requirement captures only a "moment-in-time"

picture of investment liquidity, but would *de facto* reflect considerations of stressed market conditions if markets are stressed at the time of assessment. Generally speaking, considerations of reasonably foreseeable stressed conditions occur as part of liquidity risk assessment and management at the fund level. Release at 111-113.

[16] The final rule still includes a “value impact” component (*i.e.*, “without significantly changing the market value”), but the Release notes that “funds will be less likely to interpret *significant changes* in market value as capturing very small movements in price, and thus this change should address commenters’ concern that the proposal would create a value impact standard that is impractical to apply because any sale of an investment could affect its market value to some degree.” (emphasis in original) Release at 107-108. The Release also states that this standard does not require a fund to incorporate general market movements in liquidity determinations, but only the market value impact of a hypothetical sale. Release at 108-109.

[17] “For example, relevant market-wide developments could include changes in interest rates or other macroeconomic events, market-wide volatility, market-wide flow changes, dealer inventory or capacity changes, and extraordinary events such as natural disasters or political upheaval. Asset-class and investment-specific developments that a fund may wish to consider include, among others, regulatory changes affecting certain asset classes and corporate events (such as bankruptcy, default, pending restructuring, or delisting, as well as reputational events).” Release at 178.

[18] Release at 154-174. The SEC has not included in this new guidance the proposed “[r]elationship of the asset to another portfolio asset” classification factor, the elimination of which ICI recommended. See *infra*, note 21.

[19] This is in accord with ICI’s recommendation that funds be permitted to make “top-down” classifications by asset type, subject to asset-specific exceptions where appropriate. As an example, “a fund could decide that high credit quality corporate bonds generally fall into a particular liquidity category, but if the fund or its adviser had information that certain bonds’ bid-ask spreads are significantly wider or more volatile than those of their peers, it would be required under rule 22e-4 to separately assess these bonds and potentially classify them into a less-liquid category... .” Release at 131-132. The SEC cautions that (i) “there are some asset classes, such as those encompassing some bespoke complex derivatives or complex structured securities, that have such a range of liquidity characteristics that each position would need to be classified individually;” and (ii) it does “not consider it appropriate for a fund to use very general asset class categories (*e.g.*, ‘equities,’ ‘fixed income,’ and ‘other’) in classifying the liquidity of its portfolio investments, as these broad categories would likely not permit a fund to identify investments with fungible liquidity characteristics.” Release at 134, 137.

[20] In effect, the proposal would have required a fund to (i) assume complete liquidation of its portfolio, and then (ii) classify each portfolio asset (and portions thereof, if necessary) according to its six-bucket “days-to-cash” framework, assuming little or no market impact. ICI recommended that funds be permitted to classify assets by examining the liquidity of a single trading lot (current practice for many funds), which would align the classification with typical fund experiences (*i.e.*, funds generally are not forced to sell large positions, quickly and unexpectedly, to meet redemptions). The SEC has taken something of a middle ground in the final rule: “[T]his requirement would have a fund consider portions of a portfolio position that are larger than a single trading lot, but not necessarily the position’s full size, in assessing its portfolio investments’ liquidity.” Release at 138. After determining the

portion of an investment that a fund could reasonably anticipate trading, it must consider the market depth for that investment. Then, “[i]f the fund determined, after conducting the required market depth analysis, that a downward adjustment in the liquidity classification of a particular investment is appropriate, the new liquidity classification that the fund assigns to this investment would apply to the entirety of the fund’s position in that investment (not, as proposed, to portions of that position).” Release at 142.

[21] With respect to a fund’s derivatives transactions that it has classified as moderately liquid investments, less liquid investments, and illiquid investments, the fund must identify the percentage of its highly liquid investments that it has segregated to cover, or pledged to satisfy margin requirements in connection with, derivatives transactions in each of these classification categories. The fund will report these percentages on Form N-PORT. (These requirements replace the proposed requirement that a fund consider the “relationship of [an] asset to another portfolio asset” as part of the asset classification process.) The purpose of this final rule provision is to “permit the Commission and its staff to understand what percentage of a fund’s highly liquid investment minimum is composed of encumbered assets, and would allow the public to better understand that a certain percentage of a fund’s highly liquid investments may not be immediately available for liquidity risk management purposes.” Release at 153.

[22] In this regard, the Release reiterates the need to consider reasonably foreseeable stressed conditions in setting the minimum, but the rule text stipulates that the relevant time period for this forward-looking assessment is “during the period until the next review of the highly liquid investment minimum,” which would be no more than one year. See Release at 207-213 for guidance about considering the liquidity risk factors and setting a fund-specific minimum.

[23] The SEC’s expectation is that a “primarily highly liquid fund” (not a defined term in the rule) would address in its program how it determines that it primarily holds assets that are highly liquid investments, including how it defines “primarily.” The Release also states: “In our view, if a fund held less than 50% of its assets in highly liquid investments it would be unlikely to qualify as ‘primarily’ holding assets that are highly liquid investments.” Release at n. 726.

[24] ICI opposed the proposed “three-day liquid asset minimum” (the precursor to the “highly liquid investment minimum”), in part, because it could adversely affect funds’ ability to adhere to their investment objectives, policies, and strategies; could deprive funds of investment opportunities; could depress demand for “less liquid assets,” making them less liquid still; and could reduce market liquidity generally (funds near or below their respective minimums would be precluded from making countercyclical investments in less liquid assets).

[25] These procedures are “meant to foster discussion among the fund’s management (and board) if its assets that are highly liquid investments fall below the level the fund determined to be an appropriate minimum.” Release at 217.

[26] A fund must report to its board, no later than the board’s next regularly scheduled meeting, regarding any drop in the fund’s highly liquid investments below its minimum. A fund must report to its board within one business day if this shortfall lasts more than seven consecutive calendar days (with an explanation of how the fund plans to restore its minimum within a reasonable period of time). The fund board is not normally required to specifically approve the highly liquid investment minimum, although during the time of a

shortfall, the minimum can be changed only with board approval.

[27] A fund is required to submit a non-public report to the SEC if its highly liquid investment minimum shortfall lasts more than seven consecutive calendar days. *See infra*, Section II, for a description of this new Form N-LIQUID filing requirement.

[28] *See supra*, note 14 and accompanying text, for the definition of “illiquid investment.” Unlike the proposal (which used the term “15% standard asset”), the final rule incorporates the concept of “illiquid investment” into the bucketing framework, as the final (*i.e.*, least liquid) category. As a result, the new definition of “illiquid investment” differs somewhat from the existing definition of “illiquid asset.” *See Revisions of Guidelines to Form N-1A*, SEC Release No. IC-18612, 57 Fed. Reg. 9828, 9829 (March 20, 1992). The SEC also has formally withdrawn prior guidance regarding what constitutes an “illiquid asset.”

[29] In the proposal, the 15 percent limitation on illiquid assets was purely a “time of acquisition” test, with no affirmative obligation to cure a breach. The final rule reflects the SEC’s view that “a fund should not be permitted to exceed the 15% limit on illiquid investments for an extended period of time without board oversight.” Release at 236.

[30] *See infra*, Section II, for a description of this new Form N-LIQUID filing requirement.

[31] ICI opposed both of these proposed requirements.

[32] Release at 127.

[33] *See generally* Release at 243-248 for the SEC’s cross trades guidance.

[34] Release at 246-248.

[35] The SEC also has adopted new disclosure, financial statement, and performance reporting requirements relating to swing pricing. *See* Institute Memorandum No. [30333](#) for a description of those new requirements.

[36] ICI opposed this proposed requirement.

[37] *See supra*, note 14.

[38] ICI strongly recommended that asset level liquidity classifications be kept non-public.

[39] *See supra*, note 21 and accompanying text.

[40] The proposal did not include Rule 30b1-10 or this form. These filings are meant to provide the SEC with an “early warning notification” of potential liquidity stress events at the earliest possible juncture.