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## *SEC Votes to Modify Compliance Date for Open-End Fund Liquidity Classification*

By [The Investment Management Practice](#)

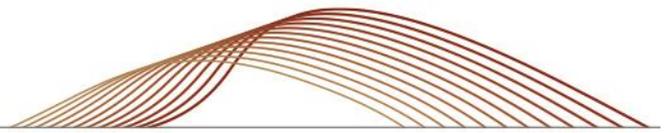
### **Introduction**

On February 21, 2018, the Security and Exchange Commission (the “SEC”) voted to extend the compliance date for the liquidity classification or “bucket” requirement of the liquidity risk management rule 22e-4 (the “Liquidity Rule”). In a press release,<sup>1</sup> announcing the extension, SEC Chairman Jay Clayton noted that the SEC’s action to extend the compliance date “is a measured step designed to help preserve key market oversight and investor protection benefits of the Liquidity Rule, while addressing certain concerns that have been raised since adoption.” In conjunction with the delay of the liquidity classification requirement, the SEC staff (the “Staff”) also issued an additional set of FAQs related to the Liquidity Rule, generally focusing on the liquidity classification process. This announcement comes two months after the SEC announced a nine-month delay of certain portions of the investment company reporting and modernization rule (the “Modernization Rule”).<sup>2</sup>

### **I. Liquidity Classification Compliance Delay**

The SEC adopted an interim and final rule extending the deadline by which open-end funds must comply with the implementation of the classification and classification-related elements of the Liquidity Rule to June 1, 2019, for larger entities,<sup>3</sup> and December 1, 2019, for smaller entities.<sup>4</sup> In addition, the SEC provided a six-month relief for board approval of the liquidity risk management program and the related annual review requirements. While delaying certain portions of the Liquidity Rule, the SEC left in place the existing compliance dates for other aspects of the Liquidity Rule—the implementation of a written liquidity risk management program and the institution of the 15% illiquid investments restriction—will go into effect as originally scheduled: December 1, 2018, for larger entities, and June 1, 2019, for smaller entities.

In addition, the SEC provided guidance on how funds can comply with the 15% limit on illiquid investments during the six-month extension. The SEC noted that one way a fund can comply with the 15% requirement is to “preliminarily identify certain asset classes or investments that the fund reasonably believes are likely to be illiquid.” The SEC believes that this “preliminary evaluation” can be accomplished based on a fund’s previous trading experience (including its experience in the investment’s typical market depth and price impact when trading), “on its understanding of the general characteristics of the asset classes it is preliminarily evaluating, or through other means.” The SEC also noted that a fund relying on preliminary evaluations would need to conduct periodic testing of the results of the preliminary evaluations to confirm that the evaluations continue to be accurate. Alternatively, if the preliminary evaluation establishes a reasonable basis for believing that



an investment is likely to be illiquid, but the fund wishes to further evaluate its status, the fund may then determine whether that investment is illiquid through the full classification process set forth in the Liquidity Rule.

## II. FAQs

In conjunction with announcing the delay of the liquidity classifications, the Staff also issued an additional set of FAQs<sup>5</sup> covering a variety of topics related to the Liquidity Rule: (i) Asset Class Liquidity Classification, (ii) Reasonably Anticipated Trading Size, (iii) Price Impact Standards, (iv) Classifying Investments in Pooled Investment Vehicles, (v) Provisional Investment Classification Activity and Related Compliance Monitoring, (vi) Timing And Frequency Of Classification Of Investments, (vii) Pre-Trade Activity And The 15% Limitation On Illiquid Investments, (viii) ETFs and Investment Classification, and (ix) Related Reporting Requirements. The SEC noted that the FAQs focus on questions that have arisen with respect to the liquidity classification process and are intended to provide additional clarity to funds as they implement the necessary requirements during the additional time that the SEC has provided.

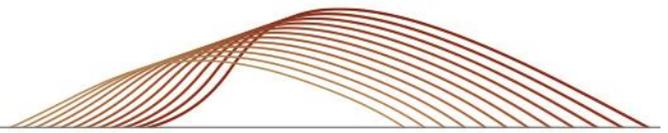
## III. Looking Ahead

It is worthwhile to note that the SEC originally scheduled an open meeting to be held on the morning of February 21, 2018 to consider adopting an interim final rule revising the compliance date for certain provisions of the Liquidity Rule and related reporting and disclosure requirements, and to propose amendments to Form N-PORT and Form N-1A related to disclosures of liquidity risk management for open-end management investment companies. However, the SEC cancelled the open meeting without any explanation. As discussed herein, the SEC subsequently delayed certain portions of the Liquidity Rule and announced this delay via a press release. In the same press release, the SEC noted that, at a later date, it anticipates considering amendments to Form N-PORT and Form N-1A related to disclosures of liquidity risk management for open-end management investment companies.

The SEC's press release can be found [here](#).

The SEC's FAQ on the Liquidity Rule can be found [here](#).

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<sup>1</sup> See <https://www.sec.gov/news/press-release/2018-24>.

<sup>2</sup> See SEC Modifies Approach to Form N-PORT Filing Requirements. Available at <https://www.sec.gov/news/press-release/2017-226>; See also the Temporary Final Rule available at <https://www.sec.gov/rules/final/2017/33-10442.pdf>.

<sup>3</sup> "Larger Entities" means funds in a group of related investment companies with aggregate net assets of \$1 billion or more as of the end of the most recent fiscal year.

<sup>4</sup> "Smaller Entities" means fund groups with net assets of less than \$1 billion as of the end of their most recent fiscal year.

<sup>5</sup> Previously, the Staff issued an FAQ related to the Liquidity Rule that focused on liquidity risk management program administrators, funds or fund complexes with sub-advisers, and In-Kind ETFs.

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