Asset Managers

Liquidity, swing pricing, and reporting rules adopted by SEC – initial view

Industry Overview

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SEC adopts new rules – liquidity, swing pricing, & reporting

The SEC voted today to adopt new rules which will require liquidity risk management programs, new and enhanced reporting disclosures, and permit swing pricing. These new rules build upon the enhanced disclosures to Form ADV adopted back in August, all in an effort to modernize the industry's governance and mitigate risk. In our initial view, we find that the rules are fairly in line with what was proposed, though there are some differences (see note on proposals).

Liquidity rules are fairly in line with proposal

Mutual funds and ETFs are now required to establish a written board approved/reviewed risk management program that classifies investment into different liquidity categories, cap illiquid investments to 15%, and establish a minimum % for highly liquid investments. The SEC will also allow mutual funds, not ETFs, to use swing pricing which is the process of adjusting NAV to pass on trading costs to the purchasing/redeeming shareholder. All of these new rules were expected.

Changes to liquidity classification & ETF exemptions

The SEC originally set forth 6 buckets in terms of days to convert to cash (1, 2-3, 4-7, 8-15, 16-30), but the final rule requires investments be grouped into 4 categories, highly liquid (3 biz days or less), moderately liquid (3-7 cal days), less liquid (7 cal days or less), and illiquid (>7 cal days). The SEC has also removed the prohibition of a fund purchasing assets other than highly liquid securities if the fund falls below its minimum highly liquid % threshold, instead a fund would alert its board, file Form N-LIQUID (also used when illiquid threshold is breached) with the SEC alerting them of the predicament, and develop a plan to restore the minimum. While ETFs will need to adhere to the liquidity risk program requirements they will be exempt from classifying investments into liquidity buckets and complying with a highly liquid investment minimum. However, ETFs that redeem more than a *de minimis* amount in cash will not be exempt.

Reporting rules are fairly in line with proposal

New forms; N-PORT and N-CEN will replace existing forms (N-Q & N-SAR) and be required monthly and annually respectively. The forms will include new and enhanced disclosures on pricing of investments, sec lending, counterparty exposure, derivatives, among other identifying measures. The forms will be filed in a structured data format which will facilitate data analysis which can be used to identify and mitigate potential risks. Additionally, the SEC is requiring funds to disclose new information on derivatives prominently in financial statements, rather than in footnotes and enhanced disclosure on SMAs on form ADV by Advisers (rule adopted in August). We found the new reporting and disclosure rules to be mostly in line with the proposals.

New rules to go into effect in 2018

Funds will be required to begin filing new reports (N-PORT & N-CEN) after June 1, 2018, though fund complexes with <$1B will be granted an additional year. Funds will be required to comply with the liquidity risk management program requirements on Dec 1, 2018, though fund complexes with <$1B will be granted an additional year.

Refer to important disclosures on page 2 to 3.

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Disclosures

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