



8011-01P

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 270 and 274

[Release No. IC-33010; File No. S7-03-18]

RIN 3235-AM26

Investment Company Liquidity Risk Management Programs; Commission Guidance for In-Kind ETFs

AGENCY: Securities and Exchange Commission.

ACTION: Interim final rule; request for comment; interpretation.

SUMMARY: The Securities and Exchange Commission is adopting an interim final rule that revises the compliance date for the requirements of rule 22e-4 for classification, highly liquid investment minimum, and board approval, as well as related reporting requirements of Part D on Form N-LIQUID and liquidity disclosures on Form N-PORT under the Investment Company Act of 1940. The revised compliance date will be June 1, 2019, for larger entities (revised from December 1, 2018) and December 1, 2019, for smaller entities (revised from June 1, 2019). The Commission is not extending the compliance date for the other provisions of rule 22e-4 and Form N-LIQUID, and liquidity-related changes to Form N-CEN — which remain December 1, 2018 for larger entities and June 1, 2019 for smaller entities. The Commission also is not extending the compliance date for the liquidity-related provisions of Form N-1A, which has already passed. Finally, the Commission is providing guidance to assist funds that will not be engaging in full portfolio classification before the revised compliance date, and In-Kind ETFs, which are not required to engage in full portfolio classification, in identifying illiquid investments for purposes of complying with the 15% illiquid investment limit.

DATES: Effective Dates: The effective date of the interim final rule is [Insert date 30 days after publication in the Federal Register]. The effective date for 17 CFR 270.22e-4 and 270.30b1-10 and the amendments to Form N-PORT (referenced in 17 CFR 274.150) published at 81 FR 82267 (November 18, 2016) remains January 17, 2017, and the effective date for amendments to Form N-CEN (referenced in 17 CFR 274.101) published at 81 FR 82267 (November 18, 2016) remains June 1, 2018.

Compliance Dates: The compliance date for 17 CFR 270.22e-4(b)(1)(ii) except to the extent referenced in 17 CFR 270.22e-4(a)(8)¹, 17 CFR 270.22e-4(b)(1)(iii), 17 CFR 270.22e-4(b)(2)(i) and (iii), certain elements of 17 CFR 270.22e-4(b)(3) related to the delayed provisions of rule 22e-4, and the liquidity-related amendments to Form N-PORT (discussed in section I.C below) and Part D of Form N-LIQUID have been extended until June 1, 2019 for larger entities, and December 1, 2019 for smaller entities, as defined in section I below.

Comment Date: Comments should be received on or before April 27, 2018.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/interim-final-temp.shtml>);
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-03-18 on the subject line; or

Paper comments:

¹ See *infra* footnote 71.

- Send paper comments to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-03-18. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/interim-final-temp.shtml>).

Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly.

Studies, memoranda, or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the Commission's website. To ensure direct electronic receipt of such notifications, sign up through the "Stay Connected" option at www.sec.gov to receive notifications by e-mail.

FOR FURTHER INFORMATION CONTACT: Zeena Abdul-Rahman, Senior Counsel, or Thoreau Bartmann, Senior Special Counsel, at (202) 551-6792, Division of Investment Management, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-8549.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission") is extending the compliance dates associated with following provisions of rule

22e-4 [17 CFR 270.22e-4]: rule 22e-4(b)(1)(ii) [17 CFR 270.22e-4(b)(1)(ii)] except to the extent it is referenced in rule 22e-4(a)(8) [17 CFR 270.22e-4(a)(8)]; rule 22e-4(b)(1)(iii) [17 CFR 270.22e-4(b)(1)(iii)]; rule 22e-4(b)(2)(i) [17 CFR 270.22e-4(b)(2)(i)]; rule 22e-4(b)(2)(iii) [17 CFR 270.22e-4(b)(2)(iii)]; and certain elements of rule 22e-4(b)(3) [17 CFR 270.22e-4(b)(3)] under the Investment Company Act of 1940 [15 U.S.C. 80a-1 et seq.] (“Investment Company Act” or “Act”). The Commission also is extending the compliance dates associated with Part D of Form N-LIQUID [referenced in 17 CFR 274.223] as well as amendments to Form N-PORT [referenced in 17 CFR 274.150] under the Investment Company Act.

I. DISCUSSION

On October 13, 2016, the Commission adopted rule 22e-4 and related rule and form amendments to enhance the regulatory framework for liquidity risk management of registered open-end investment companies (“funds”).² Specifically, we adopted rules 22e-4 and 30b1-10, new Form N-LIQUID, as well as amendments to Forms N-1A, N-PORT, and N-CEN (collectively, the “Liquidity Rule Requirements”).³ We designed these rules and forms to promote effective liquidity risk management throughout the fund industry and to enhance disclosure regarding fund liquidity and redemption practices.⁴

The compliance date for the amendments to Form N-1A was June 1, 2017. For the remainder of the Liquidity Rule Requirements, the Commission established a tiered set of

² The term “funds” used in this release includes open-end management companies, including exchange-traded funds (“ETFs”) that do not qualify as In-Kind ETFs (as defined in rule 22e-4(a)(9)), and excludes money market funds.

³ Investment Company Liquidity Risk Management Programs, Investment Company Act Release No IC-32315 (Oct. 13, 2016) [81 FR 82142 (Nov. 18, 2016)] (“Adopting Release”).

⁴ *See id.*, at text accompanying n.112.

compliance dates based on a fund group's asset size. Specifically, for larger entities,⁵ we adopted a compliance date of December 1, 2018. For smaller entities, we adopted a compliance date of June 1, 2019. As discussed in more detail below, the Commission believes it is appropriate to revise the compliance date for certain elements of the Liquidity Rule Requirements until June 1, 2019 for larger entities and December 1, 2019 for smaller entities.⁶

A. Summary of the Liquidity Rule Requirements

Rule 22e-4—Liquidity Risk Management Programs

Rule 22e-4 requires each fund to adopt and implement a written liquidity risk management program reasonably designed to assess and manage the fund's liquidity risk. A fund's liquidity risk management program must incorporate certain specified elements: (i) assessment, management, and periodic review of the fund's liquidity risk; (ii) classification of the liquidity of each of the fund's portfolio investments, as well as at least monthly reviews of the fund's liquidity classifications ("portfolio classification" or "classification"); (iii) determining and periodically reviewing a highly liquid investment minimum (the "HLIM"); (iv) limiting the fund's investment in illiquid investments that are assets to no more than 15% of the fund's net assets ("15% illiquid investment limit"); and (v) for funds that engage in, or reserve

⁵ "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. See Adopting Release, *supra* footnote 3, at n.997. We adopted this tiered set of compliance dates based on asset size because we anticipated that smaller groups would benefit from this extra time to comply and from the lessons learned by larger investment companies. See Adopting Release, *supra* footnote 3, at n.1009 and accompanying text.

⁶ The effective date of January 17, 2017 for these elements is unchanged. As described in this release, the Commission is revising compliance dates associated with certain aspects of rule 22e-4, Form N-PORT and Form N-LIQUID.

the right to engage in, redemptions in-kind, the establishment of policies and procedures regarding how they will engage in such redemptions in-kind.

The rule requires each fund to adopt a liquidity risk management program and obtain board approval of such program. Fund boards must also approve an administrator for the program (“program administrator”), and review annual reports from the fund’s program administrator on the operation of the program and the program’s adequacy and effectiveness of implementation, including, if applicable, the operation of the HLIM, and any material changes to the program.

The portfolio classification requires a fund to classify each portfolio investment into one of four defined liquidity categories, known as “buckets”: highly liquid investments, moderately liquid investments, less liquid investments, and illiquid investments.⁷ These buckets are intended to take into account relevant market-, trading-, and investment-specific considerations, as well as market depth and whether sales of an investment would significantly change the market value of the investment.⁸ While the rule permits a fund to classify portfolio investments based on asset class, it requires the fund to implement a “reasonable exceptions process” for investments that should be classified separately from their class.⁹ Finally, portfolio classification

⁷ Rule 22e-4(b)(1)(ii). This classification is based on the number of days in which a fund reasonably expects an investment would be convertible to cash (or, in the case of the less-liquid and illiquid categories, sold or disposed of) without the conversion significantly changing the market value of the investment.

⁸ Rule 22e-4(b)(1)(ii).

⁹ Rule 22e-4(b)(1)(ii)(A) (“The fund may generally classify and review its portfolio investments . . . according to their asset class, provided, however, that the fund must separately classify and review any investment within an asset class if the fund or its adviser has information about any market, trading, or investment-specific considerations that are reasonably expected to significantly affect the liquidity characteristics of that investment as compared to the fund’s other portfolio holdings within that asset class.”).

requires a fund to review its portfolio investments' classifications monthly unless a "reasonable exceptions process" requires a more frequent review.¹⁰

The HLIM requires a fund to determine the minimum amount of net assets that it will invest in highly liquid investments that are assets.¹¹ This requirement relies on the portfolio classification process to identify which investments are bucketed as highly liquid.

The 15% illiquid investment limit prohibits a fund (as well as an In-Kind ETF) from acquiring any illiquid investment if, immediately after such acquisition, it would have invested more than 15% of its net assets in illiquid investments that are assets.¹² This limit on illiquid investments also refers to the classification element of the rule, but we are providing guidance on how funds may comply with this requirement without engaging in full portfolio classification. In-Kind ETFs, which are exempt from the classification requirement, may look to this guidance to assist them in complying with the 15% illiquid investment limit on a permanent basis.

Disclosure Amendments

In addition to rule 22e-4, the Commission adopted certain public disclosure requirements to provide shareholders and other users with additional information on fund liquidity risk. It also adopted certain non-public reporting requirements to assist the Commission in its monitoring efforts.¹³ Specifically:

¹⁰ Rule 22e-4(b)(1)(ii) ("A fund must review its portfolio investments' classifications, at least monthly in connection with reporting the liquidity classification for each portfolio investment on Form N-PORT . . . and more frequently if changes in relevant market, trading, and investment-specific considerations are reasonably expected to materially affect one or more of its investments' classifications.").

¹¹ Rule 22e-4(a)(7).

¹² Rule 22e-4(b)(1)(iv).

¹³ See Adopting Release, *supra* footnote 3, at n.120.

- Rule 30b1-10 and related Form N-LIQUID provide non-public notification to the Commission whenever a fund’s illiquid investments exceed 15% of its net assets and if its amount of highly liquid investments declines below its HLIM for more than seven days.
- Amendments to Form N-PORT generally require a fund to report monthly to the Commission, on a non-public basis, the portfolio investments in each of the defined buckets and the fund’s HLIM.¹⁴ The form also requires a fund to disclose publicly the aggregated percentage of its portfolio representing each of the four liquidity classification categories as of the end of each of its fiscal quarters.¹⁵
- The amendments to Form N-1A require a fund to disclose publicly certain information regarding the fund’s redemption procedures.¹⁶
- The amendments to Form N-CEN require funds to provide public disclosure about funds’ use of lines of credit and interfund lending.¹⁷

B. Monitoring and Compliance Date Extension Requests

The Commission has received numerous requests to extend the compliance date for the Liquidity Rule Requirements.¹⁸ Some have requested that the Commission delay compliance with the entire rule,¹⁹ while others requested that the Commission only delay compliance with

¹⁴ Items B.7 and C.7 of Form N-PORT.

¹⁵ Item B.8 of Form N-PORT.

¹⁶ Item 11(c)(7) and (8) of Form N-1A.

¹⁷ Item C.20 of Form N-CEN.

¹⁸ These comment letters (File No. S7-03-18) are available at <https://www.sec.gov/comments/s7-03-18/s70318.htm>.

¹⁹ *See, e.g.*, Letter from Wellington Management Company LLP (Nov. 17, 2017) (“Wellington Letter”).

the portfolio classification and related requirements.²⁰ Several industry members, including trade associations (on behalf of their members) and funds, have expressed concerns regarding the difficulties that funds are facing in preparing to comply in a timely manner (*i.e.*, by the December 1, 2018 compliance date for larger entities).²¹ They requested that the Commission extend the compliance date for these elements for an additional period of time ranging from six months to one year.²²

Since the Commission adopted rule 22e-4 and the related rule and form amendments, Commission staff has engaged actively with funds to discuss complex compliance and implementation challenges and evaluate operational issues relating to portfolio classification. The staff also has met with third-party service providers (“service providers”) who expect to assist fund groups in implementing the classification requirements of the rule. Based on this staff engagement, we have observed that: (1) due to a lack of readily available market data for certain asset classes (*e.g.*, fixed income), the implementation of the portfolio classification requirement will be heavily dependent on service providers to provide funds with scalable liquidity models and assessment tools that are necessary for bucketing and reporting (*see* “Role of Service Providers” below); (2) fund groups believe that full implementation of service provider and fund systems will require additional time for further refinement and testing of

²⁰ See Letter from the Investment Company Institute to The Honorable Jay Clayton (July 20, 2017) (“ICI Letter I”).

²¹ See, *e.g.*, Supplemental Comments on Investment Company Liquidity Risk Management Programs from the Investment Company Institute (Nov. 3, 2017) (“ICI Letter II”); Letter from SIFMA AMG to Chairman Jay Clayton, Commissioner Stein, and Commissioner Piwowar (Sept. 12, 2017) (“SIFMA AMG Letter”); Letter from TCW to Chairman Jay Clayton, Commissioner Stein, and Commissioner Piwowar (Sept. 15, 2017); Letter from Vanguard on Investment Company Liquidity Risk Management Programs (Nov. 8, 2017) (“Vanguard Letter”); and Letter from Nuveen LLC to Chairman Jay Clayton (Nov. 22, 2017) (“Nuveen Letter”).

²² *Id.*

systems, classification models, and liquidity data, as well as for finalizing certain policies and procedures (*see* “Systems Readiness” below); and (3) funds are facing compliance challenges due to questions that they have raised about the Liquidity Rule Requirements that may require interpretive guidance (*see* “Interpretive Questions” below).²³

Role of Service Providers

Based on our staff’s engagement, we understand that market data gaps and the need to develop efficient and effective systems for liquidity classification and reporting are leading many fund groups to rely extensively on technology tools developed by service providers.²⁴ It is our understanding that these tools will collect relevant data, feed that data and other related information into liquidity models and assessment tools, and then provide the resulting information to the funds. To reasonably rely on these tools, fund groups have told our staff they expect to conduct significant diligence before determining which service provider systems to use and whether to build out some form of proprietary liquidity assessment and classification systems.²⁵ In the Adopting Release, we discussed the appropriate role of service providers in funds’ liquidity risk management programs, and provided guidance on the type of due diligence

²³ As of the date of this release, the staff has responded to some requests for interpretive guidance the Commission received. The staff is also publishing additional interpretive guidance in conjunction with this release. Due to the tiered nature and complexity of the rule’s implementation process, we expect to receive additional requests for guidance in the future, and will respond to them accordingly.

²⁴ *See* ICI Letter II (reporting a survey of its members that found that a large majority of respondents (91%) are considering using a service provider).

²⁵ For example, we understand that fund groups expect to conduct extensive classification system testing and model validation, including the installation of cybersecurity and disaster recovery protections, before these systems are usable for compliance with Commission rules.

and oversight we expect that funds would provide when using such service providers.²⁶ This diligence and oversight would take time to accomplish upon inception and on an ongoing basis.

While the fund groups with whom our staff has met vary in their degree of dependency on service providers for classification, we understand that virtually all will rely on such service providers to a significant degree. It is our understanding that many will rely heavily on the liquidity data and tools provided by these service providers, while others may use service providers largely as a source of trading and other market information that will feed into the funds' internal classification systems. We also understand that many fund groups will use service providers to assist with the reporting obligations under the rule, which may be accomplished more efficiently through third party systems, where funds benefit from the service provider's technology and economies of scale. Similarly, we understand that even for those funds that may be able to gather market data on their own or develop liquidity assessment tools internally, they may rely on service provider systems and tools to the extent it is more cost-effective to do so. We also understand that, because service providers vary in the level of data they currently have about different asset classes, some funds may need to contract with multiple service providers to gain access to the trading and market information necessary to classify all of their investments or assume responsibility for certain investments for which service providers do not currently provide classification data. In sum, we expect that virtually all fund groups will

²⁶ See Adopting Release, *supra* footnote 3, at text following n.323 (encouraging program administrators for funds that choose to rely on service providers for liquidity risk management to maintain oversight of these service providers by: (1) reviewing the quality of the liquidity data received from service providers; (2) reviewing the relevant methodologies and metrics used by service providers to determine the effectiveness of the data to inform or supplement the fund's consideration of its portfolio holdings' liquidity characteristics, and (3) assessing whether any modifications to an "off-the-shelf" service provider liquidity model are necessary to accurately reflect the liquidity characteristics of the fund's portfolio investments).

rely on service providers to some extent in meeting their obligations under the Liquidity Rule Requirements.

Systems Readiness

As a consequence of this heavy reliance on service providers, those requesting a later compliance date have focused primarily on the readiness of service providers to deploy fully-functional products to assist funds with their classification obligations.²⁷ In meeting with funds and service providers, the staff has learned that most of the service providers that plan on offering liquidity data and assessment tools to assist with classification still have gaps in the investments that they cover. For example, most do not currently have the ability to assess effectively the liquidity of certain asset classes, such as over-the-counter derivatives and certain fixed income securities.²⁸ For most of these remaining asset classes, market and trading data is more limited or unavailable and thus many plan to create models to evaluate the liquidity of these investments based on the limited data available and other information, such as the structural characteristics of the asset and analysis of comparable securities. Accordingly, we understand that under current timelines, most service providers' products will not provide full coverage for all asset classes until the end of the first quarter of 2018 or perhaps later.²⁹ Two

²⁷ See ICI Letter I (noting that most funds will engage third-party service providers to help with classification and that those service providers will not have mature products for fund groups to evaluate for some time); see also SIFMA AMG Letter (noting that the lack of readiness on the part of service providers makes it difficult for funds to make "build or buy" decisions regarding their classification systems).

²⁸ See ICI Letter II (noting that certain investment types not yet covered by one or more service providers include asset-backed securities, mortgage-backed securities, preferred securities, bank loans, and to-be-announced (TBA) securities).

²⁹ See ICI Letter II (discussing a survey of members which found that 73% of respondents did not believe that service providers' offerings will be sufficiently mature for funds to make an informed selection until 2018, with 37% of respondents believing that it will take until the second quarter of 2018 or beyond).

trade associations expressed concern that, without a compliance date extension, the challenges in building classification systems would shorten the time for liquidity model validation, testing, service provider oversight, and implementing cybersecurity and disaster recovery protections for the new technology-dependent liquidity risk management programs.³⁰

Fund groups have informed our staff that they are not able to evaluate fully the liquidity assessment tools and market data offered by these service providers until the buildout of coverage for asset classes and related models is complete.³¹ In addition, even for asset classes where service provider offerings are currently available, fund groups have informed us that different service providers' liquidity assessments of certain securities have been unexpectedly disparate.³² This has led to further delays as fund groups seek to evaluate the cause of the differences between service providers' data and assessment tools (including underlying models and assumptions), and attempt to determine whether such tools are reliable and effective.³³ As a

³⁰ See SIFMA AMG Letter (arguing that a compliance date extension is necessary to give funds time to implement cybersecurity and disaster recovery protections). See also ICI Letter II (discussing the need for a compliance date extension in order to test the classification models of service providers).

³¹ See ICI Letter II (noting that it will take two to six months for fund complexes to select a service provider once they can evaluate their offerings, and an additional three to nine months to "onboard" the vendor; also noting that fund complexes will not be in position to complete other critical implementation work (e.g., conducting an initial liquidity risk assessment for all funds, determining whether a fund qualifies as a "primarily highly liquid fund," and determining an appropriate HLIM for applicable funds). Only when all of this work is complete will fund complexes be in a position to present substantially complete liquidity risk management programs (able to perform full classification) to their boards for approval, which funds expect will take place over multiple meetings with final approval occurring after the program is substantially complete, adding additional months to the process).

³² See ICI Letter II (noting an evaluation of sample output from five service providers' current offerings, which showed a fund's liquidity classifications, when run through multiple service providers' models, may differ widely, and pointing in particular to scenarios where, depending on the vendor used, analysis of a large high yield bond fund's portfolio resulted in ranges from 7% to 95% for the fund's highly liquid bucket).

³³ See ICI Letter II (describing its September 2017 survey results of selected members where the majority of respondents cited multiple areas in which service providers need to do additional

consequence, our staff understands that many fund groups have not been able to make significant progress in finalizing the selection of their service provider(s), and do not expect to be able to do so in the near term.³⁴ Once service provider selection is completed, fund groups then expect to evaluate the need for additional internal systems to implement their classification programs, and then to build out those systems as needed.

In general, the service providers with whom the staff has met have indicated that they expect to have tools and market data for all asset classes available before the current compliance date of the rule, though they are not complete yet. They also generally indicated that they expected to have products with complete asset coverage by the first or second quarter of 2018. They also informed our staff that entering into contracts and onboarding fund groups are progressing at different paces and that fund group classification systems similarly are in various stages of development and readiness. The service providers have also acknowledged that significant disparities can exist between service providers in assessing the liquidity of the same security as a result of different models, market data, or assumptions used. The service providers informed our staff that they believed their products generally would be ready in time for most funds to meet the current compliance date of the rule, though some of the fund groups with whom they have engaged suggested that additional time may be needed to implement the required classification process and related program and reporting requirements.

work, including gaps in asset coverage, improving the quality of underlying methodologies, improving the depth, breadth and quality of data, and improving the user interface/delivery of data).

³⁴ *Id.* The ICI also stated that, beyond the survey results, additional factors suggested even more time would be necessary due to challenges that may emerge in the coming months, given that hundreds of fund complexes will be performing due diligence on and attempting to onboard the same handful of service providers at the same time. Providing the requested delay will allow for a smoother onboarding of the new services for both funds and service providers.

Fund groups have also told our staff that they generally plan to develop processes and/or systems to provide service providers with fund-specific portfolio information relevant to classification and to provide ongoing input and oversight over any classification information derived from service provider tools. These data provision and oversight elements require additional processes or system modifications, or both, that are currently being evaluated as the service providers' offerings near completion and also may require some customization by service providers or fund groups.³⁵ Finally, for asset classes where trading and market data is constrained, some fund groups and service providers have told our staff that they are building models to more qualitatively assess liquidity, which may take additional time to develop and test. The ability for a fund to classify its assets is a foundation for other aspects of the rule, such as establishing the HLIM, and thus funds generally need to establish a classification system before finalizing policies and procedures for other aspects of the rule.³⁶

One association also noted that additional complexity and time pressures exist for fund groups that engage sub-advisers for portfolio management, relating to sharing and reconciling classification information across multiple sub-advisers each of whom may have their own liquidity classification methodologies and systems.³⁷ We also understand that additional complexity results when a fund group uses multiple sub-advisers for portfolio management of certain funds and that funds with sub-advisers require additional coordination (and thus

³⁵ See ICI Letter II (noting because the liquidity rule is new, funds will need to complete an extensive assessment of the new services and how they will be incorporated into existing oversight programs).

³⁶ See *supra* footnote 31.

³⁷ See SIFMA AMG Letter. See also Wellington Letter, noting that more time is necessary and appropriate due to the additional complications that sub-advised funds face in implementing the rule.

additional technology infrastructure) for portfolio classification and to potentially reconcile classification information that may be distributed among various investment advisory firms.

Interpretive Questions

In meeting with fund groups and service providers, our staff has learned that many of the most difficult interpretive questions relating to the rule have only become apparent as funds have worked through the design, evaluation, and testing of the new and complex systems that will support compliance with their liquidity risk management programs. As a consequence, funds are still in the process of identifying certain issues that may need interpretive guidance in order to complete the build-out of their classification systems and to design and draft policies and procedures implementing their programs.³⁸ One association has requested that Commission staff provide interpretive guidance on certain questions relating to classification, and stated that any such interpretive guidance may shape how its members design certain aspects of their classification systems.³⁹ Funds have indicated that they will need time to evaluate and incorporate any such guidance as they implement the new systems and policies and procedures for managing liquidity risk required under the rule.

In addition, fund groups have cautioned that if no compliance date extension is provided, fund groups may have to incur the expense of implementing classification once now and then again to make any necessary changes to classification systems after any interpretive guidance on new questions has been issued.⁴⁰ However, if an extension is provided, funds could take the time

³⁸ See *supra* footnote 23.

³⁹ See SIFMA AMG Letter.

⁴⁰ See SIFMA AMG Letter. As noted above, Commission staff is publishing guidance today on the classification process and may publish additional guidance in the future if it deems it appropriate.

to evaluate any guidance provided in connection with building their systems, thereby avoiding the costs of rushed builds or redone systems.

Finally, as we discussed in the Adopting Release, we understood that service providers may have some role in assisting funds in complying with the liquidity rule requirements, especially in providing data and collating data for reporting.⁴¹ Nonetheless, we believed that many fund groups would build and create their own classification methodologies, considering that funds have significant practical experience in observing the liquidity of the assets that they trade.⁴² As discussed above, however, our staff has learned that with respect to most funds, implementation is more complex than anticipated and the role for service providers is going to be more extensive than we had originally understood, thereby resulting in even more complexity and raising interpretive questions.

We believe that the interpretive guidance our staff has provided, and any additional guidance it may provide in the future, should ease the complexity of compliance, and may result in more funds refining their classification systems and liquidity assessment models, whether developed internally or when using vendor-provided tools. Our staff also will consider providing future interpretive guidance as needed to assist funds as they comply with the requirements of the rule.

C. Extension of Certain Elements of the Rule

Today, we are extending by six months the compliance date for the rule's portfolio classification and certain related requirements. Based on the staff's engagement with fund groups and service providers, as well as the representations of the commenters discussed above,

⁴¹ See Adopting Release, *supra* footnote 3, at n.323 and accompanying text.

⁴² See Adopting Release, *supra* footnote 3, at text following n.709.

we believe that a six-month extension of the compliance date for the portfolio classification and certain related requirements that are dependent on the classification requirement is appropriate.

We believe this additional time will allow fund groups and service providers to adequately address these complex and technology-dependent requirements and promote a smooth and efficient implementation of the rule.

In providing this extension, we considered not only the issues discussed above, but also the objective of the Liquidity Rule Requirements more generally in advancing effective liquidity risk management across the fund industry. As a result, while we are extending the compliance date for the portfolio classification and certain related requirements, we are limiting such extension to six months, and we are maintaining the existing compliance dates for the other aspects of the rule. Indeed, two provisions of the rule that are at the heart of the investor protection benefits that the rule seeks to achieve — the requirement that a fund institute a liquidity risk management program and the 15% illiquid investment limit — will go into effect as planned.

- 1. Extension of Portfolio Classification, HLIM, and Related Reporting Compliance Dates**

In light of the concerns discussed above, the Commission believes that it is appropriate to extend the compliance date for the portfolio classification requirement of rule 22e-4 and the HLIM requirement. Rule 22e-4 defines “highly liquid investments” that count towards the HLIM requirement by referencing the broader classification framework. For a fund to establish and monitor an HLIM, it will need to determine which investments meet the definition of highly liquid investments as defined by the rule and then determine and monitor its HLIM as compared

to that bucket of investments.⁴³ Therefore, a fund’s ability to comply with the HLIM requirement is dependent on the fund’s ability to classify its highly liquid investments under the rule. Funds have experience following the 15% guideline restricting purchases of illiquid assets when considering whether to purchase additional illiquid assets. By contrast, the HLIM is a new requirement that funds have not previously been required to establish and about which funds have not received previous Commission guidance. In order to implement the HLIM independent of the full classification requirements, funds would have to establish policies, procedures, and systems to determine their highly liquid investments so that they may be able to determine and monitor their HLIM. In addition, in adopting the 15% illiquid investment limit, we specifically recognized that it was possible to comply with such limit without classification for a category of funds, the In-Kind ETFs.⁴⁴ The HLIM, on the other hand, is a new requirement specifically tied to classification for which there has been no previous Commission guidance. As a result, we believe that even with guidance, implementing the HLIM and identifying highly liquid investments would be more likely to require funds to either incur significant expenses to build out an interim system or redo certain elements of their systems as they implement the full portfolio classification requirements, or both. Therefore, we believe it is appropriate to extend consistently the compliance date for both the portfolio classification and HLIM requirements.

As a consequence of the delay in portfolio classification and HLIM, the Commission is also extending the compliance date for the classification and HLIM reporting requirements of

⁴³ See Rule 22e-4(a)(6) (defining highly liquid investments as “any cash held by a fund and any investment that the fund reasonably expects to be convertible into cash in current market conditions in three business days or less without the conversion to cash significantly changing the market value of the investment” as determined pursuant to rule 22e-4(b)(1)(ii)).

⁴⁴ See Adopting Release, *supra* footnote 3, at nn.745 and 836 and accompanying text.

Forms N-PORT and N-LIQUID.⁴⁵ Form N-PORT requires a fund to disclose information regarding the fund's HLIM and individual portfolio holding liquidity classifications on a non-public basis.⁴⁶ Currently, it also requires a fund to disclose publicly the aggregate percentage of its portfolio that is highly liquid, moderately liquid, less liquid, and illiquid on a quarterly basis.⁴⁷ Part D of Form N-LIQUID requires non-public notifications to the Commission when the fund's HLIM is breached for more than a specified period of time.⁴⁸ Because the information required by these items of Form N-PORT is related to the fund's classification of its investments, a delay in the classification requirement would also require a delay for these items. Similarly, because notifications on Part D of Form N-LIQUID are tied to the HLIM, the Commission believes that revising the compliance date for these notifications is also necessary.⁴⁹

Finally, we are providing a six-month extension of the compliance date for the recordkeeping requirements related to the elements of rule 22e-4 we are delaying today,⁵⁰ though

⁴⁵. We are not delaying reporting to the Commission information required by Form N-CEN related to lines of credit, and inter-fund lending and borrowing. It is our understanding that information related to lines of credit and inter-fund lending and borrowing activities is currently readily available to funds. Therefore, we do not believe that a delay is necessary and are not revising the compliance date for Form N-CEN. Because we are delaying compliance with the classification requirement of rule 22e-4(b)(1)(ii) and the HLIM requirement of rule 22e-4(b)(1)(iii), the in-kind status of certain ETFs may be noted as "N/A" on Form N-CEN until funds are required to comply with those requirements.

⁴⁶ Items B.7 and C.7 of Form N-PORT.

⁴⁷ Item B.8 of Form N-PORT.

⁴⁸ Part D of Form N-LIQUID.

⁴⁹ We are not delaying the implementation of rule 30b-10 (the obligation to file Form N-LIQUID or the other parts of the form). The parts of the form that are not being delayed (parts A, B, and C) relate to breaches of the 15% illiquid investment limit, which as discussed below is not being delayed. Accordingly, funds should file Form N-LIQUID reports related to such incidents as scheduled.

⁵⁰ We are extending the compliance date for the recordkeeping requirements of rule 22e-4(b)(3)(i) that relate to classification as well as the recordkeeping requirements of rule 22e-4(b)(3)(iii) related to the HLIM requirements. Similarly, we are delaying the recordkeeping requirements of rule 22e-4(b)(3)(ii) related to the materials provided to the fund's board regarding the liquidity

we are not delaying the recordkeeping requirement related to the liquidity risk management program itself, the 15% illiquid investments restriction, or the board designation of the program administrator.⁵¹

The Commission seeks comment on the delay in the classification, HLIM, and related reporting and recordkeeping requirements.

- Should the Commission provide an extension in the compliance dates for the classification requirement? Why or why not?
- Should the Commission provide an extension in the compliance dates for the requirements related to classification such as the HLIM requirement? Is it feasible to let the HLIM requirement go into effect without the related classification requirement?
- Should we delay the liquidity-related reporting requirements of Form N-PORT and Part D of Form N-LIQUID?

2. **Length of Extension**

In light of the staff's monitoring and conversations with service providers and fund groups, as well as the commenters' statements regarding the projected timelines to effectively implement the classification requirement, we believe that a six-month extension is more appropriate than a one-year extension. One association stated that a compliance date extension of at least six months is necessary for the portfolio classification and related elements of the

risk management program.

⁵¹ Rule 22e-4(b)(3)(i).

rule,⁵² and the other requested that the Commission extend the compliance date at least one year for these requirements.⁵³

We believe that a six-month period should provide sufficient time for funds to comply with the elements of the rule we are extending today. Specifically this should provide enough time to allow for service providers to provide effective classification tools and data, as well as for funds to integrate and implement these tools and certain related requirements into their programs and gain board approvals. We considered delaying the compliance date for one year rather than six months. As discussed above, many funds believe that service providers will have sufficiently mature offerings for funds to make informed service provider selections by approximately the second quarter of 2018. If funds select their service providers by June of 2018, we believe that they will be able to effectively comply with all of the Liquidity Rule Requirements, including classification, by the revised compliance dates. Therefore, we do not believe a one-year extension is necessary.⁵⁴

We previously adopted temporary rule 30b1-9(T), which will require larger entities to maintain in their records the information that is required to be included in Form N-PORT, in lieu of filing reports with the Commission, until April 2019. As a result, larger entities that previously would have been required to submit their first reports on Form N-PORT on Electronic Data Gathering, Analysis, and Retrieval (“EDGAR”) by July 30, 2018 would submit their first reports on EDGAR by April 30, 2019.⁵⁵ Because we are revising the compliance date for the

⁵² See SIFMA AMG Letter.

⁵³ See ICI Letters I and II. Several fund groups supported the ICI’s one-year extension request. See, e.g., the Nuveen and Vanguard Letters.

⁵⁴ See *supra* footnote 29.

⁵⁵ See Investment Company Reporting Modernization, Investment Company Act Release No. 32936

disclosures related to liquidity on Form N-PORT, larger entities will not need to include those disclosures in their reports on Form N-PORT until July 30, 2019.⁵⁶

We request comment on the six-month compliance period extension that we are adopting today.

- Is six months a sufficient amount of time for funds to implement classification and other related requirements we are delaying today? If not, how much additional time would funds need to comply and why?
- Should we provide a shorter compliance date extension, such as three months, or none? If so, why?
- Should we provide an additional six-month (or other period) extension in the compliance date for smaller entities, so that their liquidity classification obligations also align with their N-PORT filing requirements?

3. **Board Oversight**

We are providing a six-month extension of the compliance date for board approval of the liquidity risk management program and the related annual review requirements.⁵⁷ Although funds will need to implement liquidity risk management programs as originally scheduled, these programs need not, for now, include the rule's classification or HLIM requirements. Other than the elements that are not being delayed, funds may implement a program that achieves the goals laid out in the rule using any additional elements they view as reasonable during the period of the

(Dec. 8, 2017) [82 FR 58731 (Dec. 14, 2017)] (“N-PORT Release”).

⁵⁶ Smaller entities will be subject to classification, HLIM, and the related requirements we are delaying today on December 1, 2019, but would not be required to file that information through EDGAR on Form N-PORT until April 30, 2020.

⁵⁷ Rule 22e-4(b)(2)(i) and (iii).

compliance date extension, but need not get board approval of that program until the end of the extension period. Because the Commission is granting funds additional time to incorporate the delayed elements into their programs, we believe that it would be unnecessarily burdensome to require the board to review the fund's program before funds incorporate all elements of the program. Similarly, we believe it is unnecessarily burdensome to require the board to conduct annual reviews of the program prior to the complete development of the fund's program.

However, as we stated in the Adopting Release and as we continue to believe, requiring that the board designate a program administrator independent from portfolio management is necessary for the program to be administered with sufficient independence.⁵⁸ We also expect that having a designated program administrator will better enable funds to create and operate the liquidity risk management program, and facilitate implementation of the delayed aspects of the rule when they go into effect. Accordingly, we are not delaying the requirement for the board to designate the program administrator.

The Commission seeks comment on the delay of these board oversight requirements.

- Should we provide this delay to the board approval requirements? Why or why not?
- Should we instead require the board to approve the initial programs without the classification and related requirements? If so, why?
- Should we provide the delay to the board's annual review requirement?

4. **Liquidity Risk Management Programs**

We are not extending the compliance date for the general obligation that each fund implement a liquidity risk management program, including the required assessment,

⁵⁸ See Adopting Release, *supra* footnote 3 at n.814 and accompanying text. Rule 22e-4(b)(2)(ii).

management, and periodic review of the fund's liquidity risk.⁵⁹ We believe that implementing a liquidity risk management program, even in the absence of the classification and HLIM requirements, will enhance fund liquidity risk management practices and provide protection to investors.⁶⁰

While we understand that there are issues with the classification requirement, we are unaware of any claims that funds are or anticipate experiencing difficulties in implementing a liquidity risk management program by the original compliance date.⁶¹ We understand that many funds already have in place systems to assess and manage the liquidity of their funds. In addition, both trade associations that commented indicated that they believed that compliance with the overall obligation to implement a liquidity risk management program under the rule was feasible by the original compliance date.⁶² We believe that funds can establish a program that assesses, manages, and reviews their liquidity risk without the elements we are delaying today, using elements they view as reasonable to achieve these goals during the period of the compliance date extension.

⁵⁹ Rule 22e-4(b) requires each fund and In-Kind ETF to adopt and implement a program that is reasonably designed to assess and manage its liquidity risk. *See* rule 22e-4(b)(1)(i).

⁶⁰ Accordingly, by December 1, 2018, larger entities will be required to adopt and implement a written liquidity risk management program that is reasonably designed to assess and manage its liquidity risk. *See* rule 22e-4(b). Smaller entities will be required to comply on June 1, 2019. The program must include policies and procedures reasonably designed to incorporate the elements articulated in rule 22e-4(b)(1)(i) related to a fund's assessment, management, and periodic review of its liquidity risk. The fund's board must also designate a program administrator pursuant to rule 22e-4(b)(2)(ii).

⁶¹ The requirement for funds that engage in redemptions in-kind to implement policies and procedures under rule 22e-4(b)(1)(v) (and their related recordkeeping requirements in rule 22e-4(b)(3)) and the requirements for unit investment trusts ("UITs") to comply with rule 22e-4(c) related to a UIT's liquidity assessment and related recordkeeping requirements will go into effect as originally scheduled. We do not believe that these requirements pose a burden on funds such that a delay in compliance would be necessary or appropriate, and some commenters suggested that they could go into effect as scheduled. *See, e.g.,* SIFMA AMG Letter.

⁶² *See* SIFMA AMG Letter and ICI Letter I.

5. **15% Illiquid Investment Limit and Guidance**

We are not extending the compliance date for the 15% illiquid investment limit of rule 22e-4, or the related board and Commission reporting requirements.⁶³ Limiting the amount of illiquid investments held by open-end funds is critical to effective liquidity risk management and is a cornerstone of rule 22e-4. As stated in the Adopting Release, “a limit on funds’ illiquid investments should be a central element of managing open-end funds’ liquidity risk, which in turn would further the protection of investors.”⁶⁴

While we agree that additional time is necessary to efficiently and effectively comply with the portfolio classification and certain related requirements of the rule, we do not believe that complying with the 15% illiquid investment limit presents challenges that warrant a similar delay in compliance. Funds have experience following the previous guideline to limit an open-end fund’s aggregate holding of illiquid assets to no more than 15% of the fund’s net assets.⁶⁵ Although the final rule’s definition of illiquid investments differs in some respects from the previous 15% guideline definition of illiquid asset, we believe funds have gained significant experience in evaluating and identifying illiquid assets consistent with the prior guidance, and should be able to apply that experience and associated systems in complying with the 15% limit in rule 22e-4.⁶⁶ In addition, the guidance we provide below on complying with the 15% illiquid investment limit for funds that do not engage in full portfolio classification during the

⁶³ Rule 22e-4(b)(1)(iv); Parts A, B, and C of Form N-LIQUID.

⁶⁴ Adopting Release, *supra* footnote 3, at text following n.757.

⁶⁵ Adopting Release, *supra* footnote 3, at n.38 and accompanying text.

⁶⁶ Adopting Release, *supra* footnote 3, at n.836 and accompanying text (noting that In-Kind ETFs are exempt only from the classification and HLIM requirements of rule 22e-4).

compliance extension period should assist such funds in their compliance with this requirement, and reduce the challenges associated with its implementation.

While this limit on illiquid investments refers to the classification element of the rule, as we discuss below, we are providing guidance on how funds can comply with this requirement without engaging in full portfolio classification during the period of the extension we are providing today.⁶⁷ As noted above, In-Kind ETFs are required to abide by the 15% illiquid investment limit but are not required to classify their investments.⁶⁸ We expect many In-Kind ETFs will rely on the guidance provided below, or use other reasonable methods, to identify and monitor their illiquid investments during the period of the compliance date extension and thereafter. Accordingly, we believe that funds can effectively comply with the 15% illiquid investment limit during the compliance extension period.

We are providing the following guidance to assist In-Kind ETFs and funds not engaging in full portfolio classification during the compliance extension period in identifying illiquid investments as a part of their application of the 15% illiquid investment limit.⁶⁹ We believe one reasonable method for a fund to comply with these requirements is to preliminarily identify certain asset classes or investments that the fund reasonably believes are likely to be illiquid (“preliminary evaluation”). We expect that the fund could base this reasonable belief on its 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

⁶⁷ Rule 22e-4(b)(1)(iv).

⁶⁸ Rule 22e-4(b)(1)(ii).

⁶⁹ *See* Rule 22e-4(b)(1)(iv) (“No fund or In-Kind ETF may acquire any illiquid investment if, immediately after the acquisition, the fund or In-Kind ETF would have invested more than 15% of its net assets in illiquid investments that are assets....”).

classes it is preliminarily evaluating, or through other means. A fund could choose to determine that certain investments identified in such asset classes that it purchases are illiquid based solely on this preliminary evaluation, and not engage in any further analysis under the rule at that time.⁷⁰ This evaluation need not occur prior to the trade being placed. 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, as a secondary step, determine whether that investment is illiquid through the full classification process set forth in the rule (“secondary evaluation”). Investments in asset classes the fund acquires that it does not reasonably believe are likely to be illiquid would not need to be classified when performing this preliminary analysis.

Funds could automate such a preliminary evaluation of asset classes or investments, and they could base that evaluation on the general characteristics of the investments the fund purchases. For example, in establishing the list of asset classes or investments that the fund believes have a reasonable likelihood of being illiquid, the fund could take into account the trading characteristics of the investment (for example, whether it is a restricted security or has structural liquidity limitations, the trading history of the asset class, or whether the investment typically requires significant negotiations to trade) and use such characteristics to form the reasonable belief of illiquidity. We expect that a fund making use of preliminary evaluation would conduct periodic testing of the results of the preliminary evaluations to determine whether they continue to be accurate as part of their required review of the adequacy and effectiveness of the liquidity risk management program’s implementation.

⁷⁰ Rule 22e-4(b)(1)(ii).

In evaluating the likelihood of an asset class or investment being illiquid, we do not believe it would be reasonable to assume that a fund is only selling a single trading lot when looking at the market depth of the asset or class. However, a fund would not need to evaluate the actual size of its holdings in the asset class or engage in the full process of evaluating its reasonably anticipated trading size for the asset class under the rule. Instead, a fund could use any reasonable method in evaluating the market depth of the asset classes or investments it identifies as likely being illiquid in the preliminary evaluation.

Although the illiquidity status of an investment is generally evaluated upon acquisition (and then at least monthly thereafter),⁷¹ certain events may lead an In-Kind ETF or fund not yet subject to the classification requirement to re-evaluate the liquidity status of an investment more frequently. For example, a reasonable approach for a fund to re-evaluate the liquidity of an investment might be by identifying in its policies and procedures in advance certain events that it reasonably expects would materially affect the investment's classification. Reasonable policies and procedures could limit such events to those that are objectively determinable (*e.g.*, a trading halt or delisting of a security, an issuer or counterparty default or bankruptcy, significant macro-economic developments (such as a sovereign default), or events like extraordinary natural disasters or political upheavals, for funds with concentrated geographic exposures). This intra-month review would not create a *de facto* ongoing review requirement for classification. However, a fund generally should regularly monitor the amount of its illiquid investments to

⁷¹ See rule 22e-4(a)(8) which references rule 22e-4(b)(1)(ii). An “illiquid investment” is defined as being determined, in part, through the classification process, which requires at least monthly review. Though we are revising the compliance date for the classification provisions of the rule, we are not revising the compliance date for those provisions related to the 15% illiquid investment limit, including the related monthly (or more frequent) review requirement in rule 22e-4(b)(1)(ii) referenced in 22e-4(a)(8), subject to the guidance in this release.

ensure that it does not exceed the limit as a result of the purchase or redemption activity of the fund or changes in the value of the fund's holdings.

We believe that the method discussed in the guidance above would be a reasonable approach for a fund to help assure itself that it has not violated the 15% illiquid investment limit during the intra-month period between scheduled classifications. However, funds may use reasonable approaches other than the one described in this guidance as well.

D. Compliance Date Extension Chart

The following chart identifies the provisions of the Liquidity Rule Requirements that we are delaying and those we are not. For the items subject to the six-month extension, the compliance date will be June 1, 2019 for larger entities and December 1, 2019 for smaller entities. For the provisions that we are not delaying, the original compliance dates of December 1, 2018 for larger entities and June 1, 2019 for smaller entities remain in effect.

Requirements Not Subject to Extension	Requirements Subject to Extension
<p><u>Rule 22e-4</u>⁷²:</p> <ul style="list-style-type: none"> • Liquidity Risk Management Program [paragraph (b)] <ul style="list-style-type: none"> ○ Assessment, management, and periodic review of liquidity risk [paragraph (b)(1)(i)] ○ Illiquid investments [paragraph (b)(1)(iv)] ○ Redemptions in Kind [paragraph (b)(1)(v)] ○ Board Designation of Program Administrator [paragraph (b)(2)(ii)] • UIT Liquidity [paragraph (c)] 	<p><u>Rule 22e-4</u>⁷³:</p> <ul style="list-style-type: none"> • Classification [paragraph (b)(1)(ii)]⁷⁴ • Highly liquid investment minimum [paragraph (b)(1)(iii)] • Board Oversight <ul style="list-style-type: none"> ○ Initial approval of the liquidity risk management program [paragraph (b)(2)(i)] ○ Annual Board Reporting [paragraph (b)(2)(iii)]
<p><u>N-LIQUID</u></p> <ul style="list-style-type: none"> • Part A. General Information • Part B. Above 15% Illiquid Investments • Part C. At or Below 15% Illiquid Investments 	<p><u>N-LIQUID</u></p> <ul style="list-style-type: none"> • Part D. Assets that are Highly Liquid Investments Below the HLIM
<p><u>N-CEN</u></p> <ul style="list-style-type: none"> • Item C.20. Lines of credit, interfund lending, and interfund borrowing • Part E.5. In-Kind ETF 	<p><u>N-PORT:</u></p> <ul style="list-style-type: none"> • Item B.7. Highly Liquid Investment Minimum • Item B.8. Liquidity aggregate classification information • Item C. 7. Liquidity Classification Information

II. PROCEDURAL AND OTHER MATTERS

The Administrative Procedure Act (“APA”) generally requires an agency to publish notice of a rulemaking in the Federal Register and provide an opportunity for public comment.⁷⁵

⁷² The recordkeeping requirements of rule 22e-4(b)(3) related to these elements are similarly not subject to extension. *See supra* footnote 51 and accompanying text.

⁷³ The recordkeeping requirements of rule 22e-4(b)(3) related to these elements are similarly subject to extension. *See supra* footnote 50.

⁷⁴ As discussed in footnote 71, we are not delaying the aspects of classification that relate to the implementation of the illiquid investment limit, subject to the guidance in this release.

This requirement does not apply, however, if the agency “for good cause finds . . . that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.”⁷⁶

We have determined to adopt this interim final rule delaying certain of the Liquidity Rule Requirements. Specifically, the Commission is extending the compliance date for the classification requirement of rule 22e-4(b)(1)(ii) except to the extent referenced in rule 22e-4(a)(8).⁷⁷ The Commission also is extending the compliance date for rule 22e-4(b)(1)(iii) pertaining to the HLIM. Furthermore, the Commission is extending the compliance date for rule 22e-4(b)(2)(i) and (iii) pertaining to the requirement that fund boards initially approve the fund’s liquidity risk management program as well as the requirement that the fund’s board review annual reports on the operation of the program and the program’s adequacy and effectiveness of implementation from the fund’s program administrator. Finally, the Commission is extending the compliance date for the liquidity-related reporting requirements of Form N-PORT as well as Part D of Form N-LIQUID.

The trade associations expressed concern that, because of the significant investment funds will have to incur and the time commitment involved, funds will have to continue to build their classification technology infrastructure well before the compliance date of the Liquidity Rule Requirements, and they therefore requested that the Commission make any extension in the compliance date as quickly as possible. The SIFMA AMG Letter argued that a prompt extension of the compliance date for the classification requirement of the rule will “provide the industry with the breathing room it needs to build, implement and test the necessary systems in an orderly

⁷⁵ See 5 U.S.C. 553(b)-(c).

⁷⁶ 5 U.S.C. 553(b)(3)(B).

⁷⁷ See *supra* footnote 71.

and prudent manner” and the ICI Letter I echoed the sentiment, asking for “[q]uick and decisive action—with respect to delaying the rule’s classification requirements.”

The Commission has determined that funds are encountering significant challenges in their efforts to achieve timely compliance with the classification and related requirements of rule 22e-4 and related forms. Most notably, as discussed in detail in section I.B above, compliance with these requirements entails service providers and funds building complex, technology-dependent liquidity classification systems. These systems are not yet complete nor are they projected to be fully developed and tested by the current compliance date. We are basing this judgment on Commission staff outreach to funds and service providers, and information they have provided us discussed above. Based on this information, we believe the projected timelines for completing the development of classification tools, along with the time necessary to effectively evaluate, implement and test new systems and infrastructure, further enhance liquidity programs, and obtain approval from fund boards justify a six-month delay limited to the classification and related requirements. The scope of the difficulties that are being experienced in developing liquidity classification systems, the extent of fund reliance on external service providers to provide liquidity classification solutions, and the substantial number of implementation questions that have been posed, are matters that were not anticipated in the Adopting Release.

As discussed previously, providing immediate certainty regarding this compliance date extension is critical because funds currently are evaluating and making decisions on the source and structure of their classification systems in an effort to meet the original compliance date. By providing an extension, funds may take the time to evaluate the staff interpretive guidance that is being issued along with this release in connection with building their systems, thereby avoiding

the costs of expediting the construction of their systems (in dollar value and/or reduced quality) after having reviewed the staff interpretive guidance or revising their systems as may be occasioned by any additional subsequently-issued staff or Commission guidance. Because funds are making decisions now as to the structure of their programs and the service providers they will use, funds need to have certainty that there will be a six-month delay of the classification and related requirements so that they can take this time to evaluate and design the necessary systems and infrastructure and evaluate the need for and choice of a service provider to assist in this process. This certainty will allow them time to adjust their implementation process accordingly and avoid costs of rushed implementation and potential revisions to their programs and use or choice of service providers after service providers complete their product offerings, which costs could be passed on to the fund's investors. Waiting until after the notice and comment period to make the necessary delay effective would undermine this effort to give certainty for these complex technology infrastructure timelines and thus we believe it would be impracticable, unnecessary, and contrary to the public interest.

For these reasons, the Commission finds that good cause exists to dispense with advance notice and comment regarding the delay of the classification and related requirements outlined above.⁷⁸ The Commission and its staff will continue to monitor implementation of the Liquidity Rule Requirements to determine if further action is necessary to address questions or issues that

⁷⁸ See section 553(b)(3)(B) of the Administrative Procedure Act (5 U.S.C. 553(b)(3)(B)) (an agency may 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”). This finding also satisfies the requirements of 5 U.S.C. 808(2) (stating that if a federal agency finds that notice and public comment are impractical, unnecessary or contrary to the public interest, a rule shall take effect at such time as the federal agency promulgating the rule determines). This section would allow the rule amendment to become effective notwithstanding the requirement of 5 U.S.C. 801. The interim final rule also does not require analysis under the Regulatory Flexibility Act. See 5 U.S.C. 604(a).

may arise in addition to the delay in compliance we are providing today and to address interpretive issues as they arise.

III. ECONOMIC ANALYSIS

A. Introduction

The Commission is sensitive to the potential economic effects of extending the compliance date for certain provisions of the Liquidity Rule Requirements. These effects include the benefits and costs to funds, their investors and investment advisers, issuers of the portfolio securities in which funds invest, and other market participants potentially affected by fund and investor behavior as well as any effects on efficiency, competition, and capital formation.

B. Economic Baseline

The costs and benefits of the compliance date extension as well as any impact of the extension on efficiency, competition, and capital formation are considered relative to an economic baseline. For the purposes of this economic analysis, the baseline is the regulatory framework and liquidity risk management practices currently in effect, any systems and processes that funds have already implemented in order to comply with the Liquidity Rule Requirements as adopted, and the expected changes to liquidity risk management practices assuming the compliance dates established in the Adopting Release remain in effect.

The economic baseline's regulatory framework consists of the Liquidity Rule Requirements adopted by the Commission on October 12, 2016. With respect to current liquidity risk management market practices, the baseline remains as described in the Adopting Release, with two exceptions. First, funds are already complying with Form N-1A's requirement

that they make additional disclosures about redemption practices.⁷⁹ Second, we expect that funds will rely more extensively on third-party service providers to comply with the classification requirement relative to the baseline in the Adopting Release.⁸⁰ Under the baseline, larger entities must comply with the Liquidity Rule Requirements by December 1, 2018, while smaller entities must comply by June 1, 2019.⁸¹ The baseline also includes funds' efforts to develop the systems and processes necessary to comply with the Liquidity Rule Requirements since the rule was adopted, but we do not have data sufficient to quantify the extent to which funds have already invested in such systems and processes.⁸²

The primary SEC-regulated entities affected by this interim final rule are mutual funds and ETFs. As of the end of 2016, there were 9,090 mutual funds managing assets of approximately \$16 trillion,⁸³ and there were 1,716 ETFs managing assets of approximately \$2.5 trillion.⁸⁴ Other potentially affected parties include investors, investment advisers that advise

⁷⁹ See section IV.B of the Adopting Release for a detailed discussion of funds' current liquidity risk management practices. See section III.L of the Adopting Release for a discussion of the enhanced disclosure requirements regarding redemption practices on Form N-1A.

⁸⁰ See *supra* footnote 24 and surrounding text for a discussion of how funds will rely on service providers in complying with the Liquidity Rule Requirements.

⁸¹ See *supra* footnote 5 for a detailed description of larger and smaller entities.

⁸² We received comment letters providing certain information, including a survey of funds, regarding fund reliance on vendor solutions and vendor readiness, *see supra* footnote 21. While these letters indicate that the funds surveyed are still in the early stages of developing their classification systems because of vendor readiness issues, they do not provide concrete estimates of the extent to which funds have invested in implementing portfolio classification systems. In addition, while a large number of funds with significant assets under management responded to the survey, the survey was self-reported by members of the commenter's organization and may not necessarily reflect the state of the entire fund industry.

⁸³ See 2017 ICI Fact Book, *available at* https://www.ici.org/pdf/2017_factbook.pdf, at 22, 170, 174. The number of open-end mutual funds includes funds that primarily invest in other mutual funds but excludes 421 money-market funds.

⁸⁴ See 2017 ICI Fact Book, *available at* https://www.ici.org/pdf/2017_factbook.pdf, at 180, 181.

funds, issuers of the securities in which these funds invest, and other market participants that could be affected by fund and investor behavior.

C. **Economic Impacts**

We are mindful of the costs and benefits of this interim final rule. The Commission, where possible, has sought to quantify the benefits and costs, and effects on efficiency, competition and capital formation expected to result from the compliance date extension for certain provisions of the Liquidity Rule Requirements. However, as discussed below, the Commission is unable to quantify certain of the economic effects because it lacks information necessary to provide reasonable estimates.

Impacts on Funds

The compliance date extension provides funds with the option to delay the implementation of a full portfolio classification system. This option allows funds to forgo some or all of the additional costs that may be associated with implementing a classification system by the compliance date in the Adopting Release,⁸⁵ depending on how they choose to comply with the 15% illiquid investment limit during the compliance date extension period.⁸⁶ The option to delay may also be valuable to funds because it permits them to adjust the manner in which they

⁸⁵ See *supra* section I.B for a discussion of the issues funds may face in complying with the rule by the compliance date in the Adopting Release.

⁸⁶ For example, as discussed above (*see supra* footnote 70 and surrounding text), some funds that delay the implementation of a full portfolio classification system might comply with the 15% illiquid investment limit through the preliminary evaluation process discussed in the guidance above, which allows them to forgo most of the costs associated with the implementation of a classification system. Alternatively, some funds may choose to comply with the 15% illiquid investment limit by supplementing such an evaluation with the secondary evaluation discussed in the guidance. Funds making this compliance choice will still incur the costs of implementing systems that assess whether a given holding is an illiquid investment according to the portfolio classification requirement but will not incur the costs associated with implementing systems associated with the other portfolio classification categories.

comply with the classification related elements of the Liquidity Rule Requirements in response to new information about implementation choices, including new technologies or classification software.⁸⁷ The value of the option to delay the implementation of a full portfolio classification system for a given fund will depend on the extent to which the fund has already invested in implementing a full classification system, the remaining costs the fund expects to incur by implementing such a system by the compliance date in the Adopting Release, and the manner in which the fund would comply with the 15% illiquid investment limit during the compliance period if it chooses to exercise the option to delay.

Under the interim final rule, funds will also be able to amortize the costs of establishing systems associated with the elements of the Liquidity Rule Requirements for which the compliance date is being extended over an additional six months. As above, any change in the amortization of these costs relative to the baseline will vary with the extent to which a fund has already invested in building systems and processes to comply with these elements, whether it opts to delay its implementation of a full portfolio classification system under the interim final rule, and the manner in which the fund would comply with the 15% illiquid investment limit during the compliance date extension period. We cannot quantify these because we do not have sufficient data and cannot anticipate how funds will choose to comply with the 15% illiquid investment limit during the compliance date extension period. Funds will also save six months' worth of any ongoing costs associated with the elements of the Liquidity Rule Requirements being delayed.

⁸⁷ See *supra* footnote 40 and surrounding text for an example of how funds might modify their implementation of portfolio classification systems in response to new information.

In the Adopting Release, we estimated aggregate costs associated with some of these elements. First, some portion of the aggregate onetime cost of approximately \$641 million associated with the establishment of liquidity classification systems that has not already been incurred by funds will be amortized over an additional six months for funds that opt to delay the implementation of their classification systems, and those funds will not incur some portion of six months' worth of the associated ongoing annual costs, which we estimated to range from \$30,000 to \$2.5 million per fund complex.⁸⁸ Second, while we did not individually estimate the costs associated with implementing other elements of the Liquidity Rule Requirements that are being delayed such as the establishment of an HLIM, they constitute some fraction of the \$214 million we estimated as being associated with implementing the liquidity risk management program. Funds have the option to amortize the portion of these costs that has not yet been incurred over an additional six months. Funds will also not incur six months' worth of the ongoing costs associated with the delayed elements of the liquidity risk management program if they opt to delay implementation of those elements, which we estimated as ranging from \$10,000 to \$0.8 million depending on the size of a given fund complex. Third, the portion of the aggregate onetime costs of approximately \$158 million associated with the rule's disclosure and reporting requirements on Form N-PORT that has not already been incurred by funds will be amortized over an additional six months. Funds will also not incur six months' worth of the

⁸⁸ See Adopting Release, *supra* footnote 3, at n.1101. We assumed the classification process constitutes 75% of both onetime and ongoing costs. Estimated onetime aggregate costs of \$855 million consist of approximately \$641 million (75%) associated with a classification system and approximately \$214 million associated with the remaining elements of rule 22e-4. Similarly, the range of ongoing costs, estimated to be \$40,000 to \$3.3 million, imply a range of \$30,000 to \$2.5 million associated with the classification system and \$10,000 to \$0.8 million associated with the remaining elements of rule 22e-4. We do not have sufficient data to estimate the portion of these costs that has already been incurred.

associated aggregate ongoing annual costs, which we estimated as being approximately \$3.9 million.⁸⁹ Finally, funds will not have to incur six months' worth of the annual aggregate costs associated with filing Part D of form N-LIQUID, which we estimated as being \$52,350.⁹⁰

As a result of the compliance date extension, some funds that do not already have a liquidity risk management program in place and opt to delay the implementation of a full portfolio classification system may incur additional costs, relative to the baseline, associated with the development of interim systems and processes that allow for compliance with those elements of the Liquidity Risk Requirements that are not being delayed. For example, funds that intended to base their implementation of a liquidity risk management program on portfolio classification but opt to delay the implementation of a classification system will need to establish other interim systems and processes to assess, manage, and periodically review the fund's liquidity during the compliance date extension period.⁹¹ In addition, funds that opt to delay the implementation of their classification system under the interim final rule will have to develop systems and processes to comply with the 15% limit in the absence of a classification system. In deciding whether they should exercise their option to delay, funds will weigh the costs of implementing any interim systems and processes during the compliance date extension period if they opt to delay the

⁸⁹ See Adopting Release, *supra* footnote 3, at n.1188-1191. We estimated the total one-time costs associated with the rule's disclosure and reporting requirements on Form N-PORT as being approximately \$55 million for funds that will file reports on Form N-PORT in house and approximately \$103 million for funds that will use a third-party service provider. Similarly, we estimated the total ongoing annual costs as being approximately \$1.6 million for funds filing reports in house and \$2.3 million for funds that will use a third-party service provider.

⁹⁰ See Adopting Release, *supra* footnote 3, at n.1287-1288. We estimated that an average of 30 reports would be filed per year in response to an event specified on Part D of Form N-LIQUID at a total cost of \$1,745 per filing, resulting in an aggregate cost of $30 \times \$1,745 = \$52,350$.

⁹¹ See *supra* footnote 62 and surrounding text for a discussion of liquidity risk management program implementation in the absence of a portfolio classification system.

implementation of a full portfolio classification system against the costs of implementing a full portfolio classification system by the original compliance date if they do not.

Impacts on Investors and other Market Participants

As discussed above, the compliance date extension provides funds with the option to delay the implementation of a full portfolio classification system. The compliance date extension for certain of the Liquidity Rule Requirements will delay benefits to fund investors and other market participants who otherwise would have benefited from those portions of the rule during the compliance date extension period. These delayed benefits include, for example, the increased likelihood that funds would be able to effectively meet redemption obligations by establishing an HLIM and any benefits associated with the Commission's ability to monitor and analyze trends in fund liquidity based on the portfolio holding classifications reported on Form N-PORT.⁹² However, because smaller entities will not begin filing Form N-PORT until April 30, 2020 and the compliance date for larger entities filing Form N-PORT has been delayed until April 30, 2019, the only delayed benefits associated with disclosures on Form N-PORT would be for larger entities during the three-month period between April 30, 2019 and the extended compliance date of July 30, 2019.⁹³ In addition, to the extent that funds would not have been able to effectively comply with the provisions of the Liquidity Risk Requirements that are being extended as of the original compliance date, such benefits would not have existed under the baseline, and thus the diminution of the expected benefits would be not be attributable to the compliance date extension.

⁹² See section IV.C of the Adopting Release for a comprehensive discussion of the benefits associated with the Liquidity Rule Requirements. See Adopting Release, *supra* footnote 3, at n.1089 and surrounding text for a discussion of why we are unable to quantify these benefits.

⁹³ See N-PORT Release, *supra* footnote 55.

Efficiency, Competition, and Capital Formation

In the Adopting Release, we discussed the effects of the Liquidity Rule Requirements on efficiency, competition, and capital formation. In general, the interim final rule will delay, for six months, those effects that are associated with the elements of the Liquidity Rule Requirements that we are delaying today. For example, funds may shift their portfolios away from less liquid assets and towards more liquid assets as a result of the HLIM. Some of the potential economic effects associated with such a shift, as discussed in the Adopting Release, include a potentially lower yield on the funds available to investors, a decrease in the investment options available to investors, an additional decrease in the liquidity of less liquid securities, and an additional increase in the liquidity of more liquid securities.⁹⁴ With respect to capital formation, any shift by funds or investors away from less liquid assets and towards more liquid assets could discourage new issuance of illiquid securities or a shift in the capital structure of issuers away from less liquid assets such as bonds and towards more liquid asset such as equities.⁹⁵

The compliance date extension may disadvantage some funds that have already invested in systems and processes to implement the Liquidity Rule Requirements and would be able to effectively comply with those requirements as of the compliance date established in the Adopting Release. To the extent that the capital invested by these funds makes them less able to invest in other aspects of their business, the rule may put them at a competitive disadvantage relative to funds that have not invested as heavily in complying with the Liquidity Rule

⁹⁴ See section IV.C of the Adopting Release for a detailed discussion of the Liquidity Rule Requirements' effect on efficiency, competition, and capital formation.

⁹⁵ See Adopting Release, *supra* footnote 3, at n.1128 and surrounding text for a discussion of the effects of a shift away from illiquid assets on capital formation.

Requirements. However, to the extent that investors have a preference for funds with complete liquidity risk management programs, some funds may prefer to comply with the Liquidity Rule Requirements by the compliance date in the Adopting Release, and may perceive having significant capital invested already as a competitive advantage. In addition, to the extent that funds have complete liquidity risk management programs, they would not have to implement systems for complying with the 15% illiquid investment limit under the guidance provided in this release, which would diminish any potential competitive differential. As is the case with the amortization of one-time costs over an additional six months discussed above, this effect will vary with the extent to which a fund has already invested in implementing systems and processes to comply with these elements, which we cannot quantify.

As discussed above, funds that opt to delay the implementation of a full classification system may choose different ways of complying with the 15% illiquid investment limit during the compliance date extension period. The manner in which funds choose to comply with the 15% illiquid investment limit may lead otherwise similar funds to have different capacities for holding illiquid investments. For example, two otherwise identical funds could perform the same preliminary evaluation discussed in the guidance above, while only one of the funds might perform the secondary evaluation under the guidance. Any secondary evaluation in which it is determined that some investments are not illiquid results in the fund that performs the secondary evaluation holding a lower percentage of illiquid assets than the otherwise identical fund that only performs a preliminary evaluation. If having a higher capacity to invest in illiquid investments allows some funds to increase the expected return of their portfolios, these funds will consider this potential competitive advantage when determining how they will comply with the 15% illiquid investment limit. In-kind ETFs will consider this potential competitive

advantage on an ongoing basis. Other types of funds will consider this potential competitive advantage in determining how they will comply with the 15% illiquid investment limit during the compliance date extension period if they opt to delay the implementation of a classification system and whether it is worth exercising their option to delay.

D. Reasonable Alternatives

The Commission considered several alternatives to the interim final rule's six-month compliance date extensions. First, the compliance date could have been extended for a shorter or longer period of time. A shorter extension would have reduced the extent to which investors and other market participants will forgo any benefits associated with the delayed elements of the Liquidity Rule Requirements, but may not have provided ample time to fully mitigate the concerns raised by the commenters regarding the industry's ability to effectively comply with the elements of the rule related to classification. A longer extension would provide more time to mitigate commenters' concerns but also would have further delayed any potential benefits associated with the Liquidity Rule Requirements.

Second, the Commission could have delayed all of the Liquidity Rule Requirements. Delaying all of the Liquidity Rule Requirements would have saved funds from incurring the costs associated with any interim systems or processes required to implement a liquidity risk management program (rule 22e-4(b)(1)(i)) and to comply with the 15% illiquid investment limit during the compliance date extension period. It also would have allowed funds to amortize startup costs for the rest of the elements of the Liquidity Rule Requirements that are not being delayed over an additional six months and would have saved the ongoing costs associated with those elements for six months. However, delaying all of the Liquidity Rule Requirements would also delay any of the benefits to investors and market participants associated with the general

liquidity risk management program and the 15% illiquid investment limit, such as the reduced risk that funds are unable to meet their redemption obligations.

Third, the compliance date extension could have been applied to all elements of the Liquidity Rule Requirements that refer to the classification requirement, including the 15% illiquid investment limit, the associated board reporting requirement, and the associated reporting requirements on Form N-PORT. This alternative would have saved funds from incurring the costs associated with any interim systems required to perform a preliminary evaluation of whether an asset is likely to be illiquid and, to the extent funds opt to implement classification systems during the interim period to allow for a secondary evaluation of asset liquidity in the context of the 15% illiquid investment limit, the costs associated with building such interim systems by the compliance date in the Adopting Release. Delaying all of the classification-related elements would have also delayed any benefits associated with the 15% illiquid investment limit, such as the increased likelihood that a fund's portfolio is not overly concentrated in illiquid investments and the decreased likelihood that a fund's portfolio remains overly concentrated in illiquid investments for an extended period of time as result of the requirements that funds report violations of their 15% illiquid investment limit to their boards and the Commission on Form N-LIQUID.

Finally, the Commission could have chosen not to delay the compliance date for the HLIM requirement, and instead provided guidance as to how funds could comply with that requirement during the period that portfolio classification requirements are extended. Maintaining the original compliance date for the HLIM requirement also would have maintained any benefits associated with the HLIM during the compliance date extension period such as the increased likelihood that funds would be able to effectively meet redemption obligations.

However, as discussed previously, not delaying the HLIM requirement may have caused funds that opted to delay the implementation of a portfolio classification system to incur costs in developing any interim systems required to comply with the HLIM requirement absent a portfolio classification system, or redo certain elements of their systems when they implement full portfolio classification. Because HLIM is a new requirement for which there has been no previous Commission guidance and the establishment of an HLIM may depend more heavily on a full portfolio classification system, implementing interim systems to comply with HLIM could be more costly to funds than implementing interim systems to comply with the 15% illiquid investment limit.

E. Request for Comment

We are requesting comment on our analysis of the potential economic effects of the interim final rule delaying the compliance date for those elements of the Liquidity Rule Requirements associated with the classification requirement:

- Are there any other costs or benefits we should consider in our analysis? If so please explain why those costs or benefits are relevant and provide quantitative estimates where possible.
- Are there other reasonable alternatives to the interim final rule's delayed compliance date that we should consider?

IV. PAPERWORK REDUCTION ACT ANALYSIS

We do not believe that the revision of the compliance date for Part D of Form N-LIQUID, amendments to Form N-PORT, and certain provisions of rule 22e-4 make any substantive modifications to any existing collection of information requirements or impose any

new substantive recordkeeping or information collection requirements within the meaning of the Paperwork Reduction Act of 1995 (“PRA”).⁹⁶

We believe that the current burden and cost estimates for the existing collection of information requirements remain appropriate.⁹⁷ We are only delaying certain burdens for six months. Thus, we believe that there are no new substantive burdens imposed on the overall population of respondents and the current overall burden estimates for the relevant forms are not affected.⁹⁸ Accordingly, we are not revising any burden and cost estimates in connection with the revision of the compliance date. We request comment on whether our belief is correct.

By the Commission.

Dated: February 22, 2018

Brent J. Fields
Secretary

⁹⁶ 44 U.S.C. 3501 *et seq.*

⁹⁷ The titles for the existing collections of information are: “Rule 22e-4 (17 CFR 270.22e-4) under the Investment Company Act of 1940” (OMB Control No. 3235-0737); “Rule 30b1-10 (17 CFR 270.30b1-10) under the Investment Company Act of 1940, ‘Current report for open-end management investment companies’ and Form N-LIQUID, ‘Current report, open-end investment company.’” (OMB Control No. 3235-0754); “Rule 30b1-9 and Form N-PORT” (OMB Control No. 3235-0730).

⁹⁸ *See* section 0 above.

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